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Enabling regulatory frameworks for contract farming

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Enabling regulatory frameworks for contract farming

by
Teemu Viinikainen
Carmen Bullón Caro

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PREFACE

Responsible contract farming is contract farming which is profitable, inclusive, environmentally sensitive, and aligned with broader country objectives for agricultural and economic development as well as with the FAO “Guiding principles for responsible contract farming operations” (FAO, 2012). This Legislative Study provides guidance to the domestic regulators on appraising and potentially reforming domestic regulatory frameworks¹ for responsible contract farming. Regulatory frameworks can support an enabling environment for responsible contract farming by addressing such issues as power imbalance between parties, by increasing legal security and certainty through dispute resolution methods and by promoting transparency (see Chapter 3 Section 2).

Countries may have a range of possible options to regulate contract farming and there is no one size fits all approach. Some countries may not require specific legislation on contract farming and may instead choose to rely on their existing general regulatory framework. Indeed, every country has its own history, politics, traditions, international obligations, legislation, institutions and resources – all of which will affect its priorities and strategies for the regulation of contract farming (Vapnek & Melvin, 2005).

When evaluating possible approaches, countries should always consider their existing national legal system and legislation in force (see Chapter 2 Section 1). It is also important to examine the characteristics of the agricultural production sector, including the social and labour law applicable to farmers, the market structure, government policy priorities and the interests of all stakeholders – particularly of the producers themselves – and patterns and levels of access to international markets. Accordingly, this Legislative Study does not advocate for any single solution to regulate contract farming, but provides several examples of different possibilities. As such, it hopes to contribute to the making of more informed, evidence-based choices by readers when considering whether, and how, to regulate this area.

1 This publication uses the terms “regulatory framework”, “legal framework” and “legislative framework” synonymously.

This Legislative Study builds upon the content of the Legal Guide on Contract Farming (hereinafter referred to as the “2015 Legal Guide”)² drafted by 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). The 2015 Legal Guide focusses on the bilateral relationship between an agricultural producer and a contractor. It contains advice and guidance on the entire relationship, from negotiation to conclusion of a contract, including performance and possible breach or termination of the contract. In so doing, it aims to promote a better understanding of the legal implications of contract terms and practices. The 2015 Legal Guide 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.

This Legislative Study goes beyond the 2015 Legal Guide by discussing domestic legislative frameworks for contract farming in greater depth. It relies on several detailed analytical case studies of a representative set of countries from different legal traditions and global regions. The Legislative Study concentrates on domestic regulatory frameworks within which contract farming is conducted and strives to assist national regulators and policymakers to assess their existing regulatory framework for contract farming³ in light of critical potential issues and objectives for the sector. By doing so, it will help to connect the findings from the 2015 Legal Guide to a discussion on the enabling regulatory framework for responsible contract farming.⁴

Both this Legislative Study and the 2015 Legal Guide are aligned with the Principles for Responsible Investments in Agriculture and Food Systems (CFS-RAI Principles), approved in October 2014 by the Committee on World Food Security. The 2015 Legal Guide also shares with the CFS-RAI Principles the goal of providing a framework that stakeholders can use when developing domestic policies, regulatory frameworks, corporate

2 UNIDROIT, FAO and IFAD. 2015. UNIDROIT/FAO/IFAD Legal Guide on Contract Farming. Rome. The Legal Guide is available on the websites of FAO (<http://www.fao.org/documents/card/en/c/35879fbf-b7d2-4b34-8fbc-24d86507855d/>), and UNIDROIT (<https://www.unidroit.org/instruments/contract-farming/legal-guide>).

3 Contract farming is known by different terms, such as “agricultural contract”, “production contract”, “integration contract”, “aggregation contract”, “contract farming”, or “agro-industrial contract” UNIDROIT, FAO, IFAD. 2015, p. 19.

4 Case-studies were prepared for Brazil, Cambodia, Chile, Finland, Georgia, Germany, India, Malawi, Morocco, Russia, Spain and the US State of Minnesota. Furthermore, limited analysis of a wide variety of legislation from different countries was performed.

social responsibility programmes, individual agreements and contracts, all in responsible and inclusive ways.

Taken together, this Legislative Study and the 2015 Legal Guide provide comprehensive and complementary legal guidance on regulatory aspects of contract farming to the full range of public and private stakeholders involved in contract farming.

The Legislative Study was written by Teemu Viinikainen, with significant contributions and under the coordination of Carmen Bullón Caro, and with substantial inputs from Bill Garthwaite. Country case studies and other substantial research was provided by Bellinda Bartolucci, Christiaan Duijst, Gabriel Arancibia Fischer, Nino Gogsadze, Amina Lattanzi, Marsela Maci, Dominique Martinson, Niranjana Menon, Julia Naomi Nakamura, Komkrit Onsrithong, Pilar Sanchez Valenzuela, Luana Swensson, Kassia Watanabe and Rachel Zuroff. The core writing team is also thankful for Marco Camagni, Marie Claire Colaiacomo, Carlos da Silva, Eva Galvez-Nogales, Valerie Johnston, Christa Ketting, Caterina Pultrone, Marlo Rankin, Costanza Rizzo, Purificacion Tola Satue, Margret Vidar and Sisay Yeshanew for their comments and support throughout the process.

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ACRONYMS AND ABBREVIATIONS

ADR	Alternative Dispute Resolution
Agri-PPP	Agricultural public-private partnership
CADEC	Monitoring, Development and Reconciliation Commission
CARL	Comprehensive Agrarian Reform Law
CARP	Comprehensive Agrarian Reform Program
CFS	Committee on World Food Security
CFS-RAI Principles	Principles for Responsible Investments in Agriculture and Food Systems
CISG	United Nations Convention on Contracts for the International Sale of Goods
EC	European Commission
EEC	European Economic Community
FAO	Food and Agriculture Organization of the United Nations
IFAD	International Fund for Agricultural Development
IPRs	Intellectual Property Rights
LEGN	Development Law Service of the FAO Legal Office
OECD	Organisation for Economic Co-operation and Development
PPPs	Public-private Partnerships
RIA	Regulatory Impact Assessment
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
U.S.C.	The Code of Laws of the United States of America
UNCTAD	United Nations Conference on Trade and Development
UNIDROIT	International Institute for the Unification of Private Law

UPICC	UNIDROIT Principles of International Commercial Contracts
UPOV	International Union for the Protection of New Varieties of Plants
US	United States
USAID	United States Agency for International Development

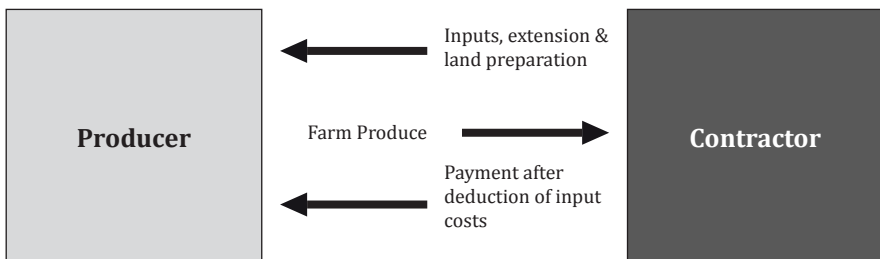
Introduction

1. What is contract farming?

Contract farming can be defined as “an agricultural⁵ production system carried out according to an agreement between a buyer and farmers, which establishes conditions for the production and marketing of a farm product or products” (FAO 2012, p.1). Typically, the farmer (hereinafter referred to as “producer”) commits to producing and delivering agreed quantities of a specific agricultural product. This should meet the quality standards of the buyer (hereinafter referred to as “contractor”) and should be supplied at a time that the contractor determines. In turn, the contractor agrees to purchase the product at agreed pricing conditions and, typically, to support production through, for example, the supply of inputs, land preparation and/or the provision of technical advice (FAO, 2012).

In practice, contract farming can take many forms and involve many different actors. While recognizing that other modalities also exist, Shepherd (2016) describes three common examples of contract farming. In the first example, the contractor supplies all inputs and extension services⁶ to the producer and then deducts their costs from the final price. This is a simple bilateral relationship and does not involve third parties. **Figure 1**, adapted from Shepherd (2016) illustrates this relationship.

FIGURE 1
Contract farming with a single producer and contractor.

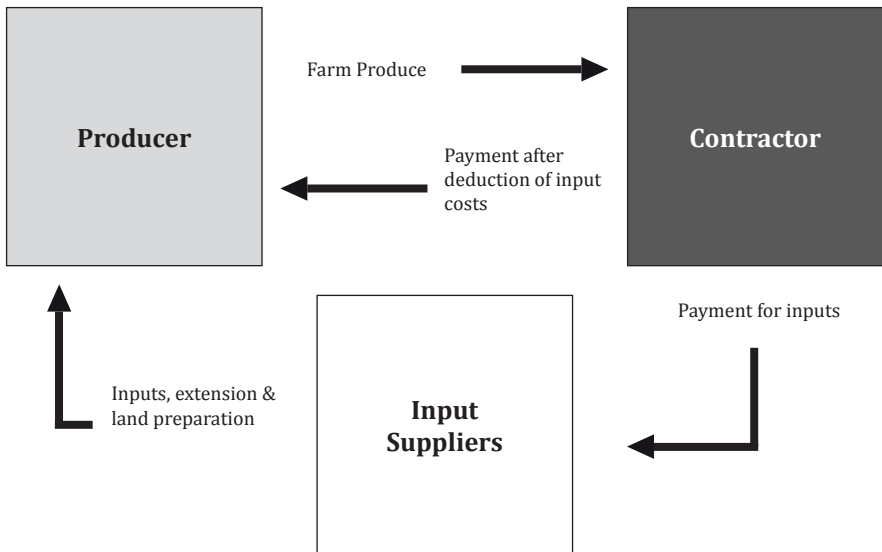


5 The term “agriculture” is used broadly here, encompassing at least: farming, wood and non-wood forestry products, fisheries and aquaculture.

6 These include at least physical inputs (seeds, fertilizers, pesticides, young animals, veterinary products, etc.) extension services (soil preparation, harvesting, etc.) and financial support (credit advances, guarantees, etc.).

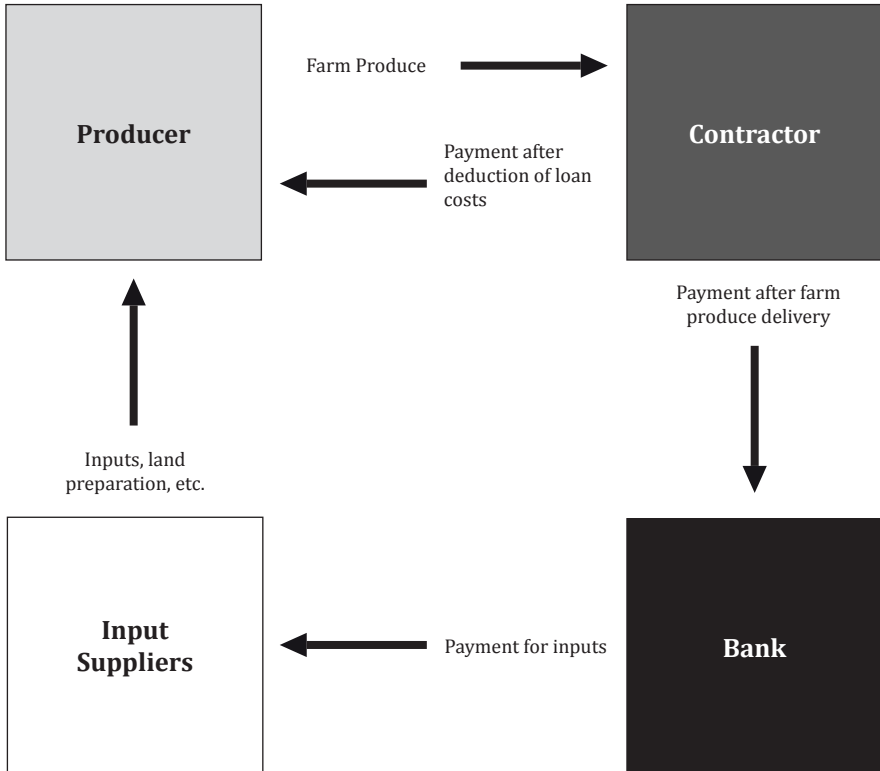
The above example represents the simplest arrangement for contract farming. Adding complexity, Shepherd (2016) introduces a second example featuring the involvement of an independent input supplier. Under this arrangement, the contractor may still provide some extension services. The contractor could also pay for the inputs that the producer had received from the third party, again by deducting their cost from the final price. **Figure 2**, adapted from Shepherd (2016) illustrates this relationship between three parties.

FIGURE 2
Contract farming with a producer, a contractor, and one or more input suppliers.



In the final example, the contractor relies on loans from a bank or other financial service provider to fund the pre-harvest activities necessary for production. An inputs supplier provides the inputs for the producer and the bank pays for the inputs based on a loan application from the contractor. After the harvest, the contractor repays its loan to the bank by deducting its cost from the final price to be paid to the producer. This relationship between four parties is illustrated in **Figure 3**, adapted from Shepherd (2016).

FIGURE 3
Contract farming with a producer, a contractor, a bank,
and one or more inputs suppliers.



In the interests of simplicity and clarity, this Legislative Study will primarily make use of the first example above – with only a producer and a contractor – to analyse examples and illustrations throughout the text. However, it is important to bear in mind that the latter two examples nonetheless still represent practices that fall under this publication’s definition of contract farming. It is important for readers to carefully identify and analyse the various types of contract farming practices found in their country, before considering the design of the regulatory framework (see Chapter 3 Section 3).

These three models are not the only way to characterize contract farming. In a cornerstone publication on contract farming, Eaton & Shepherd

(2001) present five other alternative models depending on the product, the resources of the contractor and the intensity of the relationship between the producer and the contractor. First is the centralized model, where a central processor (contractor) sources raw material from multiple vertically-coordinated smallholders. Second, the nucleus estate model, that is otherwise similar to the centralized model, sees the contractor also managing a central estate or a plantation. Third, the multipartite model, which resembles the second and third examples illustrated in **Figure 2** and **Figure 3**, may involve a variety of organizations beyond the producer and contractor. Fourth, the informal model, is characterized by individual entrepreneurs or small companies engaging based on informal contracts. Lastly, the intermediary model sees a contractor subcontracting linkages with producers to intermediaries. Eaton & Shepherd (2001) discuss the various advantages and disadvantages of all these models in detail.

Across these examples and models, contract farming can be appreciated as an important element of the wider agricultural value chain⁷ to source a steady supply of agricultural products. Contract farming connects producers to networks of processors, retailers, exporters and others, and offers them a chance to enjoy the benefits of access to sustainable food value chains. Sustainable food value chains are defined as: *“the full range of farms and firms and their successive coordinated value-adding activities that produce particular raw agricultural materials and transform them into particular food products that are sold to final consumers and disposed of after use, in a manner that is profitable throughout, has broad-based benefits for society, and does not permanently deplete natural resources”* (Neven 2014, p. vii). As will be discussed below, certain current global trends have been spurring an increasing appreciation of the importance of sustainable, vertically-coordinated value chains in agriculture, such as provided by responsible contract farming arrangements.⁸

2. Trends driving increase in contract farming

Socio-demographic changes, such as population growth, require greater

7 This publication uses the terms supply chain, value chain and production chain interchangeably, if not explicitly identified otherwise in the context.

8 For a more complete picture on the state of food and agriculture, the reader is directed towards the FAO yearly publication “The State of Food and Agriculture”, freely available at FAO website. As of writing, the latest (2016) version of the series concentrated on climate change and agriculture. See FAO. 2016a. The State of food and Agriculture. Climate change, agriculture and food security. Rome. FAO. See also FAO. 2017a. The future of food and agriculture. Trends and challenges. Rome.

food supply to feed the entire global population. According to current FAO estimates, global food demand is projected to increase by some 50 percent by 2050 compared to 2013 (FAO, 2017). Besides the quantity of food that will be needed, rapid urbanization, raising incomes and living standards result in changes in dietary patterns such as increased consumption of animal proteins, oil crops and sugar. Coordinating production through value chains can provide more efficient production and marketing structures than traditional spot markets⁹, and may thus play a part in increasing both the quantity and quality of the food produced globally. This also goes together with the commoditization of food systems, which shifts the primary aim of agricultural production from personal (subsistence) and local consumption to trade and export, for which increased quantity and quality are essential.

Emerging economies are shifting the traditional economic balance of power. One consequence of this shift can be seen in the increased flows of foreign direct investment into agriculture, particularly in developing countries. Some of these investments may take the form of large-scale land investments, with associated risks related to the displacement of smallholder farmers, loss of income and livelihoods for rural people, as well as adverse environmental impacts. Contract farming can help to minimize these risks and to strengthen positive outcomes. When investments include a contract farming component, the contract farming negotiations would allow the farmers to have a say in the implementation of the contract farming part of the project, as well as allow them to remain in control of their land. In general, this can lead to positive effects on local economic and social development, as producers can continue working on their own land (Liu, 2014).

The shift in world economic powers and the strengthening of emerging economies has also resulted in a marked increase in international agricultural trade. More and more, these international buyers are supermarkets (da Silva and Rankin, 2013). Supermarkets adopt procurement practices that favour centralized purchasing, specialized and dedicated wholesalers, preferred supplier systems and private quality standards (Shepherd, 2005). Ensuring that sufficient supply that fulfils private standards is available, might be very challenging in spot markets. To ensure availability of sufficient quantities of specific quality products, value chains increasingly use contract farming.

9 In spot markets, goods are traded for immediate delivery. In essence, a producer directly sells to a buyer, without any prior dealings.

Technological advances have also contributed to the emergence of value chains and contract farming, both at national and international levels. Improvements in storage and delivery systems make it possible to deliver fresher produce around the globe. International contractors can now directly enter into contract farming relationships with producers from far-away countries. Advances in biotechnology and other production-enhancing technologies can improve yields and quality, but often require that the contractor provide detailed guidance and instructions to the producer on the correct way to apply and use the new methods. Contract farming, with its inbuilt input and advice supply systems, can facilitate this kind of technological transfer.

Public policies, regulations and growing consumer pressure from a wealthier, better-educated population all put pressure on agriculture to become more environmentally responsible. Consumers are increasingly not only conscious of health concerns, but also of broader environmental and social responsibility issues surrounding the products they purchase, such as labour conditions, animal welfare, and environmental protection. To guarantee a steady supply of conforming products, large supermarkets, as well as other contractors, can use contract farming to ensure the producer's adherence to such requirements.

3. Benefits and risks of contract farming

In terms of countries' agricultural production systems, 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.¹⁰ Contract farming generally sustains family farming by allowing agricultural producers to continue working on their own land. This dimension has a particularly far-reaching impact in developing countries, where contract farming opens opportunities for small-scale producers to move from small scale local

10 The various benefits and risks of contract farming have been widely discussed and analysed in multiple FAO publications in the past. For example, see UNIDROIT, FAO and IFAD. 2015. UNIDROIT/FAO/IFAD Legal Guide on Contract Farming. Rome; FAO. 2013. Review of smallholder linkages for inclusive agribusiness development, by Paglietti, L. & Sabrie, R. FAO. Rome; FAO. 2015. Inclusive business models – Guidelines for improving linkages between producer groups and buyers of agricultural produce, by Kelly, S., Vergara, N. & Bammann, H. Rome, Italy; and Pultrone, C. 2012. An overview of Contract Farming: Legal Issues and Challenges. *Unif. L. Rev.* 2012 -1/2. A summary of these findings is sufficient for the purposes of this Legislative Study, and an interested reader is directed towards the FAO's Contract Farming Resource Centre, which hosts a variety of material on contract farming both from FAO and from other recognized authors on the topic: <http://www.fao.org/in-action/contract-farming/en/>.

production to larger scale commercial production. Contract farming may also foster social objectives reflected in specific standards and technical specifications. For example, contractual obligations on the parties can encourage the formation of producer groups to strengthen the capacities of small-scale producers, ensure better working conditions for labourers or foster the inclusion of certain categories of persons, such as women or traditional communities (UNIDROIT/FAO/IFAD, 2015).

Contract farming is an economic relationship between contractors and producers. Any potential benefits are unlikely to materialise if the parties' relationship is not legally and economically sound and sustainable. While regulators may approach contract farming as a tool to support smallholders and rural areas, these issues must be subservient to economic realities and must not endanger the financial sustainability of contract farming operations in order to facilitate long-term benefits. That being said, contract farming may be particularly helpful in developing private agricultural businesses in countries where market imperfections are common and where they result in prohibitive start-up and transaction costs. Agribusiness firms may find it hard to secure a steady supply of products from a market place that suffers from fragmented production, trading and processing structures. These circumstances are not conducive to the level of trust required to form professional relations (Will, 2013). Contract farming, particularly when it enjoys strong enforcement and operates under a clear regulatory framework, can help build these bridges and support private business in the increasingly competitive agri-food business sector.

Another advantage is that parties can be enabled to better coordinate the supply and demand of their products, by using written agreements to plan their production in advance. This may help avoid over or underproduction, a particularly critical issue regarding perishable products, and consequent price volatility. Several countries have recognized the potential that contract farming offers in supporting efficient valuechains. For example, a recent law enacted in Spain that aims to enhance the functioning of food supply chains, also promotes contract farming.¹¹ The preamble of the law identifies price volatility, the high cost of inputs and the instability of international markets as factors reducing the competitiveness and profitability of the food sector.¹² It proposes clearer and better regulated contractual relationships between all parties of the food chain, as a

11 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013).

12 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013), Preamble I.

potential tool to address these inefficiencies.¹³ As the preamble to the law explains, *“the proper operation of the food supply chain is essential to ensure sustainable value added for all operators and to contribute to increasing global competitiveness and ultimately to benefit consumers. Therefore, it is essential to address this problem from a global perspective taking account of all agents that interact along the food supply chain.”*¹⁴

In addition, contract farming can also connect smallholders to value chains and increase their access to markets. Secure access to markets helps producers to plan their production in advance, as they already have a guaranteed buyer. Depending on the commodity, smallholders may even have a competitive advantage over larger agricultural production establishments, given their greater labour efficiency and lower overheads. This is particularly true for certain labour-intensive products such as crops and livestock that depend on close, intensive care during the growing season or rearing cycle (UNIDROIT/FAO/IFAD, 2015). Thus, smallholder participation in contract farming can increase the efficiency of value chains, given the right circumstances, which almost invariably includes grouping producers into larger units, such as producer organizations.

However, contract farming can also present some risks for countries and their agricultural production systems. When contract farming includes the use of practices such as mono-cropping or when the crops are not available for use as food in times of need, this could in some cases pose a threat to the food and nutrition security of the producers. If deemed necessary and appropriate, policy choices such as requiring that a portion of the producer’s land be left for subsistence production, can minimize these risks (UNIDROIT/FAO/IFAD, 2015).

Environmental concerns may also arise. If left unchecked, the risk of parties opting for short-term gains at the expense of long-term environmental sustainability may grow. But, through policy and regulatory choices (see Chapter 2 Section 2(f)), contract farming can be harnessed to advance more environmentally-sustainable production practices. It has also been noted that parties involved in contract farming are paying greater attention to the environmental sustainability of production practices, often beyond legal requirements, because of consumer pressure, as mentioned above (UNIDROIT/FAO/IFAD, 2015).

13 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013), Preamble III, Articles 2 and 9.

14 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013), measures to improve the functioning of the food supply chain, Preamble I.

One of the main hindrances identified for the use of contract farming for development is its perceived inability to target the poorest of the poor. This is because it is often more financially advantageous to include the relatively better-off sections of rural smallholders, i.e. those in a better position to supply produce of consistent quality and quantity (Neven, 2014). On the other hand, the suitability of the farm's size to certain types of production is closely linked to the kind of commodity being produced; smaller farms may sometimes have a competitive advantage over larger ones, as is the case for some high quality but low-yield products such as tea or cocoa.

Looking more closely at individual producers, entering into contract farming arrangements can entail multiple benefits. Access to better quality and cheaper inputs compared to those available in the open markets is enhanced, as well as access to credit, either directly from the contractor, or from a third party. Some contract farming arrangements also provide producers with new and better technologies. More importantly, contract farming guarantees producers an outlet to sell their produce. In some cases, producers may even obtain access to more lucrative, foreign markets for high-value crops. Finally, participation in contract farming schemes may help to develop the producers' management skills (Vermeulen & Cotula, 2010).

However, contract farming may also entail some significant risks for producers. An improper use of credit provided through contract farming might lead to unsustainable levels of indebtedness. Changes in working conditions, such as the introduction of new pesticides, may affect the producer's family or workers. Labour issues are likely to have sensitive implications as well, particularly when production relies on seasonal workers who may not enjoy full or any social security protection. Depending on context, if gender equality considerations are not or are inadequately mainstreamed into agricultural supply chain systems, women may not benefit fully from the potential advantages that could accrue from contract farming (UNIDROIT/FAO/IFAD, 2015). These risks are further exacerbated by the commonly encountered imbalance in negotiation power between the producer and the contractor. At times, contractors can draft contracts in their own favour, exploiting their bigger market size and generally higher technical expertise. In some cases, particularly when similar products can be sourced from open markets at lower prices, the contractors may even try to manipulate the quality or quantity measurement at delivery as a pretext for refusal to receive goods and instead procure them from other sources (Vermeulen & Cotula, 2010).

As for contractors, one of the main potential benefits of contract farming is obtaining access to land resources without having to resort to land acquisitions, which might be expensive, difficult and entail significant reputational risks.¹⁵ Through contract farming, contractors can also secure more reliable sources of products, as spreading production over multiple smallholders diffuses the production risk; even if one smallholder's production is seriously hampered by pests or bad weather, the amount and quality of the overall supply may remain sufficient to meet the contractor's needs. Finally, a key benefit is that contractors can ensure that producers follow certain mutually-agreed practices, a prerequisite for the fulfilment of certification requirements (Shepherd, 2016).

The risks for the contractors, on the other hand, mostly relate to the possibility that producers will engage in side-selling. This refers to a practice whereby the producer sells the contracted production to a third-party rather than to the contractor to fetch a higher price for it (see Chapter 4 Section 3(a)). Side-selling may lead to the termination of the relationship, and thus will harm the long-term interest of both parties. Besides the final product, producers may also divert the inputs provided in support of the production towards that of non-contracted products, or sell them to third parties (Eaton & Shepherd, 2001). Despite the risk being spread among many different producers, contractors will nonetheless remain exposed to some level of supply risk (Vermeulen & Cotula, 2010). The situation may be worsened if a small fraction of producers fulfil their production quota by buying non-conforming goods from other producers and delivering these to the contractor. This can have negative implications for the contractor as well as for the producer. For example, when the company markets its vegetables as "pesticide-free," it is a problem if some producers have supplied vegetables from neighbouring farmers that do use pesticides (Shepherd, 2016). The benefits and risks of contract farming for both parties are summarized in **Table 1**. The above description of potential benefits and risks merely reinforces the notion that no one strategy or approach is perfect nor suitable for every context.

15 Companies that invest in land can be seen as dealing with or propping up corrupt regimes and human rights violators. They may also be perceived as land grabbers, particularly in food-insecure countries. Investors can be seen as dealing with or propping up corrupt regimes and human rights violators. They may also be perceived as land grabbers in food-insecure countries. See Cotula, L., Vermeulen, S., Leonard, R. and Keeley, J., 2009. *Land grab or development opportunity? Agricultural investment and international land deals in Africa*. IIED/FAO/IFAD, London/Rome.

TABLE 1
Potential benefits and risks of contract farming

Benefits for producers	Benefits for contractors
<ul style="list-style-type: none"> • Easier access to inputs, services and credit • Improved production and management skills • Secure market • More stable income 	<ul style="list-style-type: none"> • Consistent supply of raw materials • Products conform to quality and safety standards • Reduced input and labour costs when compared to integrated production on company-owned land
Risks for producers	Risks for contractors
<ul style="list-style-type: none"> • Loss of flexibility to sell to alternative buyers when prices increase • Possible delays in payment and late delivery of inputs • Indebtedness to creditors • Environmental risks from growing only one type of crop • Unequal bargaining power between producers and contractors 	<ul style="list-style-type: none"> • High transaction costs from contracting with many small producers • Side-selling if producers decide to breach the contract and sell to others • Potential misuse of inputs if producers use seeds and fertilizers provided by the company for another purpose • Loss of flexibility to seek alternative supply • Reputational risks if things go wrong

Source: FAO 2017b

From a public policy perspective, a government may choose to promote contract farming, among others, to increase its exports, to develop the agricultural private sector, to support rural areas and smallholders, or to increase the supply of agricultural products in the domestic market (see Chapter 3 Section 1 & 2). In particular, when the agricultural products remain in the domestic market, this contributes to food sovereignty as domestic production can offer more agricultural products for consumption at more affordable prices.

Chapter 1. Defining the Agricultural Production Contract

As the term implies, contract farming involves a contractual relationship. The cornerstone of all contract farming is the underlying agricultural production contract which connects buyers of agricultural commodities to agricultural producers.¹⁶ This Legislative Study adopts the definition of agricultural production contract used in the 2015 Legal Guide whereby: *“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”* (UNIDROIT/FAO/IFAD 2015, p. 2). Based on this definition, Chapter 1 discusses the distinctive elements used to characterize an agricultural production contract. Notably, one element that clearly separates agricultural production contracts from an ordinary sales agreement or forward sales agreements¹⁷ is the active participation of the contractor in the production process. The Chapter concludes by highlighting the distinctions between contract farming and contracts for land use, joint ventures, employment contracts, and cooperative agreements.

1. Distinctive features

While variations exist, certain distinctive features of agricultural production contracts can be identified. Identifying these features is important for revealing the nature of the transaction and which existing legal rules may apply. In addition, several of these features are particularly relevant for the purposes of assessing the potential benefits and risks that

16 For an economic analysis, see Da Silva, C. The growing role of contract farming in agri-food systems development: drivers, theory and practice, Agricultural Management, Marketing and Finance Service FAO, Rome, 2005.

17 A forward sales agreement is an agreement between the seller and buyer to deliver a specified quantity of a commodity to the buyer at some time in the future for a specified price or in accordance with a specified pricing formula. See Myong Goo Kang & Nayana Mahajan. 2006. An introduction to market-based instruments for agricultural price risk management. Agricultural management, marketing and finance working document 12. FAO.

may be involved in a contract farming arrangement, and that may need to be addressed for its smooth functioning.

a. Types of parties

The agricultural production contract typically involves two parties: a producer directly involved in the production of agricultural products and a contractor, committed to purchase or otherwise take delivery of those products – typically an agribusiness company engaged in processing or marketing activities.

Producers may participate in contract farming either as individuals, in certain corporate forms or through producer organizations such as cooperatives. Commonly, producers provide the land (as owners, tenants or based on other use rights), capital equipment, labour and some of the inputs for production. The form in which the producer participates may have important implications in many countries as to which set of domestic laws and regulations apply to the relationship. For example, transactions between cooperatives and their members may be covered in a specific law related to cooperatives, rather than in laws related to contract farming or other more general pieces of legislation (see Chapter 1 Section 2(d)) (UNIDROIT/FAO/IFAD, 2015).

The contractor is the party commissioning the production from the producer and providing a certain degree of support, 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. The contractor could also be a wholesaler or an exporter. Besides private, single commercial entities, cooperatives may also act as contractors.

The agreement may also be part of a complex transaction involving other parties, such as several producers, an input supplier or a banking institution (see Introduction Section 1). As a result, these separate contractual relationships may either have an influence on, or be themselves affected by the agricultural production contract. This Legislative Study does not go into detail of these more complex systems, but may refer to them when relevant.

Although somewhat uncommon, public government entities can also

participate as contractors in agricultural production contracts. Public entities are often institutional buyers of agricultural products intended for schools, hospitals, the military or other needs in the public services context. When a public government entity is involved in contract farming, many countries apply special rules to the procurement process, including competitive bidding proceedings to select the contracting party (UNIDROIT/FAO/IFAD, 2015). This Legislative Study limits itself to legal rules applicable to relationships between private parties, and does not cover these public procurement rules.

b. Contractor's role in production

The main feature which distinguishes agricultural production contracts from other contracts used in agriculture, such as sale or forward sales contracts, is the active participation of the contractor in the production process. Agricultural production contracts typically give the contractor the right to exert some level of control and oversight over the production process, which may include the provision of physical inputs, services and technology, financial support, instructions and technical guidance, etc. In addition to participating in production, the contractor would also undertake to purchase the product or, depending on the arrangement, to remunerate the producer for the services rendered in the commodity's production. Under the contract, the producer's main obligation is to produce and deliver the goods to the contractor in accordance with the terms and conditions of the contract, often using inputs and financing received from the contractor (UNIDROIT/FAO/IFAD, 2015).

The performance of both parties is often subject to strict and complex specifications under the contract, as well as to public regulations, especially regarding the quality and safety attributes of the final product and/or required production methods. Moreover, the obligations of the parties are often interlinked, with the result that one party's performance will often depend on the other party's compliance. Other distinctive features include the entering into the agricultural production contract before production begins, and setting the contract for a fixed term, either for one production cycle or more.

2. Distinguishing agricultural production contracts from other types of contracts in the agricultural sector

The agricultural production contract used in contract farming is by no

means the only contractual option available for the parties to organize their agricultural production. This section considers four different types of contracts which may be functionally similar to contract farming: land contracts, joint ventures, employment contracts and agreements between cooperatives and their members. This selection is not exhaustive, and different countries may recognize other similar contractual relationships. Many of these contracts may be subject to their own specific regulatory framework which, while potentially overlapping with contract farming, would not necessarily fully apply to agricultural production contracts. Therefore, a regulator interested in contract farming may need to clarify early on which other similar contractual arrangements already exist in their legal systems, and what their relationship is to contract farming.

a. Contracts for land use

Contract farming is not a contract for land use. One of the main benefits of contract farming for the contractors is that it grants them access to agricultural products, generally without ascribing them rights to the land used for production. The producer will often provide the land, whether as the owner or as a tenant, or under another type of usage right. Other contract forms used in agriculture will allow agribusinesses, or sometimes producers, to access the land without having to purchase it. Lease and management contracts, for example, refer to the variety of arrangements under which the land is worked upon by a party other than the land's owner (Vermeulen & Cotula, 2010).

At the core of effective leasing arrangements is the relationship between landowners and tenants, which should in some way be guaranteed or supported by the state (FAO, 2004). Rather than contracting the smallholders' agricultural production, the parties to a lease agreement contract directly the land upon which the production takes place. The contractor would then provide its own workforce, such as by establishing a plantation, to work the plot of land. The landowner would not necessarily be involved in the production at all, but would be paid a fixed rent for use of the land. Leasing agreements are often covered by specific legal regimes. The legislation covering leases can in some cases be extended to cover certain forms of contract farming, when permitted by the legal system. Management contracts are similar to leases and allow an agribusiness to maintain full control over production on the land held by the landowners. Instead of only a fixed rent, management contracts provide a wider range of options for revenue sharing, such as sharing the final profit according to an agreed formula (Vermeulen & Cotula, 2010).

Unlike in contract farming, the landowner would not have the power to make decisions regarding farm management under either the lease or the management contracts. The landowner in these contracts is a passive party, providing access to the land, but not necessarily participating in the actual production. Thus, the distinction with contract farming is clear: in contracts for land use, only access to land is provided, while contract farming focuses on the deliverable product and includes the labour and other services provided by the landowner and its workforce.

Sharecropping agreements are another version of management contracts, in which individual producers work the land of larger scale agribusinesses or other producers, and the crop (or its proceedings) is split between the two parties in accordance with pre-set proportions. They can thus be considered a mirror version of the first two contract forms, providing smallholders with access to land rather than providing access to smallholders' land for agribusinesses (Vermeulen & Cotula, 2010). Sharecropping allows for the sharing of risks and the provision of incentives to the sharecropper – their success is directly tied to the success of the crop they are caring for – and has historically provided the landless with land access. On the other hand, sharecropping is often less efficient than cash rental contracts, and can be exploitative (Vermeulen & Cotula, 2010).

Sharecropping is similar to contract farming, with some of the roles reversed. In sharecropping, the generally stronger party provides the land where the production takes place and the producer usually provides labour as well as all unfixed inputs, such as machinery, seeds and fertilizers. Compared to contract producers who cultivate their own land, tenants on land rented from a company tend to be in a weaker negotiating position, as they may lose the access to land if they do not comply with the conditions imposed by the company (Vermeulen & Cotula, 2010).

b. Joint ventures

Contract farming is not a joint venture. While economically linked to the contractor as an independent legal party, a producer under an agricultural production contract should maintain its autonomy in terms of assets and management of the undertaking. When the nature and degree of control by the contractor evidences the producers' lack of legal autonomy, the conclusion may be made that a joint venture has in fact been created between the producer and the contractor. This joint venture is sometimes referred to as a partnership, a *de facto* company or other similar concepts (UNIDROIT/FAO/IFAD, 2015).

Joint ventures entail a co-ownership of a business venture by two independent market actors, such as an agribusiness and a producer organization. The parties share the financial risks and benefits in a joint venture, and in most but not all cases, the decision-making authority is proportionate to their equity share (Vermeulen & Cotula, 2010). In theory, both sides should be equal partners and co-owners of the project, but in practice the real power of smallholders in a joint venture may be limited, with the agribusiness taking all the business decisions (de Schutter, 2011).

From a legal point of view, the joint ownership of a project distinguishes joint ventures from contract farming. Making this distinction may be difficult however, particularly when joint ventures are not incorporated and are run without a separate joint venture company with distinct legal personality (Vermeulen & Cotula, 2010). Thus, when considering revisions for their regulatory framework for contract farming, regulators should make sure that their intervention is limited to contract farming per se and does not inadvertently affect or discourage true joint ventures between equal partners, as those relationships do not necessarily benefit from the types of rules that are found in enabling frameworks for contract farming. This may be done, for example, by explicitly stating in the legislation that the parties are independent from each other.

c. Employment contracts

Contract farming is not an employment relationship. In some cases, it may be difficult to draw a clear line between contract farming and an employment relationship, particularly when the contractor has extensive supervisory rights and control over the producer, thereby effectively reducing the producer's real independence (UNIDROIT/FAO/IFAD, 2015). In any case, because the parties to a contract farming agreement are considered independent from, and equal to, each other, they are not in an employment relationship. This is sometimes even explicitly clarified in the regulatory framework, such as in Brazil, where the law on contract farming clarifies that a contract farming relationship does not constitute an employment relationship.¹⁸

In some cases, contract farming can be used to disguise an employment relationship, motivated mainly by the intention to avoid employers' responsibilities (Yeshanew, 2016). Particularly in countries where general

18 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvipastoris (Nº 13.288), Article 2(3).

labour law also applies to rural workers, the temptation to use contract farming to avoid the sometimes substantial costs – financial and otherwise – that come with being an employer, may be alluring to some contractors. This may give further impetus for the regulators to ensure that their definitions of agricultural production contracts and of employment contracts are both sufficiently clear and differentiated, so as to make it harder to disguise one as another.

d. Producers' agreements with cooperatives

Cooperatives are a special type of enterprise that balances two main goals: satisfying its member's needs and pursuing profit and sustainability (FAO, 2012b).¹⁹ Cooperatives can have different types of agreements between itself and its members to support or participate in the marketing of the member producer's products. While there are many different possibilities, such as collective sales agreements or direct sales with common marketing elements, two illustrative contract types are considered in this section: an agency agreement and sales agreement.

Where there is a need to keep each members' crops separate from another and if the time between delivery and sale to the contractor is relatively short, an *agency agreement* can be used between the cooperative and the member (the producer), in which the cooperative is the producer's agent. An agent is a legal or physical person vested with the power to negotiate and/or conclude contracts on behalf of another person – in this case on behalf of the producer – for the sale or purchase of goods or services supplied by the producer. Since an agent derives all authority from the producer, an agency agreement should describe the extent of control an agent can exercise over the producer's goods. There is no contractual relationship between the agent and the contractor, as the agent merely represents the interests of the producer in this relationship (Poole, 2012).

By contrast, if members' production is to be pooled or processed into value-added items, or if considerable time is likely to elapse between delivery and sale, a *sale agreement* may be implemented, which gives the cooperative the right to resell the product to third parties. This means that if a marketing contract calls for the member's product to be purchased by the cooperative, the cooperative not only takes possession, but also assumes title for it. The risk of loss in the goods passes from the member to the cooperative only after the cooperative takes both delivery and title.

19 FAO. 2012b. *Agricultural cooperatives: key to feeding the world*. Rome.

In practice, due to the extensive authority it can exercise over a member's goods, a cooperative often releases a member from any potential liability after delivery of the goods to the cooperative, even though the member may still technically hold title (Reilly, 1992).

Both forms of agreement may closely resemble an agricultural production contract as covered in this Legislative Study. The main difference is that the cooperative would not be the final buyer of the product, but would rather support and share costs with the producer in the marketing and production of the product. Certain legal systems include specific provisions to prevent confusion between these two types of contract. For example, the law in France on standard contracts used in contract farming specifies that the relations between agricultural cooperatives and their members are not governed by the contract farming provisions.²⁰

Chapter 2. Assessing the legal framework governing contract farming

1. What is the legal framework governing contract farming?

Contract farming is always governed by a national legal framework, regardless of whether a country has adopted any legislation containing specific rules for it. Depending on the legal system, a variety of different laws and regulations with different regulatory purposes and with varied scope may be applicable to contract farming. These include, but are not limited to, general contract laws; agricultural laws; supply chain legislation; and commodities specific legislation. This section briefly introduces the most common legal areas that may regulate contract farming, both when they contain specific contract farming related rules and when they do not. Importantly, even if specific contract farming rules do exist in the legal system, laws governing other areas could still contain provisions that would apply to contract farming by default or explicitly (see Box 1). Such provisions would thus act as gap fillers by providing solutions to issues not addressed in the more specific legislation.

BOX 1
Default and mandatory rules

Regulators may rely on “default rules”, i.e. rules, which are applicable whenever the agreement is unclear, incomplete or silent on a particular issue in contract farming related legislation. Default rules are gap-fillers, which serve to ensure a smooth operation of the agreement and to promote what can be seen as the best interests of the parties in terms of contractual justice and economic efficiency, by offering solutions to either general or specific issues.

Alternatively, regulators may rely on “mandatory rules”, i.e. rules that may not be varied nor excluded by the parties. Mandatory rules limit the freedom of negotiations by, for example, obliging the parties to either include or not include certain provisions in the contract. When the rules are mandatory, the legislation should also provide for an effective enforcement mechanism.

As a starting point, in many legal systems, general contract law sets the mandatory minimum standards of conduct in any contractual dealings, and determines who has legal capacity to enter into a contract. General principles applied under most legal systems, although with varied scope and application, include the duty to act in accordance with good morals, in good faith, reasonably, with loyalty and in fair dealings during the whole contract relationship. In addition, general contract law deals with fundamental aspects of all contracts, such as their interpretation, formation and validity, content or object, non-performance and remedies, limitation periods, and assignment of rights.

When a country relies on its general contract law as the basis for contract farming, the rules applicable to the agricultural production contract depend on the contractual relationship that is identified as applicable by analogy²¹. One element which may determine a contract's classification under a specific legal category is the nature of the essential obligation that characterises the contract, for example, whether it relates to the provision of goods or the provision of services. Complex contracts, as many agricultural production contracts tend to be, with plural and varied essential obligations can be difficult to classify, and legal systems use different approaches to characterise such transactions. Three types are described here. First, the relationship's mixed nature may lead to identifying different underlying contractual structures (e.g. "sales", "lease", "bailment"²²) and, as a result, the overall relationship will be subject to a combination of contractual regimes, as if the identified contractual obligations were unrelated. Second, under a simpler, more straightforward approach, one particular performance – such as sale or provision of services – may be considered as prevailing in the transaction, resulting in the application of the legal regime corresponding to that performance to the entire relationship. Yet another approach is where the character of the transaction is totally unique ("*sui generis*"). Here, rules concerning similar contracts (see Chapter 1 Section 2) will be applied by analogy and only to the extent compatible with the particular transaction (UNIDROIT/FAO/IFAD, 2015).

Some regulators have chosen to embed contract farming related provisions directly into provisions on contractual obligations contained in general

21 The application of a legal provision 'by analogy' is most typical of Common Law legal systems.

22 "Bailment is the transfer of possession but not ownership of personal property (as goods) for a limited time or specified purpose (as transportation) such that the individual or business entity taking possession is liable to some extent for loss or damage to the property." "Bailment" in Merriam-Webster.com. 2017 (14/12/2017).

contract law. Such provisions are often drafted in general terms as they are generally applicable to all forms of agriculture.

An example can be found in the Russian Civil Code. The Russian Civil Code only contains a few articles dealing directly with contracts for agricultural procurement, and these list the main duties of the contractor and of the producer, as well as the liabilities related to the production.²³ Importantly, the same articles also make explicit reference to various other sections of the Civil Code as follows “*the rules for the contract for delivery (Articles 506-524) shall be applicable to the relations covered by the contract and not regulated by the rules of this paragraph, while in cases of the delivery of goods for state needs, the rules for the contract sale of agricultural produce for delivery (Articles 525-534) shall be applicable.*”²⁴

Relying on general contract law as the legal basis for the agricultural production contract will often place such contracts under the jurisdiction of regular state courts. Every legal system should guarantee free and fair access to justice and enable private parties to settle their disputes 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. However, general courts often involve complex and lengthy proceedings, which may reduce their suitability for resolving contract farming disputes (see Chapter 4 Section 3(a)) (UNIDROIT/FAO/IFAD, 2015).

Agricultural laws, which in some countries are compiled in agrarian codes, may commonly deal both with agricultural production and marketing and provide rules for agricultural contracts in general. These broader agricultural contracts may not necessarily fall under the definition of contract farming as used in this Legislative Study. But, the rules applicable to them could still be applicable to the agricultural production contract, through analogy and to the extent and manner appropriate for the legal system. They would also define the broader legal context in which such contracts can operate. Rules governing agricultural contracts can cover the prohibition of abusive clauses, the inclusion of clauses on identification of the parties, the description of the object and duration of the contract, as well as terms of payment, date of execution and signature of the parties.²⁵

23 Russia. Гражданского кодекса, Articles 535-538.

24 Russia. Гражданского кодекса, Article 535 (2).

25 As an example, see Panama. Código Agrario de la República de Panamá, Article 49.

The specific contract farming provisions themselves can be as detailed or general as the regulators intend, and as reflective of the national legal tradition. For example, France and Panama have compiled agrarian laws that include provisions on contract farming. In France, issues related to contract farming are mostly covered in the Rural and Fishery Code (Code rural et de la pêche maritime), which contains rules of varying specificity depending on the commodity in question. Thus, at least for certain commodities, the Code establishes content requirements, including specification of the product, mutual obligations of the parties, contract duration, conditions for its renewal, provisions on *force majeure*, remedies and dispute settlement.²⁶ In Panama, the Agrarian Code for the Republic of Panama (Código Agrario de la República de Panamá)²⁷ contains general provisions governing all agricultural contracts,²⁸ as well as specific provisions further regulating vertical integration contracts where the buyer provides technical services to the farmer.²⁹ As neither the French nor the Panamanian Codes are comprehensive, their respective Civil Codes will necessarily have a role to play (Pultrone, 2012).

Commodity-specific legislation generally covers aspects relevant to the single commodity, such as price, production specifications and regulatory obligations of the parties. While these are not necessarily created with a contract farming scenario in mind, they may inform the parties' contractual relationship and the underlying agricultural production contract. Regulators can also include contract farming provisions in their commodity-specific acts. In these cases, the rules would relate only to the contracts for those specific commodities, and would not apply to other agricultural commodities.

Tanzania, for example, has introduced commodity-specific laws for tea, coffee, sisal, cotton, tobacco, pyrethrum and sugar. These rules make the use of the contracts mandatory for the facilitation of registered farmers, place minimum content requirements for the agricultural production contracts and requires their registration with the relevant authority.³⁰

26 France. Code rural et de la pêche maritime, Articles R631-11 – R631-14; Articles R326-1 – R326-10 and Articles R631-7 – R631-10.

27 Panama. Código Agrario de la República de Panamá, (No. 55 of 23.05.2011).

28 Panama. Código Agrario de la República de Panamá, (No. 55 of 23.05.2011), Article 41-49.

29 Panama. Código Agrario de la República de Panamá, (No. 55 of 23.05.2011), Articles 134-138.

30 Tanzania. Tea Act, 1997 (No. 3 of 1997), Article 25A; Tanzania. Coffee Industry Act, 2001 (Act No. 23 of 2001), Article 34A; Tanzania. Sisal Industry Act, 1997 (No. 2 of 1997), Article 19A; Tanzania. Cotton Industry Act (Act No. 2 of 2001), Article 14A; Tanzania. Tobacco Industry Act, 2001 (Act No. 24 of 2001), 7A; Tanzania. Pyrethrum Act (No. 1 of 1997), Article 24; Tanzania. Sugar Industry Act, 2001 (Act No. 26 of 2001), Article 37.

In the State of Rio Negro, Argentina has legislation specifically related to the use of contracts for the production of certain fruits. Such legislation requires minimum content from the production contract, registration of the parties and the contract, and provide incentives for the parties to register their contracts.³¹

Including provisions related to contract farming in agricultural or commodity-specific legislation could also bring them under the purview of special jurisdictions set to cover agriculture-related disputes. These courts or tribunals often have simpler and speedier procedural formalities, and lower cost implications for the parties (Masrevery, 1975), while preserving the impartiality and enforceability of judicial dispute resolution, which can be advantageous for resolving conflicts arising from contract farming. Even without explicitly placing the contract farming related rules in agrarian legislation or commodity-specific legislation, regulators may nonetheless bring the agricultural production contracts under the jurisdiction of these specialised courts by ensuring that their jurisdiction extends to contracts between agricultural producers and enterprises (see Chapter 4 Section 3(a)).

Supply chain legislation is another area of law that may be relevant to contract farming operations. Rather than only considering the relationship between the primary producer and the contractor – an early link in a long supply chain³² – supply chain legislation may consider linkages throughout the entire production chain, from the producer (or even input supplier) to the final consumer. This type of legislation may also contain rules related to forward sales contracts, which may apply to certain types of agricultural production contracts.

Supply chain legislation may also include specific rules for one of the first links of the production chain, i.e. the agricultural production contract. As the scope of these pieces of legislation often covers the whole of the chain, the specific rules related to the contract farming relationship are often drafted in a manner that is more sensitive to the needs of the supply chain as a whole. As an example, they may include greater detail on the roles and rights of third parties further along the chain. Spain has adopted legislation that explicitly acknowledges the linkage between contract farming and

31 Rio Negro, Argentina. Regimen de transparencia para la vinculacion entre la produccion, empaque, industria y comercializacion de frutas en Rio Negro (E 3.611), Articles 3, 4, 17, 21-28.

32 The very first link is usually understood to be the link between the input supplier and the producer.

food supply chains. The legislation, in the definition of its scope, addresses contract farming in the context of the whole supply chain, and takes into account all the agents that interact along the food supply chain.³³

Regulators may also embed rules specifically related to contract farming in legislation related to public development programs, when contract farming is a meaningful part of such a program. In the Philippines, for example, the Comprehensive Agrarian Reform Law (CARL) of 1988 created the Comprehensive Agrarian Reform Program (CARP).³⁴ CARP aims to provide land to tenant farmers and better opportunities for the rural poor (FAO, 2016). The CARL supports Agribusiness Venture Arrangements, which are the local equivalent of contract farming.³⁵

In Brazil, contract farming is a key element in the National Program for the Production and Use of Biodiesel, approved by governmental decision.³⁶ In addition to the national economic goals involved, the targeted inclusion of small-scale farmers is a specific objective of the programme and contributes to sustainability objectives, with the industry-farmer relationship regulated by a certification scheme called the Social Fuel Seal. The Social Fuel Seal consists of a certification granted by the Ministry of Agrarian Development. To get this certification, biodiesel producers must source a certain amount of oilseed through contracts with smallholders. The legislation requires that these contracts include input and service provisions, as well as technical assistance and training to the producers – in essence creating contract farming agreements. In order to qualify for the Seal, an official representative body (trade union, association or federation) must mediate the negotiations for the contract farming agreement (da Silva & Rankin, 2013). Certified biodiesel producers benefit from tax incentives and are allowed to participate in exclusive auctions organized by the Brazilian National Agency of Petroleum, Natural Gas and Biofuels, which represent 80 percent of the biodiesel traded in the country (da Silva & Rankin, 2013).

A regulatory approach that is often used to frame contract farming operations is the drafting of standard contracts. Legislation may provide for the development of standard contracts for parties to use, either

33 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013) Article 2.

34 Philippines. Comprehensive Agrarian Reform Law of 1988 (RA 6657).

35 Philippines. Comprehensive Agrarian Reform Law of 1988 (RA 6657), Section 29.

36 Brazil. Dispõe sobre os critérios e procedimentos relativos à concessão, manutenção e uso do Selo Combustível Social (Portaria 337/2015).

on a mandatory or voluntary basis. It may provide guidance for the development of standard contracts and indicate which kind of terms may be considered unfair. It may also regulate the use of standard contracts with the aim of protecting the weaker party, may impose information obligations on contractors using standard form contracts or requirements on the readability and clarity of the terms (see Chapter 2 Section 3).

Spain provides standard contracts for specific sectors of agricultural production, through the Law 2/2000 regulating standard contracts for agri-food products. These standard contracts are created by an Inter-professional Agro-Food Organization which represents production, processing and marketing actors. The law stipulates a standard set of requirements for the contracts, but the drafting of the specific provisions is left to the negotiations of the parties' representative organs. The standard contract includes the identification of the parties, term of validity of the contract, object of the standard contract (product, quantity, quality, delivery, and other commercial aspects), price and payment terms, as well as a dispute resolution mechanism.³⁷

France has likewise enacted legislation covering the creation of standard contracts used for 'agricultural integration' – the local equivalent term for contract farming. These standard contracts are drafted by interested parties in the private sector and approved by a decision of the Minister of Agriculture. The legislation places minimum requirements for these contracts and requires them to set out, by production sector, the reciprocal obligations of the parties involved, and the minimum guarantees to be granted to producers. In particular, the standard contracts must specify the methodology used to fix prices, payment periods beyond which the legal interest is due to the producer without giving rise to formal notice, the duration of the contract, the volume and cycle of production under the contract, as well as the indemnities due by the parties in case of non-compliance with these clauses. Only those contracts that conform to such requirements can qualify for public investment aid.³⁸ In addition, when the number of individual integration contracts concluded between agricultural producers and a contractor exceeds a number fixed by the Minister of Agriculture, or when at least two-thirds of the producers who have entered into an integration contract with the same contractor so request, a collective standard contract shall substitute the individual contracts

37 Spain. Ley de enero, reguladora de los contratos tipo de productos agroalimentarios (2/2000), Article 3.

38 France. Code rural et de la pêche maritime, Article L326-5.

between the parties.³⁹ For these collective standard contracts, France has approved specific standard integration agreements, for example, for veal calf production⁴⁰ and broiler production.⁴¹

Regulators may also adopt more self-contained pieces of legislation that aims to regulate all usage of contract farming in the country, regardless of the underlying commodity. Core aspects of such legislation often include the requirements that agreements be in writing, that certain minimum content clauses are included, as well as clear procedures for resolving disputes or ensuring enforcement. The scope of specific contract farming legislation is not limited to certain commodities. Its scope is instead limited by the definition of contract farming adopted in the country (see Chapter 4 Section 1(a)). As such, it provides a legal basis for contract farming across agriculture. The rules contained in such legislation are often drafted in a more general manner than in commodity-specific legislation, so that they can be applied across various commodities.

Several states in the United States of America have enacted specific laws regulating contract farming. As an example, in 1990, Minnesota became the first State to enact legislation⁴² specifically and directly governing agricultural production contracts (Peck, 2006). The law includes requirements on the language and form of the contract, contract formation and review and dispute resolution, among other topics. In Morocco, the act covering contract farming provides a list of mandatory clauses that must be included in any contract farming agreement.⁴³ These include, for example, price and payment, standards concerning minimum quality of the goods, delivery rules, obligation of each party to keep records, and the nature of the assistance that contractors should provide to the producers.⁴⁴

Some countries have also created model contracts, whether as part of their contract farming related legislation or not, to guide the use of contract farming in the country. As opposed to standard contracts which are often drafted and agreed by stakeholders (see above), the text of a model contract is specified in the legislation itself. These model contracts can either be made mandatory or voluntary, providing the parties with a

39 France. Code rural et de la pêche maritime, Article L326-4.

40 France. Arrêté du 15 mars 1988 relatif à l'homologation d'un contrat type d'intégration pour l'élevage à façon de veaux de boucherie.

41 France. Arrêté du 15 mars 1988 relatif à l'homologation d'un contrat type d'intégration pour la production de volailles de chair à façon.

42 Minnesota. The Minnesota Agricultural Contracts Act, (17.90-19.98).

43 Morocco. Loi relative à l'agrégation agricole (n° 04-12).

44 Morocco. Loi relative à l'agrégation agricole (n° 04-12), Article 9.

potential workable solution, which they can use as a basis and modify as needed to best address their individual needs and relationship. The model contracts may contain both mandatory and voluntary provisions. India, for example, has a Model Act⁴⁵ on Agricultural Marketing which includes a model agreement. The Model Act identifies which of the clauses and content of the model contract are mandatory and which are best practices that the State wishes to promote.⁴⁶

Specific rules related to contract farming need not be incorporated into primary legislation, i.e. legislation passed by a parliament. Depending on the national legal system and the policy objectives sought, the regulator is naturally free to choose any regulatory instrument that best suits their needs and fits the scope of the adopted rules. Some countries have opted for subsidiary legislation – i.e. legislation passed by government in the exercise of subordinate law-making authority – as the main legal tool to cover contract farming. Depending on the legal system, there might still be a need for a parliamentary-level legislation to provide the legal grounds for such subsidiary legislation, housed under the various types of primary laws identified above. For example, in Viet Nam, Prime Minister’s Decision 62/2013/QĐ-TTg currently covers contract farming. While not as high within the legislative hierarchy as laws passed by the parliament,⁴⁷ Prime Minister’s Decisions are “Legal Normative Documents” and thus contain legally binding rules (Loi, 2015). As a policy choice, the Decision 62/2013/QĐ-TTg only focuses on large-scale agricultural projects, and thus promotes horizontal cooperation between farmers so as to merge small land plots into larger zones to achieve economies of scale (Dang et al., 2014).

2. Other legal areas influencing contract farming

There are several legal areas which may require consideration by domestic regulators to determine whether they may have an impact on contract farming operations. These areas, discussed in more detail in the below section, include: laws on competition, on unfair trade practices, investment codes, laws on intellectual property rights, on international human rights and environmental protection. Many other areas of the law, such as labour law and production-related legislation, are often relevant as well and deserve a close analysis. The presentation below is by no means exhaustive

45 A model act has to be implemented by the individual states for it to be enforceable in that state.

46 India. Agricultural Produce Marketing Act. Addendum on Contract Farming Agreement And Its Model Specifications 9th Sept 2003.

47 Viet Nam. Law on the promulgation of Legal Documents (80/2015/QH13), Article 4.

and not all areas covered here are necessarily relevant for all countries. An in-depth, country-specific analysis will always be necessary and will undoubtedly identify other relevant legal areas not included below.

a. Competition law

Competition law will usually only apply if a practice diminishes fair and open competition in the market as a whole, regardless of whether there is abuse of a single producer (US Department of Justice, 2012). Thus, competition law (also known as antitrust law) does not provide redress for all kinds of abuses that may surface in contract farming arrangements. The effect of antitrust laws which “*were enacted for the protection of competition, not competitors.*” (US Department of Justice, 2012, p. 20), are defined by their scope. In the same vein, “*EU antitrust law is not concerned with particular outcomes of contractual negotiations between parties unless such terms would have negative effects on the competitive process and ultimately reduce consumer welfare.*” (European Commission 2010, p. 28). There are two main intersections between competition law and contract farming; first, when buyers of agricultural products abuse their market power by restricting competition in the relevant market; and second, the exceptions to the application of competition rules in the agricultural sector.

i. Buyer power in contract farming and competition law

Monopsony power, as the converse of monopoly power, means market power on the buying side of a market. Companies with such market power may depress the prices of products supplied by agricultural producers below competitive levels, or limit production and discriminate among supplying producers or producer organizations – all of which are examples of potential abusive behaviours by dominant companies that are prohibited by competition laws (see Chapter 2 Section 2(b)).⁴⁸ Buyer power may result from collusion of two or more firms thus creating a prohibited cartel. Cartel prohibition bans agreements between undertakings that distort competition, in particular those which directly or indirectly fix purchase prices, limit or control production, share markets or discriminate among trading parties.

While the competition issues that occur in contract farming often implicate

48 United States of America. Sherman Antitrust Act (U.S.C. §§ 1-7) Section 2; European Union. Consolidated version of the treaty on the functioning of the European Union (C 326/47), Article 102.

a producer and a contractor, the underlying cause of these issues is to be found in the structure of the market where the contractors operate. Such markets are often highly concentrated (OECD, 2005a & OECD, 2013a), and such concentration, or lack of competition for the contractor, poses competition problems because it determines the potential market power of the business operators in a particular market, which then allows the contractor the possibility to impose unfair terms and practices on the producer (OECD, 2013). For this reason, merger control by a competition authority is a prerequisite for avoiding future exertion of market power by strong purchasers and processors of agricultural products.

Legislation may also specifically address gross abuses of bargaining power at the time of contracting. Traditionally, competition laws require the contractor to have a dominant position in the relevant market before the laws can be applied. Even when the contractor does not have a dominant position, the producer may be so economically dependent on the contractor, that they are unable to negotiate effectively in a balanced manner. Some European countries have moved to counter this imbalance and introduced prohibitions for unfair behaviour. These countries have either expanded the reach of their competition law rules or provided similar rules in specific business-to-business legislation or in sectoral legislation governing retail trade or specific subsectors, such as agri-food (Renda et al., 2014).

ii. Producer organizations and competition laws

Some antitrust law regimes provide for an exemption from competition rules for the activities of producer organizations, to the extent that competition is not unduly restricted. As a lot of contract farming is conducted through producer organizations, these exemptions can influence the viability of contract farming.

The exemption from competition rules for agricultural producer organizations can be limited in scope and application by certain conditions applying to their commercialisation activities. That is to say, the same laws which grant exemptions from competition rules include provisions that enable public authorities (competition authorities or other) to intervene in order to protect the public from harmful anti-competitive conduct by producer organizations (Barnes & Ondeck, 1997). As an example, the European Union competition authority (the European Commission), or national competition authorities, can reopen a particular negotiation by the producer organization – or may decide that this should not take place at

all – if they consider that this is necessary in order to prevent competition being jeopardised.⁴⁹

Producer organizations may in some cases abuse the antitrust exemptions to monopolize or restrain trade. This can unduly enhance the price of an agricultural product. Producer organizations may also restrict competition by imposing membership obligations upon their members. These obligations may come in the form of termination clauses, including payments of excessive fees on withdrawal, or requirements of exclusive supply of their agricultural produce for long periods, thereby depriving the members of the possibility to approach competitors. As the European Court of Justice has ruled, the combination of such clauses can render a market excessively rigid and have a negative effect on competition.⁵⁰

b. Legislation covering unfair trade practices

i. Unfair trade practices in agriculture

There are certain practices that will commonly be considered as unfair in different legal systems. Legal systems may curb the parties' ability to exclude or limit one party's liability, or their ability to shift their own responsibilities to the other party. Various unilateral rights and obligations, such as allocating the right to terminate for only one party,⁵¹ excluding or limiting liability for only one party,⁵² or allowing just one of the parties to modify the terms of the contract without consulting the other, are often found unfair. Given the potentially far-reaching effects of contract termination, regulators may also classify terminations without a notice period or without justifiable grounds as unfair trade practices. Similarly, pricing, whether too low or too high, and late payments may be considered unfair trade practices. While the legislation covering these is rarely created specifically to apply to contract farming, its scope is commonly open enough to be applicable to agricultural production contracts.

The agricultural and food sector is a good example of a field where imbalance in bargaining power and unfair practices has raised concerns, both because of possible distortions caused to the functioning of the supply

49 European Union. Regulation establishing a common organisation of the markets in agricultural products (1308/2013), Article 149 (6), Article 169 (5), Article 170 (5), Article 171 (5).

50 Case C-399/93 Oude Luttikhuis, para. 16.

51 France. Code de commerce, Article L. 442-6.

52 Thailand. Unfair Contract Terms Act (B.E. 2540), Section 4.

chain, and from the perspective of the individual parties. Further, unfair trade practices may have disproportionate effects on small and medium sized enterprises, “*which often lack specialist knowledge about complex contracts, have higher switching costs and fewer trading relationships, [and] are less willing to use formal enforcement mechanisms and have less countervailing power against powerful trading partners*” (EU, 2013, p. 9).

In general, legislation covering unfair trade practices applies between commercial parties. For example, in France, imposing obligations on a commercial partner that create a “*significant imbalance between the rights and obligations of the parties*” may be considered unfair.⁵³ Certain legal systems have also created special rules that afford protection to small businesses in particular. For example, South Africa extends the same protection granted to consumers to small businesses as well. In South Africa, the definition of consumer in the Consumer Protection Act is wide enough to cover small businesses below a certain threshold, and thus offers protection for the producer when the latter buys inputs from the contractor.⁵⁴ However, this protection may only apply in restricted circumstances or for particular purposes, for example when such businesses deal on the basis of standard form contracts.

Some legal systems cover unfair terms and practices directly in their contract farming specific legislation. Spain has identified three categories of unfair practices, which are considered particularly relevant to contracts in the supply chain, including agricultural production contracts. First, under the section that discusses unilateral changes and unforeseen commercial payments, unilateral modification of established contractual terms or additional payments over the agreed price are prohibited. Second, while parties are to provide each other with information necessary for the fulfilment of their obligations, under no circumstances may a party require another to divulge sensitive information about their products to third parties. Third, the parties must manage brand names in a manner consistent with competition laws and so as to avoid confusion with other operators’ brands or trade names.⁵⁵

ii. Enforcement of legislation covering unfair trade practices

Several countries have designated a specific authority as having competence for the review and sanctioning of unfair practices between trading parties.

53 France. Code de commerce, Article L. 442-6.

54 South Africa. Consumer Protection Act (no. 68 of 2008), Articles 1 and 5.

55 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013), Articles 12-14.

This can either be within the competition authority itself, often to cover certain specific industries such as the food or grocery sectors, or such authority may be located under the Ministry of Agriculture, or other, for example under the “Department for Business, Energy & Industrial Strategy” in the United Kingdom.⁵⁶ (Renda et al., 2014).

The scope of such competence and reach of decisions varies from country to country. At least within the European Union, one can see some typical features of public enforcement mechanisms for unfair trade practices. In some legal systems, the aggrieved party can file an anonymous complaint to avoid the other party’s possible retaliation, thus providing at least a partial answer to the issue of “fear factor”⁵⁷ (Renda et al., 2014). In contract farming, it may sometimes be hard to ensure this confidentiality in practice, as the contractor may be able to easily deduce which of its limited number of suppliers has made the complaint.

Another typical feature is for the competition authority to have the power to investigate on its own initiative, without a complaint or other request by an affected party. This power is often limited to breaches of competition laws, at least in the European Union (Renda et al., 2014). Given the potentially strong fear factor that may prevent even an anonymous complaint, investigations launched by competition authorities on their own initiative can help with enforcing unfair trade practice rules in contract farming contexts.

Rules in legislation covering unfair trade practices may also be implemented through private enforcement by litigating before national courts⁵⁸. However, to what extent parties can access private enforcement mechanisms, whether before state courts or non-judicial forums, may be limited because of the fear factor.

c. Investment codes

Particularly when foreign investors participate in contract farming, the domestic rules related to investments may become relevant for contract

56 Department for Business, Energy & Industrial Strategy (<https://www.gov.uk/government/organisations/department-for-business-energy-and-industrial-strategy>) Last accessed 28/06/2017.

57 “Fear factor” in this context refers to the fact, that the weaker party in a contractual relationship may be discouraged from using its legal remedies, for a fear of retaliation by the stronger party, which may lead to the termination of the contract.

58 According to the European Union, private enforcement in the context of competition law means: “application of antitrust law in civil disputes before national courts.” European Commission (2005), Green Paper - Damages Actions for Breach of the EC Antitrust Rules, Brussels, p. 3.

farming. In addition to commercial law, some countries rely on investment codes to regulate investments, especially foreign investment. Well drafted codes will be aligned with the Principles for Responsible Investments in Agriculture and Food Systems (CFS-RAI Principles), and will support progressive realization of the right to adequate food (see Box 2). This section concentrates on the interface between investment codes and contract farming.

BOX 2
CFS-RAI Principles

CFS-RAI Principles were prepared and adopted by the Committee on World Food Security and developed based on an inclusive process of consultations. The CFS-RAI Principles are voluntary responsible investment in agriculture and food systems that contribute to food security and nutrition. The Principles are global in scope and are developed to be universally applicable, though they recognize that not each and every principle may be equally important in all agricultural investments. CFS-RAI consists of ten principles, which are related to food security and nutrition; sustainable and inclusive economic development and poverty eradication; gender equality and women's empowerment; youth; tenure of land, fisheries, and forests and access to water; sustainable management of natural resources; cultural heritage, traditional knowledge, diversity and innovation; safe and healthy agriculture; inclusive and transparent governance structures, processes, and grievance mechanisms; impacts and accountability. The CFS-RAI Principles importantly also envision roles and responsibilities for various stakeholders, including states.

Source: Committee on World Food Security, Forty-First session "Making a Difference in Food Security and Nutrition". Rome, Italy, 13-18 October 2014. Principles for responsible investment in agriculture and food systems.

National investment codes cover a wide range of rules that mostly concern inward foreign investments (Burgstaller & Waibel, 2011). Such codes will typically include a definition of the investments they apply to, conditions for admissibility of investments, economic sectors open to investments, conditions for termination of an investment, planning of investments, and tax breaks and other incentives to encourage foreign investment (Parra, 1992).

Whether or not a contract farming operation can be considered as an investment depends on the legal system it is governed by. In general,

the scope of these laws can be considered broad (Parra, 1996), and thus contract farming could be subject to rules located in investment codes. For example, the 2013 investment law of Cameroon considers contractual rights as a type of investment,⁵⁹ and could therefore be applied to contract farming. The personal scope of these instruments often includes both legal and natural persons, and thus would not limit their application. Similarly, the Lao People's Democratic Republic Law on investment promotion states that an "*investor means an individual or a legal entity, internal and foreign, who makes an investment in the business activities in Lao PDR.*"⁶⁰

When contract farming does fall under the ambit of investment codes, it would then be subject to the rules contained in them. While investment codes differ between countries, there are some common themes, which could be relevant from the contract farming point of view. They commonly contain both investment protections and restrictions which might in turn affect how contract farming can be practiced.

Rules related to investment protection are aimed at creating a more attractive investment climate in a country, and this may include contract farming investments. In the spirit of CFS-RAI, some rules also aim to ensure the economic, social and environmental responsibility of the investments. Investment protection guarantees protection from arbitrary state interference with the investment (Sornorajah, 2004). For example, such protection can shield against uncompensated expropriation, guarantee fair and equitable treatment, and afford protection from discriminatory measures (Mbengue, 2012). By doing so, it contributes to the climate of trust required for the parties to enter into a long-term contractual relationship, such as contract farming.

Investment codes also contain restrictions on investments that can have a significant effect on contract farming. Whether in their investment codes or elsewhere in their legal framework, certain countries have limited the possibility for foreigners to own land. The Uganda investment code, for example, does not allow foreign investors to lease land for agricultural purposes or to engage in crop or animal production. However, the code also stipulates that "*a foreign investor may provide material or other assistance to Ugandan farmers in crop production and animal production.*"⁶¹

59 Cameroon. Law to lay down private investment incentives in the Republic of Cameroon (2013/004), Section 3.

60 Lao People's Democratic Republic. Law on Investment Promotion (02/NA), Article 3.

61 Uganda. Investment Code Act (Cap. 92), Article 10(2). Also see: FAO 2013, Trends and Impacts of Foreign Investment in Developing Country Agriculture: Evidence From Case Studies, p. 326.

Restrictions on land ownership may increase the use of contract farming by foreign investors, as they can prevent the adoption of other business models, such as plantations (Simmons, 2003).

Performance requirements are a special category of restrictions. Investment codes may include requirements that aim to ensure that investments are beneficial for the economic development of the country (Collins, 2015). These requirements can either be mandatory, or linked to an incentive, such as a tax break (UNCTAD, 2003). For example, certain countries may oblige the investing firms to transfer technology to locals (UNCTAD, 2003). Contract farming can provide substantial scope for technology sharing (see Introduction Section 3), and provide an effective method for an investor to fulfil the transfer obligation.

d. Intellectual property rights legislation

Modern agriculture often includes the use of inputs that are protected by intellectual property rights (IPRs). In contract farming, these rights are usually held either by the contractor or a third-party. Generally, a contractor will be well aware of IPRs, whereas a producer may not fully appreciate all of its implications (UNIDROIT/FAO/IFAD, 2015). Good contractual practices require that both parties fully understand their obligations. Some countries, such as Brazil,⁶² attempt to redress such imbalances by obliging the contractor to provide information to the producer on the relevant aspects of the contract before it is signed (UNIDROIT/FAO/IFAD, 2015). Given this inherent imbalance of knowledge, regulatory frameworks for contract farming may need to pay particular attention to ensure that a producer is placed in a position to fully understand the implications of the use of IPR-protected inputs.

While different IPRs, such as trademarks, geographical indicators, or trade secrets, may be relevant in contract farming, this section will illustrate the effects of IPR issues on contract farming with reference to patents and plant variety rights (also known as breeder's rights). Patents and plant variety rights are two legal options available to protect new plant varieties. These may include an exclusive right to produce, sell or otherwise market

62 In Brazil, the contractor must provide the producer with a Pre-Contractual Information Document (DIPC), which contains information about the integration production system to present to producers interested to be part of vertical integration contract. The DIPC allows the producer to have prior knowledge of the risks and potential profit of the business with business transparency. See, Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvipastoris (Nº 13.288), Article 9.

the protected product, among other protections. In many countries, the main difference is the subject of the potential protection. As allowed by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) article 27.3(b), the Member States⁶³ may exclude plants and animals from patentability, given that plant varieties will nevertheless be able to enjoy some form of protection.⁶⁴ Regardless, some countries, and most prominently the United States of America, have chosen to extend patentability to plants (FAO, 2010). A broadly used system is the one introduced by the International Union for the Protection of New Varieties of Plants (UPOV). UPOV is an intergovernmental organization with the aim of encouraging the development of new varieties of plants, for the benefit of society. The main legal instrument of the UPOV is the UPOV convention⁶⁵. The UPOV convention provides a *sui generis* form of intellectual property protection specifically adapted for plant breeding.

In principle, both forms of protection may prevent the producer in a contract farming scheme from re-using the excess production as seeds for its own production for the following harvest. This may force the producer to buy its seeds year after year, rather than relying on its own supply from a previous harvest. However, as farmers throughout the ages have been accustomed to using the crop of the previous harvest as seeds for the future harvest, many countries have introduced some form of farmers' privilege in their legislation governing plant variety rights.⁶⁶ Farmers' privilege in general allows farmers to use the seed protected by plant variety rights on their own holding to plant the next crop, for crops where it is common practice for farmers to save harvested material for further propagation (UPOV, 2009). Different countries have chosen different prerequisites for the use of this right, such as remuneration of the right holder, or only granting the right to smallholders (UPOV, 2009). For example, Finland requires the producer to pay remuneration to the

63 All Member States of the World Trade Organization are Member States to TRIPS.

64 Article 27.3(b) of TRIPS: "*Members may also exclude from patentability: plants and animals other than micro-organisms, and essentially biological processes for the production of plants or animals other than non-biological and microbiological processes. However, Members shall provide for the protection of plant varieties either by patents or by an effective sui generis system or by any combination thereof.*"

65 International Convention for the Protection of New Varieties of Plants.

66 In international law, farmers' privilege is protected in the International Convention for the Protection of New Varieties of Plants (UPOV). Article 15(2) of the UPOV provides an optional exception to plant variety rights: "*Notwithstanding Article 14, each Contracting Party may, within reasonable limits and subject to the safeguarding of the legitimate interests of the breeder, restrict the breeder's right in relation to any variety in order to permit farmers to use for propagating purposes, on their own holdings, the product of the harvest which they have obtained by planting, on their own holdings, the protected variety or a variety covered by Article 14(5)(a)(i) or (ii).*"

contractor at a rate substantially lower than royalty-rates to the holder of the breeder's right.⁶⁷ In Zimbabwe, a farmer who cultivates less than ten hectares of land may use the harvest from any prescribed plant for the purpose of propagating the plant on that land. Moreover, a farmer who derives at least eighty percent of his annual gross income from farming on communal land or on resettlement land may multiply the seeds of any prescribed plant and exchange with any other such farmer.⁶⁸

e. Human rights

International human rights obligations can influence how governments regulate contract farming. This section will explore the examples of freedom of association and the human right to adequate food to illustrate the kinds of issues that regulators may need to be aware of. Other rights, such as the right to work, the right to healthy environment and the right to health, among many others, may place similar restrictions and requirements for the regulatory framework for contract farming, but will not be covered here. The exact impact of human rights law on contract farming will necessarily depend upon the country context, and as such each country's circumstances would warrant in-depth analysis by a regulator.

When States become parties to international human rights treaties, they commit to the three dimensions of any human right, i.e. the responsibility to respect, protect and fulfil the human rights contained in such treaties. These responsibilities also extend to the manner in which domestic regulators can regulate contract farming. For instance, freedom of association, which guarantees the right of individuals either to join or not to join any associations, and is widely recognised in all major human rights instruments⁶⁹, can be used to exemplify how these responsibilities play out in the contract farming arena. Often, well-functioning producer organizations or associations, such as cooperatives, are a prerequisite for the success of contract farming schemes (see Chapter 3 Section 1(c)). The government must guarantee freedom of association by allowing individuals to join lawfully organized associations and by not forcing membership on anyone who does not want to participate in an association. In a contract farming regulatory framework, this may mean a careful consideration

67 Finland. Plant Breeder's Right Act (1279/2009), Article 5.

68 Zimbabwe. Plant Breeders Rights Act [Chapter 18:16], Article 17 (c) and (d).

69 "For example, see: Article 20 of the Universal Declaration of Human Rights; Article 22 of the International Covenant on Civil and Political Rights; Article 11 of the European Convention on Human Rights; Article 10 of the African Charter on Human and Peoples' Rights; and Article 16 of the American Convention on Human Rights."

about how to promote the formation and use of producer organizations while guaranteeing human rights. To protect the right, the legislation must prevent others, particularly the contractor, from denying the producers their right to choose whether to be a part of an association or not. For example, in the United States of America, the Agricultural Fair Practices Act prohibits buyers from retaliating against the producers' decision to join or not join an association of farmers.⁷⁰ Finally, the legal framework should aim to fulfil freedom of association by ensuring that everyone actually has the option to join or not. This may mean ensuring that the formal requirements to join are not complex for rural producers to meet or too expensive to afford.

Among the human rights that are closely linked to contract farming, one of the most central is the right to adequate food⁷¹ (UNIDROIT/FAO/IFAD, 2015). Whether intended or not, the legal framework for contract farming can have both positive and negative implications for the producers' right to food. Legal frameworks and/or economic policies that end up promoting the use of cash-crop monocultures may incentivise producers and contractors to favour more profitable, not necessarily edible, crops. However, this switch from subsistence farming to commercial agriculture may deprive producers from an important source of food. Similarly, if the cash crop fails to generate enough income, this would place farmers at risk of not being able to cover their food costs. A concentration on cash crop monocultures may also lead to adverse effects on food security of the country as a whole. Thus, any revision of regulatory frameworks for contract farming needs to carefully consider its potential impact on the right to adequate food.

Finally, several underlying human right principles should guide the drafting or revision of contract farming regulatory frameworks. At a minimum, these would include participation, accountability, non-discrimination, transparency, human dignity, empowerment and the rule of law. Participation, empowerment and non-discrimination are particularly important for fostering the role of vulnerable parties, especially women. The latter are commonly the predominant producers for certain commodities, but they are often excluded from decision-making and, in most cases, defer

70 United States of America. Agricultural Fair Practices Act (7 U.S.C. §§ 2303).

71 According to the United Nations Committee on Economic, Social and Cultural Rights General Comment 12, para. 8, the core normative content of the human 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.

to men for contract signature. Women's role in agriculture should be fully recognised and supported by governments promoting gender equality in agriculture by facilitating their access to negotiation and decision-making platforms, agricultural inputs and income-generating opportunities such as contract farming agreements (UNIDROIT/FAO/IFAD, 2015). Therefore, and bearing in mind that gender neutral practices and approaches do not necessarily lead to gender equitable results (Rebeca et al., 2015), regulators should consider the need to ensure that revised contract farming legislation adequately protects all parties, with particular attention and sensitivity to marginalised parties.

f. Environmental law

The promotion of contract farming may, in some cases, lead to unintended negative consequences for the environment, and thus the ambit of environmental law may become relevant. Generally, environmental protection law will impose restrictions on agricultural production that is harmful to the environment. Environmental laws can contain several direct obligations affecting both producers and contractors, which must be taken into account in agricultural production methods.

For example, in Brazil, the law governing contract farming operations places upon the parties an obligation to include clauses on environmental responsibilities in the production contract, as well as to plan and implement damage prevention measures, as well as mechanisms to mitigate and restore environmental damage. Rather than explicitly setting out these environmental requirements, the law references existing environmental laws and regulations, and requires the parties to align their clauses to them.⁷²

g. Production standards and technical product specifications

Domestic regulatory frameworks for contract farming may often contain production standards and technical specifications regulating both the characteristics of a product and its production process. In addition, certification requirements and services may be in place to encourage adherence to such standards and specifications. These standards and specifications can serve as basis for technical specifications that parties will include in their contracts. It should be noted, however, that it may

72 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvipastoris (Nº 13.288), Article 4(XII) and 10.

not always be necessary for such product or process specifications and standards to be established by central government legislation. More often, it may be more appropriate to leave this to the private sector, as discussed in the next section (Chapter 2 Section 3).

When placed in legislation, specifications covering either the product or the process may contain varying degrees of detail. For example, product specifications can refer to quality grades depending on factors such as the size, weight, colour, external appearance and shape of the product. Establishing objective quality grades helps to facilitate contract farming, as the parties do not necessarily have to negotiate the exact grades to be applied, but can instead choose to rely on objective and universal legislative standards. Legislation may also require the product to be packaged in a certain way and labelled with important information for consumers, such as the country of origin, variety and quantity of product (Liu, 2007).

Production process standards may cover issues such as input use or production methods, which may include mandatory obligations related to safety, environmental or social standards (UNIDROIT/FAO/IFAD, 2015). These process-related obligations may or may not have an identifiable and testable effect on the quality of the final product (Morgera et al., 2010). By using process standards, legislation may aim to achieve certain government policy objectives through the contract farming mechanism, such as a thriving agricultural sector or environmental protection.

Appropriate regulatory frameworks regulating certification and accreditation of specific quality products would be an important element of an enabling contract farming environment. These may help to facilitate the certification process and support the outcome of fair and honest contract farming relationships.

3. Private sector participation in contract farming regulatory frameworks

The private sector has an important role to play in contract farming operations, including participating in the regulation of contract farming through self-regulation or co-regulation. The private sector is generally more closely attuned to the realities of existing market needs, and thus able to determine more appropriate requirements. Allowing for sectoral self- or co-regulation may be a more cost-effective and flexible method for a government to improve the regulatory frameworks for contract farming (OECD, 2015).

Another option to foster public-private collaboration in regulating contract farming are agricultural public-private partnerships (agri-PPPs) (see Box 3). Under an agri-PPP, the public and private sector parties have common and concrete objectives, i.e. ensuring the success of the contract farming scheme. This can create a strong incentive for both to comply with existing legislation and to agree upon any particularities relevant to the individual agri-PPP.

BOX 3
Contract farming and agri-PPPs

Public actors can also participate in contract farming through public-private partnerships (PPPs). Contract farming is a commonly used method to connect smallholder farmers into PPPs. The public institution does not necessarily have to be a direct party in the contract farming agreement, but it may require that the other actors in the PPP engage with local producers through contract farming. In this way, an agricultural public-private partnership (agri-PPP) gives the state greater control over individual contract farming schemes, and the ability to ensure that their preferred socio-economic objectives are met. An agri-PPP can be defined as *“as a formalized partnership between public institutions and private partners designed to address sustainable agricultural development objectives, where the public benefits anticipated from the partnership are clearly defined, investment contributions and risks are shared, and active roles exist for all partners at various stages throughout the PPP project lifecycle.”* (Rankin et al. 2016 p. 10). Besides private commercial entities, these agri-PPPs can also include financial institutions providing credit, non-governmental organizations, small and medium agri-enterprises, farmer organizations and individual farmers. One of the main identified problems with agri-PPPs is their high dependency on the enabling environment. The problem is made worse by the existence of limitations in the national PPP laws, which are rarely applicable to agriculture.

Source: Rankin et al. 2016

Under such schemes, the private sector may develop codes of practice, standard terms and/or guidance on the drafting and enforcement of contracts in contract farming operations. To ensure that such guidance documents are unbiased and balanced, the government would need to ensure that their development be the result of a voluntary, participatory and transparent process, thus reflecting a wide array of interests (UNIDROIT/FAO/IFAD, 2015). Private sector participation, including self- and co-regulation and PPPs, should take place in an atmosphere of trust

and shared responsibility, promoting and respecting fundamental values, such as honesty, good faith, respect for others, openness to partnership, and a competitive spirit (Darmanin, 2013).

Examples of private sector driven regulatory instruments in the area of contract farming may include “inter-professional” agreements agreed by private parties of a specific value chain. These agreements can be considered an example of self- or co-regulation, depending on the level of government involvement. The public regulator may either encourage or require the establishment of structured entities, for example associations for a given commodity or value chain, where the production sector and the agribusiness industry are represented, and where the government can be represented. Such entities have a number of policy and technical functions aimed at improving and increasing production, which becomes more responsive to market needs, and enhancing market stability. They would also be responsible for organising and harmonising practices between individual producers and buyers.

Stakeholders can agree on common conditions reflected in standard agreements, which will set the basis for individual contracts between producers and buyers regarding the supply of the particular commodity. The legislation often requires these contracts to be in writing and that minimum contract requirements be included, typically on identification of the parties, identification of the object of the contract, price formula and payment terms, delivery conditions, parties’ obligations, contract duration renewal and revision, and grounds and conditions of contract termination (see Chapter 2 Section 1). Unfair trading practices are also frequently addressed.⁷³ Italy, for example, regulates inter-professional agreements by requiring certain minimum content be placed in such agreements, such as defining the product, as well as the timing and modalities for delivery, the minimum price, quality control systems for the products, and guarantees for the contracting parties.⁷⁴ Incentives, such as access to preferential aid, are offered to parties who comply with the terms of inter-professional agreements.⁷⁵

Codes of conduct are another example of regulatory instruments that might be led by the private sector. Such codes might be approved by

73 France. Code rural et de la pêche maritime, L631.1 – L631.23.

74 Italy. Norme sugli accordi interprofessionali e sui contratti di coltivazione e vendita dei prodotti agricoli (16 Marzo 1988 n. 88), Article 5.

75 Italy. Norme sugli accordi interprofessionali e sui contratti di coltivazione e vendita dei prodotti agricoli, (16 Marzo 1988 n. 88), Article 12.

commercial actors in the food processing and wholesaler industry. Codes of conduct can reflect global standards of business dealings with commercial partners,⁷⁶ and are a typical example of self-regulation when they form naturally from the decisions of the private parties. These codes may be voluntary, meaning that individual players may freely agree to be bound by the code. Codes can also be made mandatory by the government, requiring that all parties above a certain threshold, such as companies with very high annual turnover, must adopt the code and be bound by its requirements. While these would reach a wider audience, they contradict the voluntary principle underpinning private sector led initiatives, and may be more burdensome and less popular than voluntary codes.

For example, in the United Kingdom, any retailer operating in the grocery sector with a turnover exceeding GBP 1 billion must adopt the Groceries Supply Code of Practice.⁷⁷ In Australia, the Food and Grocery Code of Conduct is a voluntary code providing an additional framework for dealings between the retailers or wholesalers and suppliers prescribed under the Competition and Consumer Act 2010.⁷⁸ The Code does not override existing statutory legislation, but either fills gaps or gives more detail on provisions in related legislation. It includes some significant and important provisions that ensure that key elements of grocery supply agreements are discussed and agreed upon upfront, such as delivery, grounds to reject the groceries, quality and quantity requirements, provisions on payment, and rules on termination.⁷⁹ Kenya has chosen the path of public actors drafting and recommending general industry practices between farmers and processors for scheduled crops. The Kenyan Horticultural Crops Developmental Authority has developed a Horticulture Code of Conduct⁸⁰ that caters to all parties involved, including contractors and producers. The code contains a checklist for obligations as well as the essential elements of the contract (UNIDROIT, 2014).

76 Policy guidelines on prescribing industry codes under Part IVB of the Competition and Consumer Act 2010, May 2011, Commonwealth of Australia.

77 United Kingdom. The Groceries (Supply Chain Practices) Market Investigation Order 2009, Article 4.

78 Australia. Competition and Consumer (Industry Codes—Food and Grocery) Regulation 2015.

79 Australia. Competition and Consumer (Industry Codes—Food and Grocery) Regulation 2015, Article 8.

80 Kenya. Agriculture, Fisheries and Food Authority – Horticulture Code of Conduct, Guidelines for contractual agreements between the producer and dealer in the industry.

Chapter 3. How could a government develop an enabling environment for responsible contract farming?

Governments can actively contribute to creating an enabling environment for responsible contract farming that minimises risks and maximises its benefits (see Introduction Section 3). Within a suitable enabling environment, parties with vastly different bargaining power can negotiate and enter into mutually beneficial agricultural production contracts. Enabling environments are also conducive to the long-term sustainability of contract farming as they establish a setting where contract farming operations can be conceived, can develop and thrive (Christy et al., 2009).

An enabling environment for contract farming is created by broad, macro-level forces – political, social and economic – that influence all sectors of the economy. More specifically, an enabling environment for contract farming would also include a number of other, more specific factors, such as: clear land tenure systems, access to finance and risk management products, consistent trade policies and access to global markets, availability of skilled human resources, improved technologies and adequate infrastructural facilities and utilities (particularly rural roads and storage facilities) (Konig et al., 2013). Not all of these are necessarily under the control of governments however.

This Chapter discusses various public policy goals and roles that a government may have set itself in developing an enabling environment for contract farming. Beginning with a brief discussion on policy goals that can be advanced through government support to contract farming, and which may not require any regulatory reform, it will then look at the possible use of legal reform to contribute to the enabling environment. Some guidance on possible avenues of legal reform are provided at the end of this Chapter.

1. Government's support of contract farming operations and public policy goals

Governments' role in facilitating responsible contract farming may be direct, e.g. by specifically supporting different stages of the contract life cycle (such as contract formation or dispute resolution), or be indirect by

contributing to an enabling environment in which contract farming can operate. The role of a particular government, and of its various entities, will always depend on national contexts and institutional framework (see Chapter 4 Section 2). In many countries with a well-developed private sector, governmental intervention is limited to approving policies and actions encouraging the development of market-driven and financially sustainable contracts between well-informed parties, without overly regulating their content (USAID, 2015). The optimal level of governments' participation will depend on the structure and capacity of the private sector; the type of contract farming that takes place in the country and the national policy priorities. Too little public involvement may allow the stronger party to tilt the contract in their favour, while too much public involvement may render contract farming too costly and cumbersome for it to be an attractive and financially viable option.

Governments may choose to pursue various public policy goals based on their general mandate to manage the economy of a country, which would also benefit contract farming operations. Some examples are given below. In addition, it should be noted that governments will also be responsible for a variety of other actions with relevance to the enabling environment, such as ensuring sufficient infrastructure (roads, warehouses etc.), promoting corporate social responsibility and ensuring availability of high-quality inputs, all being features that can support contract farming.⁸¹ Governments may also want to promote private sector participation in contract farming regulatory frameworks, as discussed above in Chapter 2 Section 3.

a. Improving producers' technical and contractual capacity.

Many agricultural producers do not have the technical and contractual skills or the resources and inputs required to participate in commercial agriculture on their own. Public policy aimed at assisting them to develop their skills and capacity may lead to an increasing uptake of contract farming.

81 For reference, please see the Contract Farming Resource Centre: <http://www.fao.org/contract-farming>, and in particular: Martin, Prowse. 2012. *Contract Farming in Developing Countries – a review*. Agence Française de Développement; Carlos da Silva. 2006. *The growing role of contract farming in agri-food systems development: drivers, theory and practice*. FAO, Rome; FAO. 2013. *Enabling environments for agribusiness and agro-industries development – Regional and country perspectives*. Rome.

The government may choose to provide direct technical support to smallholders to improve their production processes and thereby increase their chances to participate in contract farming schemes. While the contractor in a contract farming relationship may choose to provide some of the inputs and training for the producers, the contractor may not always be in a position to supply this adequately or in sufficient amounts. Further, when the government provides technical support, inputs and training through its extension services, smallholders are likely to hold a stronger negotiation position, as the contractor would not be the sole source of inputs and support. FAO field experience shows that it is common to find that the government and private extension and training services complement each other (FAO, 2017c).

Governments may also provide direct assistance to smallholders in the drafting and implementation of individual contracts, or provide training for them to better understand the basic concepts of contract law and fair contractual practices in general (Pultrone, 2012). The more educated producers and contractors are about their rights and obligations under the applicable legislation, the greater chance they will have of entering into fair and complete contracts without outside assistance. This capacity building can be done, for example, through general extension services, local support officers and paralegals (see Box 4).

BOX 4
Paralegals and contract farming

Paralegals can prove to be useful in assisting the parties to create mutually beneficial and balanced contracts as well as assisting in their implementation. A paralegal is a layperson with basic training in legal matters and may assist smallholders and rural populations in contract drafting and implementation. Countries can vary greatly in their use of paralegals as well as in their regulatory and supervisory systems. Paralegals can increase access to justice and bring legal services to communities as they are often closer to the communities they serve than lawyers. They can also draw on a broad range of advocacy tools, some of which may fall outside the bounds of typical legal service activities, such as working collaboratively with customary leaders to resolve contract disputes. While paralegals can be more cost-effective than lawyers, they must still receive extensive initial and ongoing training and supervision from the government. Lawyers would still be needed to back up the work of paralegals. Finally, the government must put in place arrangements to ensure that the paralegals do protect the interests of their communities, including the poor and marginalized, and to address the challenges that might arise in the relationship between paralegals and local leaders (Maru, 2006; Tanner & Bicchieri 2014; Cotula et al., 2016).

In Mozambique, the government always participates in the annual meeting of cotton producer representatives and processors as a neutral facilitator in the negotiation and acceptance of the price (Pultrone, 2012). In the Lao People's Democratic Republic the role of local authorities as facilitators is important, especially at the village level, for giving the parties the opportunity for open dialogue and negotiation. The local authorities provide information and advice to farmers on both advantages and risks of contract farming and may also facilitate the access to inputs (UNIDROIT, 2014). In the United States of America, the growers engaged in the livestock and poultry industries have the statutory right to discuss the terms to the contract's offer with, among others, a Federal or State agency.⁸² In this approach, the cost implication may be lower, as the parties do not need to include third parties in the negotiation, but if the producer is unsure whether the contract is fair, they can always turn to a government partner for help.

Capacity issues can also encompass the financial capacity to participate in contract farming, with producers in particular suffering from lack of access to finance. Governments can assist by creating an enabling environment for private sector financing, or by creating financial incentives and subsidies specifically for contract farming (Chapter 4 Section 3(b)).

b. Efficiency: developing connections and reducing transaction costs

Dealing with a large number of scattered, small-scale producers may be inefficient and carry with it high transaction costs, rendering contract farming less attractive for contractors. To increase the uptake of contract farming, a policy objective for a government may be to increase the efficiency of contract farming operations and reduce its related transaction costs. One way to achieve this is to create fora for the parties to meet each other and have the government participating in negotiation process.

It is not always easy for the two parties to find each other and start a relationship. Interested parties may not always be aware of each other, and may not have effective private channels to create the required connections on their own. Therefore, governments can take steps to foster dialogue between producers and contractors. As a first step, governments can organize market-matching exercises, by organizing fora where agribusiness entrepreneurs can meet producers' representatives (Eaton

82 United States of America. 7 U.S.C. § 229b.

& Shepherd, 2001).

Once these connections are formed, governments can organize joint meetings where the parties have the opportunity to discuss contractual terms and their duties, to explain management programs, to rectify misconceptions and to understand and formulate ways in which to resolve conflicts (Pultrone, 2012). Governments' participation in the negotiations may contribute to balancing bargaining power. The participation should, however, maintain the interests of both parties in mind and aim to achieve mutually beneficial contracts. The participation of a government's representative in the negotiations of every agricultural production contract can be onerous. A more affordable option could be to allow the producers to invite a government, or other third party representative to participate in the negotiations when they feel they require such assistance and support.

Producer organizations may also be an effective way to reduce transaction costs, as contractors do not have to enter into individual agreements with every single producer, but may instead deal with suppliers collectively. Supporting producer organizations directly can also bring additional benefits, as discussed in the following section.

c. Supporting producer organizations

Producer organizations are often crucial for the success of a contract farming scheme, and their promotion may represent an important policy goal in and of itself. Producer organizations can support the achievement of economies of scale and a stronger bargaining position through collective action. In addition, they can help producers to move up the value chain (de Schutter, 2011). Governments can play an important role in developing mechanisms aimed at supporting the organization of parties' representation and empowering producer organizations (UNIDROIT, 2014).

These support mechanisms may need to take into account the often smallholder nature of participants in producer organizations, and could include financial assistance.⁸³ The registration processes of various

83 As an example, the European Union in the Preamble (131) of the Regulation 1308/2013 establishing a common organisation of the markets in agricultural products, recognizes the useful role of producer organizations in concentrating supply, improving the marketing, planning and adjusting of production to demand among other beneficial outcomes. The regulation has detailed rules on the amount of either Union or Member State financial assistance that can be made available to producer organizations forming in the fruit and vegetable sector.

producer organizations should thus be kept simple and affordable, so that they do not prevent resource-poor smallholders from forming or joining them. To this effect, certain countries have adopted simple legal forms intended for groups with small-scale producer memberships. This can allow them to formalize and engage in formal dealings with buyers (UNIDROIT/FAO/IFAD, 2015). Both the creation of and joining a producer organization should be voluntary, in line with the universally recognized right of freedom of association (Chapter 2 Section 2(e)).

For example, in Cambodia, the government “*encourages the formation of associations, agricultural communities, or agricultural organizations as the bases to develop contract-based agriculture*”.⁸⁴ Following this policy, the Law on Establishment of Agricultural Communities was promulgated in 2013. The law allows farmers to organize themselves in legal cooperatives and establish agricultural communities, unions of agricultural communities, and the alliance of agricultural communities (Yi, 2014).

2. Provide an enabling regulatory framework to support contract farming operations

While specific legislation on contract farming is not always necessary in every country context to support effective contract farming operations (see Preface), a clear regulatory framework is instrumental to the pursuit of certain key public policy objectives. Governments, naturally, have a critical role to play in shaping the regulatory framework to support responsible contract farming and this role is the main focus of this publication (see Chapter 4). As described above in Chapter 2(1), the legal framework can bring stability and certainty by clarifying the roles and responsibilities of the different parties involved in contract farming, including the government itself. By the nature of its creation process, legislation is meant to be more stable and longer-lasting than policies and initiatives. Legislation can be enforced, providing the government with a strong tool to foster successful outcomes and to overcome specific obstacles and identified problems in the national context.

For the parties involved in contract farming, the sustainability and enforceability of rights provides legal security. They know that their legal rights and obligations will be respected and that they will remain constant in the future. Thus, the legal framework serves, among others: to recognize the contract determinations as binding on the parties; to protect overriding interests through rules that the parties must follow; to facilitate

84 Sub-Decree No. 36 on Contract Farming, 24 February 2011, Article 4.

contract relationships by providing rules that would apply in absence of choice by the parties; and to ensure that contract stipulations and legal rules are enforced through public justice institutions.

Legislation can also serve as a vehicle to make different policy objectives enforceable. If a country has adopted a contract farming-specific policy, this will be at the basis for any potential legislative reform related to contract farming. Besides contract farming policies, another very important source of guidance can be the country's overall agricultural policy. For example, the recent national agricultural policy of Zimbabwe (2012) promotes the use of contract farming to enhance smallholders' access to inputs and markets.⁸⁵

This subsection outlines several public policy objectives which may provide justification for countries to undertake regulatory reform. Updating the regulatory framework may help the government, among other objectives, to ensure balanced and fair practices between parties, or to facilitate their access to dispute resolution mechanisms. The section does not intend to be exhaustive, but only to provide examples of policy requirements or objectives that may trigger regulatory reform.

a. Addressing power imbalance and unfair practices

As commercial relationships in agriculture have become even more complex, addressing the power imbalance between parties has become a central policy objective underpinning many regulatory initiatives. Uneven bargaining power enables the stronger party to shift costs onto suppliers, unilateral changes of contractual terms and other potentially unfair practices (Chapter 2 Section 2(b)). Because of their often weaker structural bargaining position, producers are sometimes not able to resist these practices. One major inhibiting factor is the fear of being subject to retaliation, which may ultimately lead to losing the contract.

The regulatory framework for contract farming as a whole may be used to clarify the rights and obligations of the parties and contribute to redressing power imbalances and unfair practices, by promoting positive behaviour and placing restrictions on negative behaviour (Chapter 2 Section 1 and Chapter 4 Section 3). As mentioned above, rights and obligations enshrined in legislation are enforceable. This contributes to the creation of an enabling environment, as it provides the parties with a legal foundation

85 Zimbabwe. 2012. Comprehensive agricultural policy framework (2012-2032). Executive Summary, p. 15.

upon which they can start building their mutual, trust-based relationship.

As an example, legislation related to contract farming can provide a list of clauses to be included in contract farming agreements. This would contribute to ensuring a balanced relationship between the two parties, as both would be required to undertake certain key responsibilities (see Chapter 4 Section 3). Similarly, when the producer can obtain inputs and services from the market or the government, it is less tied to the contractor and, as a result, may have a more equal bargaining position (see Chapter 3 Section 1(a)). A similar effect can be achieved by offering sustainable financing options for the producer (see Chapter 3 Section 1(a) & Chapter 4 Section 3(b)). When producers form a producer organization, they can achieve stronger bargaining power and negotiate more evenly with the contractors (see Chapter 3 Section 1(c)). Problems related to unfair practices and power imbalance can also be partially tackled by using provisions of competition law (see Chapter 2 Section 2(a)) or of legislation covering unfair trade practices (see Chapter 2 Section 2(b)).

b. Increasing legal security and certainty through dispute resolution mechanisms

Increasing access to dispute resolution may be an important policy objective to potentially drive legal reform. Effective dispute resolution mechanisms are a crucial part of an enabling environment for contract farming. Without an institute to take their disputes to, parties with uneven bargaining power are unlikely to be able to solve the disputes arising from their relationship in a fair and equal manner. Unfortunately, proceedings in regular state courts are rarely well suited for disputes arising from contract farming, as they can be very formal, slow and expensive (UNIDROIT/FAO/IFAD, 2015).

There are many different ways in which governments can provide better access to dispute resolution. For example, they may use legislation to create summary proceedings to be applied under regular courts, which can address many of the issues related to lengthiness and expensiveness of court use (see Chapter 4 Section 3 (a)). Certain legal systems may also allow for the creation of agrarian courts, dedicated to disputes arising from agricultural activity (see Chapter 2 Section 1 and Chapter 4 Section 3(a)).

Either setting up or otherwise promoting the use of alternative dispute resolution (ADR) mechanisms in legislation can be a very effective way for governments to promote access to justice. These non-judicial methods may be particularly suitable for disputes arising out of agricultural production

contracts because they are usually more timely and flexible than judicial proceedings (UNIDROIT/IFAD/FAO, 2015). Mediation and arbitration may be considered as representative examples of ADR suitable for contract farming. In mediation, the parties seek a mutually acceptable solution with the assistance of a third person (a mediator) and commit to apply it on a voluntary basis. Under arbitration, the parties refer the settlement of their dispute to a neutral third party (arbitrator), whose decision will be binding and enforceable under the law (see Chapter 4 Section 3(a)).

c. Better regulation and increased transparency for contract farming operations

An underlying policy objective that helps governments to create an enabling environment for contract farming is to better understand how contract farming and production sector functions in their country. For this, the governments need accurate data. This may require performing or funding research that helps to further develop contract farming practices that can keep up with the changing circumstances of agriculture. For this purpose, Spain has created the Food Supply Chain Observatory, which monitors, advises, consults, informs and studies the functioning of the food supply chain and food prices. To assist the Observatory, the same law 12/2013 also creates an Information and Food Control Agency, which will, among its other responsibilities, collaborate with the Food Supply Chain Observatory in performing works, conducting studies and drafting reports on the products and markets of various sectors.⁸⁶

Governments can also gather accurate information on the kinds of contracts that exist between the parties operating in their country by setting up a system of contract registration through legislation. Registration can also contribute to other policy objectives, such as supporting contract farming operations and providing regulatory control. In addition, transparency and legal certainty for the parties can be increased. One of the aims of registration may also be to bring the parties' transaction under the regulatory framework and help to ensure that the parties abide by any contract form and formation requirements established by the legal framework (see Chapter 4 Section 3(a)).

Registration of contracts or parties – or both – can be made mandatory or voluntary. Voluntary registration schemes, such as in Chile, would allow the parties to opt-in to the system (see Box 5). The parties would be free

86 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013), Title IV.

to choose to abide by any form and content requirements specified in the legal framework (see Chapter 4 Section 3(a)), when they find that the related benefits, or the incentives offered by the government are worth the sacrifice of some of their contractual freedom.

BOX 5
Mandatory or optional regimes

Regulators may either choose to create a mandatory regime covering contract farming or set up an opt-in regime, which would only bind parties that choose to subject their contracts to it.

A mandatory regime requires that all certain types of transactions must be done through the legally characterized type of contract. This ensures that the legislation has as wide reach as possible, as it is only limited by the scope of the legislation itself. This may help achieving the policy objectives the regulator has set for itself, as the whole field of activities is covered. On the other hand, mandatory regimes may be more expensive and cumbersome to run than their voluntary counterparts.

Opt-in regimes are more sensitive to the widely cherished principle of freedom of contract, as the parties are not necessarily required to comply with them. One way for the legislation to set up an opt-in regime is to make the registration of contracts voluntary, but requiring all registered contracts to follow certain form, formation and content requirements. The weakness of opt-in regimes is that they will not cover as many subjects as mandatory regimes do. Particularly in cases of uneven bargaining power, the stronger party may be able to unilaterally decide whether or not to subject their contractual relationship to the regime or not, by either registering or not registering their contract.

While avoiding market disruptions, domestic regulators may consider using incentives – such as taxes, subsidies and access to timely dispute resolution forums – to encourage the use of opt-in regimes.

The incentives offered by the government can be financial, such as an application of a more beneficial taxation regime, to provide access to dedicated dispute resolution mechanisms or the ability to enforce the contracts against third parties. In Chile, registering a contract makes it enforceable against third parties. The law also provides sanctions for non-compliance with the registered contract, which may be extended to third parties. The original contractor can also sue for damages in a summary

judgment.⁸⁷ In the State of Rio Negro, Argentina, registering both parties and their fruit production contract allows the parties to request a reduction of ten percent of the real estate tax on the properties directly affected by the contract. Further, both parties are awarded a reduced income tax rate, and are exempted from stamp duty.⁸⁸ Registering contracts allows the parties to access dedicated mediation services and allows the producer to request summary proceedings without incurring expenses in the court of its residence.⁸⁹ While registering is voluntary, the names of the contractors who do not register their contract may be published in the Official Gazette.⁹⁰

Mandatory registration is a more rigid system and inevitably increases the transaction costs for parties when participating in contract farming. Mandatory registration would however, extend the associated benefits to more actors and provide more information for the government, as more contracts and parties are registered. For wine production, Argentina has chosen mandatory registration and requires that the contracts for wine production be registered within a set deadline,⁹¹ under a penalty of a fine.⁹² Similarly, in Tanzania, for selected agreements for the production of selected crops, each contract must be registered.⁹³

3. Guidance on reforming a regulatory framework for contract farming

a. Legal reform process

In view of the policy and regulatory objectives discussed above, a government may decide to undertake legal reform. Any legal reform process should begin by identifying existing regulatory needs and challenges. The government should establish whether new regulation

87 Chile. Ley crea un registro voluntario de contractos agrícolas, (N° 20.797), Article 18.

88 Rio Negro, Argentina. Regimen de transparencia para la vinculacion entre la produccion, empaque, industria y comercializacion de frutas en Rio Negro, (E 3.611), Articles 21 and 22.

89 Rio Negro, Argentina. Regimen de transparencia para la vinculacion entre la produccion, empaque, industria y comercializacion de frutas en Rio Negro, (E 3.611), Articles 31-33.

90 Rio Negro, Argentina. Regimen de transparencia para la vinculacion entre la produccion, empaque, industria y comercializacion de frutas en Rio Negro, (E 3.611), Article 23.

91 Argentina. Contratos de elaboracion de vinos, (Ley 18.600), Article 1.

92 Argentina. Contratos de elaboracion de vinos, (Ley 18.600), Article 12.

93 Tanzania. Tea Act, 1997 (No. 3 of 1997), Article 25(3); Tanzania. Coffee Industry Act, 2001 (Act No. 23 of 2001), Article 34A(3); Tanzania. Sisal Industry Act, 1997 (No. 2 of 1997), Article 19A(3); Tanzania. Cotton Industry Act (Act No. 2 of 2001), Article 14A(3); Tanzania. Tobacco Industry Act, 2001 (Act No. 24 of 2001), 7A(3); Tanzania. Pyrethrum Act (No. 1 of 1997), Article 24(3); Tanzania. Sugar Industry Act, 2001, (Act No. 26 of 2001), Article 37(3).

is needed to address such issues, or whether providing support to the parties and better enforcing existing legislation, or another non-legislative approach (see Chapter 3 Section 1), is sufficient to address them. Thus, at an early stage, regulators should clarify the goals, objectives and desired outcomes of introducing new or revising existent contract farming or contract farming-related legislation.

If new legislation is needed, then its content and regulatory approach should be prepared in a participatory and inclusive manner. This facilitates that the regulatory approach and the content of the rules chosen to cover contract farming are well-suited to the individual country's context, including the interests and needs of stakeholders. It can also facilitate consensus building and paves the way for the implementation of the new legislation.

The choice of the legal instrument, the quality of new legislation and its successful implementation all depend in large part on the engagement of a wide roster of stakeholders during the process (Vapnek & Melvin, 2005). All categories of stakeholders, both at the central and local level, as well as in urban and rural contexts, should be genuinely involved in the drafting process (see Chapter 2 Section 3).

The national legal tradition, i.e. the legal system in place for interpreting and enforcing the law as embodied in the national legal framework, provides the outlines within which any new legislation must operate and influences the content and implementation of the legislation.

Also as part of the effort to assess whether there is a need for regulatory revision to cover contract farming, the regulator needs to analyse the existing national legal framework related to contract farming, as discussed under Chapter 2 Sections (1) & (2). The analysis can help to identify gaps in coverage as well as insufficient or outdated legislation that may negatively affect contract farming activities. This analysis should include, at the very least, the constitutional provisions that may influence contract farming legislation, legislation governing contract farming, other legal areas that can affect contract farming, subsidiary legislation used to implement the primary legislation, relevant court decisions and customary law and practices (Vapnek & Melvin, 2005).

Besides a desk-study of existing legislation and other legal sources, the analysis of the national legal framework should include an assessment of the actual effects that relevant legislation has had, because unless the regulator addresses the reasons that have hampered the success of

current legislation, any new legislation is unlikely to produce better results (Vapnek & Melvin, 2005).

Similarly, by conducting a regulatory impact assessment (RIA), the regulator can assess the likely positive and negative impacts of the proposed regulatory measures. An RIA analyses a range of regulatory options, which may be used to regulate contract farming together with their socio-economic impact. An RIA should estimate the likely direct and indirect costs of the various options (e.g. current/anticipated cost to government of the different regulatory approaches, current/anticipated cost to producers and contractors of complying with contract farming legislation, etc.) and describe their expected benefits (e.g. reduced incidence of side-selling, higher quantity and better quality agricultural products, better prices to producers, etc.). Additionally, an RIA should summarise who (e.g. the contractors, producers, government agencies or other groups) bears the costs and benefits of each option. Ultimately, a best option should emerge, and an RIA should clearly explain why that choice among many is proposed to pursue the policy objectives (FAO, 2006).

Finally, the legal instrument should be written in a language that is understandable to the regulated public or at the very least to the government officials who will be responsible for its implementation and enforcement. Since the final audience of any legislation on contract farming includes agricultural producers and their organizations, the legislative text should be written in plain language and avoid complex syntax, terms with definitions that differ greatly from their commonly-used meanings, and confusing chains of cross-references. When possible, legislation could be translated to local language and dialects. The legislation should also follow a logical structure, with general rules preceding specific ones. A layperson should be able to read and understand the major points of the proposed new legislation without assistance (Morgera, 2010).

b. Choosing a legal instrument

Equally important as following the process outlined above, is to choose a legal instrument to cover contract farming that best fits the regulator's policy needs and legal system as a whole. As mentioned in the Preface, there is no single correct regulatory approach and the choice depends on the national context. In order to assist in this decision, this section discusses some general advantages and disadvantages related to the choice between different types of legal instruments.

Choosing to embed the new contract farming related provisions in existing general contract laws or agricultural laws covering other similar contracts, may help to avoid risks of overlap and inconsistency between the already existing legal framework and the new, similar, rules on contract farming (Jull, 2016). Embedding new provisions in existing legislation may also highlight the interconnectedness of the legal system, helping the users understand the multiple sources of legislation which may apply to contract farming. On the other hand, when contract farming-relevant provisions are included within such general pieces of legislation, they risk being drafted to a level of detail which may not be sufficient to provide appropriate legal security for parties in contract farming.

Placing contract farming-specific rules in commodity-specific acts allows the regulator to account for any particularities of that specific form of production, and thus may allow for more specific rules covering the contractual relationship of the parties. Excessively prescriptive rules, even when aimed at a particular sector, may become burdensome for the parties and stifle both agricultural and contractual innovations. The choice of commodity-specific legislation would also limit the application of the rules only to the covered commodities, and would not cover other forms of agricultural production. Similarly, placing the rules in supply chain legislation would create a single regime covering all stages of production and marketing, regardless of the product. Again, the level of detail in such legislation may fall short of what is needed in regulating contracts in primary production.

Having contract farming-specific rules in legislation related to public development programs or PPPs would allow the regulator to further fine-tune the applicable rules in order to achieve the stated policy objective of these programs. Access to these programs can also be highly sought after by contractors and producers alike, as they may provide financial as well as social benefits. Making contract farming one of the main requirements for a certification seal can help to entice the parties to formalize their relationship and bring it to the purview of the regulatory framework. Naturally, these rules would be limited only to the particular programs, and would not help facilitate contract farming relationships in the wider agricultural context. On the other hand, these limited in scope programs may allow the government to pilot the effectiveness of the legislation, prior to extending its reach.

When the regulators have identified clear policy objectives, or have encountered well-defined needs arising out of the contract farming sector,

choosing to draft a single piece of legislation aimed specifically at contract farming would allow the regulators the possibility to tailor a solution that specifically advances the policy or addresses those needs. For example, if the national contract farming sector suffers from uneven bargaining power between parties that results in unfair terms and practices in contracts across commodities, regulators may choose to draft specific contract farming legislation that strengthens the position of producers, prevents the use of these kinds of terms and practices and supplies more equitable alternatives. Naturally, if the policy objectives and problems are more general, or if the unfair practices manifest themselves in non-agricultural contracts as well, choosing to address these issues in more general pieces of legislation would allow the regulator to cover a wider field.

A single piece of legislation can promote transparency by simplifying the understanding of obligations and legal requirements for a contract. A new specific legal instrument can provide more visibility and clarity for the contract farming rules and make interpretation easier and more predictable. Increased legal certainty may increase the attractiveness of the system for its potential users. Enacting a new piece of legislation may also be a simpler endeavour, as compared to amending long established civil codes, general contract laws or rural codes, which can be more difficult to pass through a parliamentary process. A new single legal instrument is also easier to amend in the future if need be (Wehling & Garthwaite, 2015).

Using subsidiary legislation as the main legal tool to cover contract farming may be easier, faster and cheaper than drafting parliamentary level legislation. As the authority of any subordinate law-making entity will always be more limited than that of parliament, the government may not always be able to achieve its policy objectives through subsidiary instruments.

Governments may also incorporate model contracts as schedules in legislation or in soft-law documents (see Chapter 2 Section 1). These model contract can also be elaborated by the private sector, through co-regulation or self-regulation (see Chapter 2 Section 3). Model contracts can provide the parties with a ready contract that includes the most important clauses for the particular commodity, lowering the transaction costs of the parties. Through model contracts, the regulated population may also find it easier to understand what the legislation requires from them. However, it may not always be straightforward to draft a model contract that is both comprehensive enough to be useful, and sufficiently general and flexible to cover a sufficiently wide range of possible applications.

Finally, and as mentioned above, none of these methods are necessarily better than the other, but each one may be more appropriate depending on the ultimate objective sought. The choice of whether to use general or specific instruments always depends on the national legal tradition and the policy objectives sought by the regulator.

Chapter 4. Elements for improving regulatory frameworks for responsible contract farming?

As discussed earlier, countries have a variety of different regulatory options available to tailor their legislation to their identified public policy objectives and the needs of their country's specific contract farming relationships (see Chapter 2 Section 1), and should follow a participatory approach to legal reform, based on national legal analysis and clear identification of policy and regulatory priorities (see Chapter 3 Section 3). This section will address elements that might be considered for inclusion in a domestic regulatory framework for contract farming. It will also provide selected examples of how different jurisdictions have addressed these elements in their legislation to illustrate prevalent trends. It is important to note that these examples do not necessarily constitute good practice and that the potential or actual impact of any one option in a specific country context has not been taken into consideration. The purpose of the Chapter is not to collect good practices based on actual analysed regulatory impact, but rather to present a variety of regulatory options that may – or may not – work for different countries depending on the regulatory, policy and economic context.

A government's decision on what to include, and where, in their regulatory framework will always depend on a close analysis of the national legal framework, its policy priorities and contractual practices, the structure of the agricultural market, the capacity of producers to represent themselves and defend their contractual interests, and the role that the government wants to assume to monitor and support these activities. This section can only offer broad guidelines and general discussion on the choice of legal instrument, without promoting the adoption of a specific piece of legislation for contract farming, and on the potential elements that regulators might want to consider in their national legal framework for contract farming (see Preface).

Regardless of the instrument chosen to regulate contract farming (see Chapter 3 Section 3(b)), the provisions included must be realistic and aligned to the extent possible with common contractual practices. They should also aim to preserve the parties' contractual freedom by offering flexible solutions. In some cases, legislation - which may still advance

important social justice or economic purposes - can end up being overly prescriptive and not necessarily flexible enough to meet the constantly evolving and fluctuating reality of agriculture. For example, strict rules on the price of agricultural products may incentivise the parties to operate outside the law if either of them is unable to turn profit. On the other hand, when well drafted, these rules may contribute in stabilizing prices for both producers and customers. The finding can be generalized to cover other regulatory overreaches: as a result of excessive regulation, parties involved in contract farming arrangements may be more inclined to seek alternative, non-legal routes to obtain results (Jull, 2016). In the longer term, if legislation is seen as an obstacle rather than as a guarantee for a level playing field for all participants, faith in the rule of law may begin to erode. When national capacities for the implementation of the proposed legal protections or innovations are weak, legal requirements can be introduced in an incremental fashion and can be reviewed and added to over time as capacity increases (Morgera et al., 2012).

1. Scope and other opening provisions of legislation

Regardless of whether countries have chosen to use specific legislation for contract farming, or whether they prefer to rely on pieces of legislation that are more general in nature, the legislation will include a set of opening provisions. These provisions, which may include objectives, principles, scope and definitions of key terms, are commonly placed at the beginning of a piece of legislation to provide a statement of regulatory goals and desired outcomes. The opening provisions can be useful to explain the purpose of the legislation and why it was enacted (Vapnek & Spreij, 2005). Further, they can be used to link the piece of legislation with other relevant legislation, clarifying its role in the wider regulatory framework (Morgera et al., 2012).

a. Scope

The scope of the law describes what the law will cover and/or will not cover (Vapnek et al., 2007), and so regulators should make sure that their chosen scope can accommodate their legislative aims. The scope can either be defined in a dedicated provision, or be evinced from the definitions, objectives and other provisions. Contract farming can be embedded in legislation with a broad range of options with regards to the scope. The scope may cover all agricultural production contracts or, more broadly, different contractual relations in the agricultural domain (see Chapter 2

Section 1). For example, if a country chooses to include contract farming related provisions in their commodity specific legislation, this would limit the application of those rules for only that particular commodity (see Chapter 2 Section 1). The scope may also be limited to contracts or parties that are registered, creating an opt-in regime (see Box 5), or only between parties in a food supply chain (see Chapter 2 Section 1). Regardless of the commodities covered, the scope should always extend to agriculture production contracts between both natural and legal persons, as well as any combination thereof, in order to allow producer organisations to participate in contract farming.

In Viet Nam, the Decision 62/2013 Regulating Contract Farming includes within its scope contracts between individual farmers, as well as representative farmers organizations, and entrepreneurs, but it only focuses on large-scale agricultural projects (Dang et al., 2014). In Belgium, the Loi relative à l'intégration verticale dans le secteur de la production animale covers the contracts used in animal production and applies to contracts within the livestock sector between parties to either produce products of animal origin or to raise animals.⁹⁴ In Spain, the law covering contract farming applies to the commercial relations between the operators that intervene in the food chain from the production to the distribution of foods or food products, hence expanding the scope of the legislation to other stages of the supply-chain.⁹⁵

b. Definitions

In many jurisdictions, laws include a section on interpretation with a list of definitions of key terms whose meaning can contribute to the consistent interpretation of the law. Well-drafted definitions can eliminate confusion, as they clarify what the legislation means and when and where it applies. Definitions can also help to facilitate the implementation and enforcement of a piece of legislation (Vapnek & Spreij, 2005).

In the context of contract farming, particularly important terms that deserve definition in the applicable legislation may include: the agricultural production contract itself and the parties to the contract (the producer and the contractor). These terms are crucially important, as they effectively

94 Belgium. Loi relative à l'intégration verticale dans le secteur de la production animale, (1976-04-01/32), Article 1.

95 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria, (12/2013), Article 2.

limit the scope of the legislation to a specific type of a contract entered into by defined type of parties. The exact definition of these terms ultimately depends on the policy choices of the regulator as well as on the general national legal context. International guidance documents, such as the 2015 Legal Guide, can provide guidance and inspiration on how to define the terms relevant for contract farming. Aligning domestic definitions with terms used internationally contributes to greater harmonization between legal systems, and may help the regulators to draft sufficiently accurate definitions that fit their policy purposes.

If the regulators' intention is that contract farming rules cover all agricultural production, this should be consistent with the definition of agricultural production contract. In the US State of Minnesota, the corresponding contract is known as an "agricultural contract" and is defined as any written contract between a contractor and a producer. The definition further clarifies that it does not include a contract between a licensed grain buyer who purchases grain from a producer as a merchant or seller of grain and does not contract with the producer to grow or raise the crops producing the grain.⁹⁶ The legislation covering contract farming in Chile also includes a definition of "an agricultural contract" as a contract of trading of agricultural commodities between an agricultural producer and an agro-industrial entity or an intermediary.⁹⁷

Legislation can also use the definition of agricultural production contract to fine tune the scope of the law, by providing more requirements on what constitutes an agricultural production contract. In this case, the definition needs to be carefully drafted so as not to unintentionally include or exclude relationships. For example, regulators may need to ensure that the definition of an agricultural production contract in the legislation is sufficiently different from that of an employment contract (see Chapter 1 Section 2(c)).

In Brazil, agricultural production contracts are referred to as "vertical integration contracts" or "integration contracts." The applicable law defines the contract as a contract signed between the integrated producer and the 'integrator' (the local term for contractor), which establishes, among its other purposes, its attributions in the production process, the commitments to social responsibilities, health requirements and

96 Minnesota. The Minnesota Agricultural Contracts Act, (Section 17.90 (1a)).

97 Chile. Ley crea un registro voluntario de contratos agrícolas (N° 20.797), Article 3. See also Decree N° 149 from the Ministry of Economy, Promotion and Tourism which approves the Regulation of the Law N° 20.797.

environmental responsibilities; it regulates the relationship between the parties to the contract.⁹⁸ The State of Punjab (India) calls such contracts “contract farming agreements” and defines them as a contract between the buyer, who offers to purchase the produce, and the producer, who agrees to produce the crop, and under which the production and marketing of an agricultural product is carried out as per the conditions laid down in the agreement.⁹⁹

As was seen in the discussion above, the definitions of agricultural production contracts rely on the definitions of the parties, i.e. the producer and the contractor. In the US State of Minnesota, the Minnesota Agricultural Contracts Act defines the producer as a person who produces or causes to be produced an agricultural commodity in a quantity beyond the person’s own family use and: (1) is able to transfer title to another; or (2) provides management, labour, machinery, facilities, or any other production input for the production of an agricultural commodity. Under the same law, a contractor means a person who in the ordinary course of business buys agricultural commodities grown or raised in the state of Minnesota or who contracts with a producer to grow or raise agricultural commodities in the state of Minnesota.¹⁰⁰ In Brazil, the Lei Nº 13.288 defines producer as an “agrosilvipastoril” producer, natural or legal person, who individually or in an associative way, with or without the labour cooperation of employees, is connected to the integrator by means of a vertical integration contract, receiving goods or services for the production and for the supply of raw material, intermediate goods or final consumer goods. A contractor, or integrator, is a natural or legal person that is linked to the integrated producer by means of a vertical integration, supplying goods, inputs and services and receiving raw materials, intermediate goods or final consumer goods.¹⁰¹

c. Objectives

The objectives of a legal instrument depend on the priorities and policy choices made by the regulator. They are rarely legally binding in themselves, but good drafting practices require that the substantive elements (see Chapter 4 Section 3) be aligned with the objectives (Vapnek et al., 2007).

98 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvipastoris (Nº 13.288), Article 2.

99 Punjab, India. The Punjab Contract Farming Act (No. 30 of 2013), Article 1.

100 Minnesota. The Minnesota Agricultural Contracts Act, Section 17.90.

101 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvipastoris (Nº 13.288), Article 2 (II and III).

In this manner, the objectives can provide guidance on the implementation and interpretation of the more substantial provisions in the legislation. The objectives may, for example, relate to facilitating the functioning of the agricultural markets by enhancing producers' access to markets and increasing the fairness of the contractual relationship between producers and contractors.

In Morocco, where the *Loi n° 04-12 relative à l'agrégation agricole* covers contractual relations in agriculture, the objective of the law is to secure transactions, in particular commercial transactions, between the contracting parties.¹⁰² In Spain, the *Ley 12/2013* states its purpose as being to improve the functioning of the food supply chain and, more specifically, to increase the efficiency and competitiveness of the food sector and to develop new distribution channels for food products.¹⁰³ In India, the *Punjab Contract Farming Act* has an even more explicit objective: to improve the marketing of agricultural products through contract farming and to regulate the development of efficient contract farming systems.¹⁰⁴

Objectives related to contract farming operations can be found in legislation with a scope broader than contract farming, such as commodity-specific legislation containing rules applicable to the contract farming relationships for that commodity. In Bolivia, where the law for sugar production contains contract farming related rules, the objective of *Ley N° 307* is to regulate the production, processing and commercial activities of sugar cane, the commercialization of sugar cane, as well as safeguarding food sovereignty by prioritizing domestic markets as the destination for sugar products.¹⁰⁵ In El Salvador, the law related to sugar production regulates the relations between the sugar industry and sugar producers and guarantees justice, rationality and transparency in both production and marketing of sugar and honey.¹⁰⁶

d. Principles

Besides objectives, legislation can identify general principles that help in its interpretation and implementation, either by referring to external

102 Morocco. *Loi relative à l'agrégation agricole* (n° 04-12), Article 1.

103 Spain. *Ley de medidas para mejorar el funcionamiento de la cadena alimentaria*. (12/2013), Preamble and Articles 1 and 3.

104 Punjab, India. *The Punjab Contract Farming Act* (No. 30 of 2013), Preamble.

105 Bolivia. *Ley del complejo productivo de la caña de azúcar* (N° 307), Articles 1 and 3.

106 El Salvador. *Ley de la producción, industrialización y comercialización de la agroindustria azucarera de El Salvador* (Decreto N°. 490), Article 1.

instruments or by including them directly into the piece of legislation. Legal principles may also be useful for developing subsidiary legislation. At the international legal principles level, the CFS-RAI Principles,¹⁰⁷ the FAO “Guiding principles for responsible contract farming operations”¹⁰⁸ and the 2015 Legal Guide, may provide regulators inspiration for the kinds of principles relevant for contract farming. A common principle in many of these instruments, is the promotion of the idea that contract farming should be mutually beneficial. Mutually beneficial relationships contribute to the fairness of the relationship, as well as other policy objectives.

In Brazil, this fairness principle is enshrined in the law that governs contract farming relations. Lei Nº 13.288 clearly identifies that its guiding principle is that the pooling of resources and efforts, as well as the fair distribution of the results, characterize the relationship between the parties.¹⁰⁹ In Spain, a similar principle guides the Ley 12-2013, as the law holds that the commercial relations subject to it shall be governed by the principles of balance and fair reciprocity between parties, freedom to enter into agreements, good will, mutual interest, equitable sharing of risks and responsibilities, cooperation, transparency and respect for free market competition.¹¹⁰

As far as contractual relationships are considered, multiple international instruments may provide guidance for the Governments in the choice of principles. The 2015 Legal Guide provides a good overview of such principles relevant for a contract farming contractual relationship. On a more general level, and in particularly in the context of contract farming agreements which can be categorized as sales contracts, the United Nations Convention on Contracts for the International Sale of Goods, 1980 (CISG)¹¹¹ and the UNIDROIT Principles of International Commercial Contracts, 2010 (the UNIDROIT Principles or UPICC)¹¹² may provide useful references.

107 Committee on World Food Security, forty-first session “Making a Difference in Food Security and Nutrition”. Rome, Italy, 13-18 October 2014. Principles for responsible investment in agriculture and food systems.

108 FAO. 2012. Guiding principles for responsible contract farming operations. Rome.

109 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvopastoris (Nº 13.288), Article 3.

110 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013), Preamble and Articles 1 and 3.

111 United Nations Convention on Contracts for the International Sale of Goods, Vienna, 11 April 1980, S.Treaty Document Number 98-9 (1984), UN Document Number A/CONF 97/19, 1489 United Nations Treaty Series 3.

112 Article 1.6(2) UNIDROIT Principles 2016.

2. Institutional set-up

Contract farming legislation should designate a competent authority to oversee the implementation of the legislation and undertake the related regulatory roles. Responsibility for the implementation of the legislation can either be assigned to a new institution created for that purpose, or assigned to an existing institution. There are different manners in which legislation can designate the competent authority and assign responsibilities. In the State of Rio Negro, Argentina, the law covering contract farming in fruit production holds that the Secretariat of Fruit Growing of the State of Rio Negro will be the authority that applies the law and is in charge of ensuring compliance both with the law and the subsidiary legislation it dictates.¹¹³ In the State of Punjab (India) the Punjab Contract Farming Act constituted the Punjab Contract Farming Commission that is endowed with the responsibility to ensure the proper implementation of the act as well as to promote and enhance the performance of contract farming. The Commission consists of a Chief Commissioner and three Commissioners, all eminent experts of agriculture with varying degrees of experience and/or retired, high-ranking members of the government's corresponding areas of competence.¹¹⁴

While there should always be a lead institution responsible for implementing and/or coordinating the implementation of the legislation, legislation may also allocate specific responsibilities to different institutions. Also, in countries with a constitutional division of roles and duties, different entities might be assigned duties to implement different tasks under the law. This can be the case, for instance, with regard to the monitoring and enforcement of the law. These roles may, in some cases, be implemented by decentralized entities and/or local authorities, who may have a constitutional mandate, closer connection to the region and better capabilities to monitor and enforce the legislation.

Legislation should clearly set up the key roles and responsibilities of the different entities in charge of implementing the law. The content of these responsibilities will depend on the role the government will assume in contract farming (see Chapter 3). These roles could include the provision of extension services and training, provision of technical specifications and provision of financial support and incentives to complement the ones provided by the contractor. Government may also support the creation of

113 Rio Negro, Argentina. Regimen de transparencia para la vinculacion entre la produccion, empaque, industria y comercializacion de frutas en Rio Negro (E 3.611), Article 30.

114 Punjab, India. The Punjab Contract Farming Act (No. 30 of 2013), Article 15.

the necessary connections between parties and contract formation and, if the country so wishes, the establishment of transparency and enforcement mechanisms such as a registry of contracts, public support to ADR, or research and development.

In addition, legislation might create supporting bodies to monitor implementation, enable stakeholders' participation or to provide advice to the competent authority. As an example of a monitoring role, the Ley 12/2013 governing the contractual relations in agriculture in Spain creates a Food Supply Chain Observatory, a collegiate body attached to the Ministry of Agriculture, Food and Environmental Affairs. The Observatory will monitor, advise, consult, inform and study the functioning of the food supply chain and food prices. The law ensures the inclusion of the most representative organizations and associations of the food supply chain ranging from producer to final consumer.¹¹⁵

Legislation may also designate an entity or a body to serve as a forum for public-private dialogue with vested advisory or executive functions (see Chapter 2, Section 3). Within these bodies, it is important that the viewpoints of both producers and contractors are included. This is frequent in commodity based legislation where the law usually creates a public-private management body that may assume different functions across the contract life cycle. Both El Salvador and Costa Rica have sectoral legislation for sugar production, which covers contract farming and sets up a national body in charge of guiding the sector. In El Salvador, the Salvadoran Council of Sugar Agroindustry consists of eight members and their alternates, with two representing the State, three representing the producers and three the private sector.¹¹⁶ In Costa Rica, the Agro-Industrial League of Sugar Cane is a non-state public entity and is directed by a Board of Directors composed of three representatives of producers, three of the industrial sector and two of the State (Solera & Gamboa, 2005). Costa Rica also has similar bodies for rice¹¹⁷ and coffee.¹¹⁸

As alluded to above, the competent authority, whether at a central or decentralized level, will also have a role in the enforcement of the law. These activities may include conducting inspections and audits, as well as being

115 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria, (12/2013), Title IV.

116 El Salvador. Ley de la producción, industrialización y comercialización de la agroindustria azucarera de El Salvador, (Decreto N°. 490), Article 7.

117 Costa Rica. Ley de la Creación de la Corporación Arrocerera, (Ley 8285), Article 1.

118 Costa Rica. Ley sobre el régimen de relaciones entre productores, beneficiadores y exportadores de café, (Ley 2762), Article 102.

involved in dispute resolution processes, including conventional and ADR. These issues are discussed below in Chapter 4 Section 3(a) and (c).

3. Substantive elements of contract farming legislation

Besides opening provisions and provisions on institutional set up, all legislation contains substantive provisions. These substantive provisions are the core of the legislation and are usually aimed at (i) achieving the regulatory purpose; (ii) creating rights and obligations for the related stakeholders; and (iii) ensuring that the regulatory authority has the legal tools and mandates necessary to fulfil its duties and ensure the achievement of the objectives of the legislation.

Substantive provisions of legislation will set up the various instruments required to achieve its regulatory purpose. In the case of contract farming, one possible important regulatory purpose is to characterize the agricultural production contract, in particular in relation to other similar contracts used in agriculture (see Chapter 1 Section 2). This characterisation relies on the elements of the contract which the law makes mandatory, as discussed below. In addition, the substantive provisions may include mechanisms that the government can use to support responsible contract farming (see Chapter 3 Sections 1 & 2).

a. Elements of contract farming agreements

This section will discuss the ways in which the legislation may incorporate the elements that the parties should include in their agricultural production contracts. These elements are crucial in order to ensure that the contracts used in contract farming are complete and balanced enough to contribute to mutually beneficial and fair contract farming relationships. The national legislator would naturally be free to include or not include any of these provisions, or other similar elements, as necessary to reach their regulatory purpose.

Legislation may be limited to merely providing form and content requirements for the parties, and in effect function as an extension of general contract law. This would place the legislation firmly within the body of private law, and rely on the regulatory and enforcement mechanism created therein. In any case, requiring parties to include certain clauses in their contract, with or without detailed content requirements, may allow the legislation to ensure that the contract captures at least the most

important aspects of the contract farming relationship. It can also facilitate contract drafting by providing an outline for the parties to follow.

In France, integration contracts – one of legally characterised forms of contract farming under French law– must contain a defined list of clauses. For example, the contract must include clauses related to the delivery of goods, which must also specify the process for weighing and classifying the goods, potentially in the presence of the producer or its representative. The contract must also clearly state the formula for calculating or modifying the price and shall establish a method of payment as well as what inputs are to be provided by which party. Other mandatory clauses include: the place of production; the duration; the conditions of signature, renewal, extension and termination of the contract; the duration of each obligation, and; the time period between obligations.¹¹⁹ Within the countries analysed for this Legislative Study, similar lists of requirements were found in Cambodia¹²⁰, Spain,¹²¹ Morocco,¹²² Belgium¹²³, El Salvador¹²⁴, Brazil¹²⁵, State of Rio Negro, Argentina¹²⁶, Turkey¹²⁷ and Costa Rica¹²⁸.

i. Parties, formation and form of contract

Parties to the contract

The producer and the contractor are the main parties to an agricultural production contract. Legislation should ensure that both parties can be either natural or legal persons, to allow agricultural producers to join resources and participate in contract farming through producer organizations. Other types of requirements set for the parties can be as simple or complex as needed, to adjust the scope and fulfil the specific policy objectives sought by the regulator. The more targeted an audience

119 France. Code rural et de la pêche maritime, Article R326-1.

120 Cambodia. Sub-Decree on Contract Farming, (No. 36/2011), Article 8 and 9.

121 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria, (12/2013), Article 8 and 9.

122 Morocco. Loi relative à l'agrégation agricole, (n° 04-12), Articles 9 and 10.

123 Belgium. Loi relative à l'intégration verticale dans le secteur de la production animale, (1976-04-01/32), Article 3.

124 El Salvador. Ley de la producción, industrialización y comercialización de la agroindustria azucarera de El Salvador, (Decreto N°. 490), Article 33.

125 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvopastoris, (N° 13.288), Article 4.

126 Rio Negro, Argentina. Regimen de transparencia para la vinculacion entre la producción, empaque, industria y comercialización de frutas en Rio Negro, (E 3.611), Article 4.

127 Turkey. Regulation regarding procedures and principles of contract farming, (No. 26858.)

128 Costa Rica. Decreto Ejecutivo 28665: Reglamento a la Ley Orgánica de la Agricultura e Industria de la Caña de Azúcar N° 7818, Article 226.

the regulator has in mind, the more detailed definition of the parties the regulator may wish to use (see Chapter 4 Section 1(b)).

An objective of some contract farming legislation is to protect the weaker party in the contractual relationship. To ensure that the benefits of the legislation reach the intended beneficiaries, the legislation can be drafted to limit its application to producers below a certain size, as measured by their income, land holdings, amount of total production, or other objective indicators, as used in the country. For example, Brazil has created a Social Fuel Seal scheme which particularly aims at the social inclusion of small-scale farmers (see Chapter 2 Section 1).¹²⁹ Another example is found in Costa Rica, where production of sugar cane must take place under a contract and the independent producers may include all natural persons, legal entities, de facto companies, estates, trust or trustworthy orders that produce them, but only if their delivery amounts to a maximum of five thousand metric tons of cane per harvest. With respect to cane delivered in excess of this quantity, the producer would no longer be considered as an independent producer, and would not enjoy the protections set out in the law.¹³⁰

While the producer and the contractor are the main parties to any agricultural production contract, they are not necessarily the only parties. Particularly, when intermediaries play an important role in contract farming in the country, regulators may wish to formalize their role.

As an example, the Australian Horticulture Code of Conduct – which is a mandatory industry code prescribed under the Competition and Consumer Act 2010 – includes a potential role for the agents of the producer. The agent, among its other responsibilities, must act in the best interest of the producer and provide periodical reports on its marketing activities to the producer.¹³¹ The Wisconsin legislation applicable to milk contractors clearly specifies the role and power of qualified producer agents, who may represent the producers in milk production contracts with contractors, while clarifying that the producer agent does not obtain the title to the producer's milk.¹³² In Chile, the law covering contract farming simply

129 Brazil. Dispõe sobre os critérios e procedimentos relativos à concessão, manutenção e uso do Selo Combustível Social, (Portaria 337/2015), Article 3 (I-III).

130 Costa Rica. Ley organica de la agricultura e industria de la cana de azucar, la asamblea legislativa de la Republica de Costa Rica, (Ley 7818), Article 55.

131 Australia. Competition and Consumer (Industry Codes—Horticulture) Regulations 2017, Articles 27 and 29.

132 Wisconsin. Producer agents, (Department of Agriculture, Trade and Consumer Protection 100.16), Section 1.

defines producer as a natural or legal person who produces goods that came directly from agriculture. The contractor, known as “agroindustrial”, is defined as the natural or legal person who processes or uses the product. The Chilean law also envisions a potential role for intermediaries, and defines them as a natural or legal person that participates in the first transaction of agricultural products as a buyer, with the intention to later sell those products.¹³³

Formation requirements for contracts

Traditionally, the concepts of offer and acceptance have been used to determine whether and when the parties have reached an agreement. These, as well as issues related to capacity and consent, are usually well covered in a country’s general contract laws and would also apply to contract farming relationships (UNIDROIT/FAO/IFAD, 2015).

As the contract farming relationship is often between parties with great differences in bargaining power, the legislation may place some additional requirements to ensure fair and equal formation of the contract. For example, the legislation may require the contractor to provide detailed information to the producer prior to signing (see Chapter 4 Section 3 (b)), allow the producer some time to carefully consider the contract even after signature (see Chapter 4 Section 3) or require the contract to be registered or approved by a public actor (see Chapter 3 Section 2(c)). However, public approval may introduce an unnecessary element of rigidity as the process tends to be lengthy, costly and susceptible to corruption.

To ensure fair contracts, the legislation may also allow or require the government to participate in the formation stage, such as by creating connections between the parties interested in contract farming (see Chapter 3 Section 1(b)).

Form requirements for contracts

As an essential feature, legislation should require that the contracts are written and signed by the parties. Written, straightforward and simple contracts improve the clarity, completeness, enforceability and effectiveness of the parties’ agreement. The promotion of transparency, 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 (UNIDROIT/FAO/IFAD,

133 Chile. Ley crea un registro voluntario de contractos agrícolas (N° 20.797), Article 3.

2015). Exceptions may be provided for contracts of very small value, for which the form requirements might be too burdensome.

An explicit written requirement can be found in European Union Regulation 1308/2013, which requires that all contracts for buying sugar beet and sugar cane, including pre-sowing delivery contracts – which fall under the definition of agricultural production contracts as used in this Legislative Study – shall be governed by written agreements.¹³⁴ In Cambodia, agricultural production contracts must be in writing.¹³⁵ In the US State of Minnesota, the definition explicitly requires the contracts to be in writing.¹³⁶ Similarly, the Belgian law for livestock production requires that the contract and any amendments thereto be in writing.¹³⁷ In Spain, agricultural production contracts must be in writing, except in cases where it is possible to estimate that the value of the contract is below 2 500 Euros.¹³⁸

While, for the sake of clarity, the requirement that a contract be in writing should be explicit, it can also be deduced implicitly via requirements for mandatory clauses and for registration for example. This is the case in Morocco, where the contract farming specific law does not explicitly require a written form for the contract, but this is implied by the law's requirement to include multiple mandatory clauses in the contract.¹³⁹ In the State of Punjab (India) the Punjab Contract Farming Act does not explicitly require the contract to be written, but does require it to be registered,¹⁴⁰ which implies a need for a written contract.

Countries do not necessarily need to adopt contract farming specific legislation to require the contracts used in contract farming to be written. Countries can use their general contract laws to require that specified categories of contracts be in writing, which may include contracts used for contract farming. This form may be required, for example, when the contract is made between legal entities and individuals, or when the value

134 Regulation (EU) No 1308/2013 of the European Parliament and of the Council of 17 December 2013 establishing a common organisation of the markets in agricultural products and repealing Council Regulations (EEC) No. 922/72, (EEC) No. 234/79, (EC) No. 1037/2001 and (EC) No. 1234/2007, Article 125.

135 Cambodia. Sub-Decree on Contract Farming, (No. 36/2011), Article 9.

136 Minnesota. The Minnesota Agricultural Contracts Act, Section § 17.90 (1a).

137 Belgium. Loi relative à l'intégration verticale dans le secteur de la production animale, (1976-04-01/32), Article 2.

138 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria, (12/2013), Article 2.

139 Morocco. Loi relative à l'agrégation agricole, (n° 04-12), Articles 9 and 10.

140 Punjab, India. The Punjab Contract Farming Act, (No. 30 of 2013), Article 4(3).

of the contract exceeds a certain threshold. This approach would allow the regulators to extend the benefits of written contracts to contract farming, whether or not they otherwise want to create rules specifically for contract farming.

Uganda, where agricultural production contracts are governed by the Sale of Goods Act, requires that in order for a contract of sale for goods with a certain value or higher to be enforced by a court, a note or memorandum of the contract should be in writing and signed by the party to be charged.¹⁴¹ In Malawi, where contract farming also greatly relies on the Sale of Goods Act, sales contracts for goods with certain value or higher must be written or evidenced in writing.¹⁴²

In some countries and under certain circumstances, producers may have relatively low levels of literacy. Legislation can be used to facilitate the readability and accessibility of agricultural production contracts by requiring that contracts used in contract farming be written in a language that is clearly understandable by all parties to the contract. Understandable language requirements may also facilitate informed consent, as parties become better aware of their rights and obligations under the contract.

A clear example comes from the US State of Minnesota, where the Agricultural Contracts Act requires that all agricultural contracts must be in legible type, appropriately divided and captioned by its various sections, and written in clear and coherent language using words and grammar that are understandable by a person of average intelligence, education and experience within the industry.¹⁴³ Similarly, in Brazil, the integration contracts, under a penalty of nullity, must be written with clarity, precision and logical order.¹⁴⁴

ii. Parties' obligations

Quality and quantity requirements

Quality, and particularly quantity, are issues often best left for the parties to decide between themselves. While the regulator may be able to draft specific quality standards for the parties to adopt in their contracts,

141 Uganda. Sale of Goods Act 1932, Section 10 (5) and (6).

142 Malawi. Sale of Goods Act, (48:01), Section 5.

143 Minnesota. The Minnesota Agricultural Contracts Act, Section 17.943 Subdivision 1.

144 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvipastoris, (Nº 13.288), Article 4.

mandating a specific quality or quantity to be produced in the relationship is rarely useful.

Nevertheless, the quantity of contracted product to be delivered or received is a critical piece of information for both parties. Legislation may therefore require a clause on quantity to be included in the contract. The content of the clause may be left open for the parties to decide or additional requirements may be specified. For example, legislation may require that some degree of embedded flexibility (e.g. small percentage of overall quantity) be included in quantity clauses to allow for the producer to stray from the agreed quantity without suffering negative consequences.

For example, a clause on quantity is mandatory in Chile for all commodities grown under an agricultural production contract, if the parties want to have their contract registered in the voluntary registry.¹⁴⁵ In Costa Rica¹⁴⁶ and El Salvador¹⁴⁷, a quantity clause is mandatory in sugar cane production contracts. Panama also includes quantity as one of the mandatory clauses in any agricultural production commodity, regardless of the underlying commodity. The Panamanian agricultural code goes further by requiring the parties to clarify how much, if any, margin of tolerance the quantity clause accommodates.¹⁴⁸ Similarly, the Civil Code of Hungary allows an agricultural producer to perform ten percent below the quantity stipulated in the agricultural production contract.¹⁴⁹

If regulators want to ensure that the quality of goods is considered and addressed by the parties, a simple way to do so is to require that the parties include a clause on quality in their contract. Particularly when the contract farming related rules are intended to cover multiple different commodities, it may be very difficult to set specific quality requirements, and thus it would be reasonable to leave this decision to the parties. For example, Cambodia¹⁵⁰, Panama¹⁵¹ and Morocco¹⁵² have included quality clauses in their list of mandatory clauses.

145 Chile. *Ley crea un registro voluntario de contratos agrícolas* (N° 20.797), and Decree N° 149 from the Ministry of Economy, Promotion and Tourism which approves the Regulation of the Law N° 20.797, Article 6.

146 Costa Rica. Decreto Ejecutivo 28665: Reglamento a la Ley Orgánica de la Agricultura e Industria de la Caña de Azúcar N° 7818, Article 226.

147 El Salvador. *Ley de la producción, industrialización y comercialización de la agroindustria azucarera de El Salvador*, (Decreto N°. 490), Article 33.

148 Panama. Código Agrario de la República de Panamá, (N°.55 of 23.05.2011), Article 140.

149 Hungary. Civil Code, Chapter XXXIV, Section 6:232.

150 Cambodia. Sub-Decree on Contract Farming, (No. 36/2011), Article 9.

151 Panama. Código Agrario de la República de Panamá, (No. 55 of 23.05.2011), Article 140.

152 Morocco. *Loi relative à l'agrégation agricole*, (n° 04-12), Article 9.

To ensure the high quality of certain key commodities, legislation may be used to establish more elaborate rules on quality requirements to be included in the agricultural production contract. Legislation may establish bodies that are granted the competency to establish quality standards. The legislation may also either provide the standards itself - such as by referring to existing legislation - without requiring the parties to mandatorily use them, or mandate subsidiary legislation to provide the standards.

In Argentina, where specific legislation exists for the production of wine under contract, the alcoholic strength of the wine to be delivered by the contractor shall be at least that established by the National Institute of Vitivinculture.¹⁵³ In Costa Rica, the implementing regulation for the law related to rice production provides minimum quality standards to which rice production contracts must adhere.¹⁵⁴ Zimbabwe provides quality grades for all grains and grain products, the use of which is mandatory for the parties.¹⁵⁵

Input supply

The provision of inputs by the contractor to the producer is a defining element of many contract farming relationships (see Chapter 1 Section 1). Thus, legislation may include the provision of inputs to the producer by the contractor in the definition of the agricultural production contract itself (see Chapter 4 Section 1(b)). Alternatively, or in addition, a clause on the provision of inputs may be mandatory in the agricultural production contract.

Requiring the contractor to provide inputs can help smallholders to access inputs at a competitive price, which may facilitate their engagement in production activities. On the other hand, not all contractors have the resources, or inclination, to provide extensive inputs. Excessive input requirements can thus limit the role of the contractor to only those parties that can afford the prescribed input provisions. Contractors may also sometimes charge excessive prices for the inputs, which may lock the producer into the costs and quality of inputs from the contract that do not reflect either the best prices or quality available (UNIDROIT/FAO/IFAD, 2015).

For example, Morocco requires that the parties include a clause on input

153 Argentina. Contratos de elaboracion de vinos, (Ley 18.600), Article 3.

154 Costa Rica. Ley de la Creación de la Corporación Arrocera, (Ley 8285), Article 33.

155 Zimbabwe. Agricultural Marketing Authority (Grain, Oilseed and Products) By-laws, (Statutory Instrument 140 of 2013), Article 8.

provision – including the nature, quantity and supply modalities – in their agricultural production contracts.¹⁵⁶ The law does not provide further requirements as to what inputs should be provided and how, leaving it up to the parties to decide. In Cambodia, the contractor must provide agricultural inputs, providing the examples of vegetation species, crop seeds, aquatic animal species and animal breeds, clearly showing how contract farming is envisioned to be practiced in a variety of fields.¹⁵⁷ In Belgium, in agricultural production contracts for livestock, the parties must include a clause on how goods and services provided by the integrators (the local term for contractors) are calculated or exercised.¹⁵⁸ The method on how this is done would be decided during the negotiations between parties.

Legislation may also influence the pricing of inputs sold to the producer by the buyer, to ensure that the producer has access to inputs at a competitive price and/or that the price of the inputs is connected with the final price to be paid to the producer. When the contractor is the sole source of inputs for the producer, the temptation to charge exorbitant fees may arise. To counter that, the legislation may place some generally worded caps on the prices to ensure that the price of inputs provided by the contractor to the producer will not excessively exceed the prevailing market price, or alternatively require the price to reflect the price for the final goods. In Brazil, the final price for the inputs must be approved by a Monitoring, Development, and Reconciliation Commission (CADEC) and should not be a source of extra income for the contractor.¹⁵⁹ In France, for certain agricultural production contracts, the formula for calculating the product price to be paid to the producer must take into account the variation of the price or the qualities of inputs necessary for the performance of the contract, as agreed upon in the contract.¹⁶⁰

Product delivery

Delivery of the final product is a crucial part of any contract farming relationship and may be a source of confusion and dispute, as well as nationally defined legal effects, such as passage of title or transfer of risks.

156 Morocco. Loi relative à l'agrégation agricole, (n° 04-12), Article 10.

157 Cambodia. Sub-Decree on Contract Farming, (No. 36/2011), Article 9.

158 Belgium. Loi relative à l'intégration verticale dans le secteur de la production animale, (1976-04-01/32), Article 3.

159 CADECs are discussion forums between the parties created by law, which are mandatory in each contract farming operation. A CADEC is equally composed by representatives of the producer and the contractor. The goal of the CADEC is facilitating transactions between the parties. Lei n° 13.288 De 16 Maio De 2016, Article 4 (VIII).

160 France. Code rural et de la pêche maritime, Article R326-1 (5).

Legislation may require the parties to consider the issue of delivery by requiring a mandatory clause in their agricultural production contract. Regulators may also wish to ensure that the regulatory framework provides guidance for the parties on how to organize delivery. This guidance does not necessarily have to be detailed, as different commodities may require very different delivery modalities. Nevertheless, the regulator may wish to ensure that at least some basic obligations, such as who is to undertake delivery, and where and when the delivery should take place, are provided in the regulatory framework. Often, countries have used default rules for these types of issues, subject to national legal tradition (see Box 1).

This does not necessarily mean that specific legislation on contract farming needs to be adopted, as general contract laws often already provide default rules on delivery, allocating the most basic responsibilities between the parties. Very commonly, unless the parties decide otherwise, general contract laws require the producer to deliver the product to the contractor in the producer's place of business - which in agriculture would often be the farm gate - within a reasonable time frame. In Uganda, where the Sale of Goods Act can be applicable to many agricultural production contracts, the seller is required to deliver the goods to the buyer within a reasonable time. The place of delivery is generally the producer's place of business. If the contract is for the sale of specific goods, the real location of the goods would be the default place of delivery.¹⁶¹

Regulators may in some cases find it useful to provide specific rules for the delivery of the regulated commodities. This method may allow the legislation to better take into account issues that arise from the nature of the commodity, such as when agricultural products are likely to deteriorate rapidly. While it might be easier to draft detailed delivery rules for individual commodities, those too may end up being needlessly rigid and resulting in delivery methods not preferred by either party nor justified by a policy preference of the regulator. Thus, the regulator may need to carefully consider the level of detail its commodity-specific delivery rules provide.

An example of a commodity-specific delivery rule that takes into account the nature of the regulated commodity can be found in the law regulating sugar production in El Salvador. Harvested sugar cane loses its quality quickly after harvest. In light of this, under the El Salvadorian law, the producer must deliver the contracted sugar cane to the sugar mills within seventy-two hours of harvest and the contractor is obligated to receive

161 Uganda. Sale of Goods Act 1932, Section 29.

them within the same time-span. In this case, the delivery must be done at the contractor's place of business and not at the producer's. In case of non-compliance by either party, the party in breach must compensate its counterpart for the total or partial loss incurred.¹⁶²

The issue of side-selling

Related to both quantity and delivery is the issue of side-selling. Side-selling, which refers to a producer's breach of contract by selling the contracted goods to a third party, is one of the major risks a contractor faces when participating in contract farming (see Introduction Section (3)). Prohibition of side-selling is always an implicit part of any legislation covering contract farming; when parties have entered into a legally valid contract, the producer is bound to deliver the contracted goods to the contractor. When a producer engages in side-selling, the contractor not only loses the final goods, but may also suffer financial loss associated with the inputs provided to producers for production. Considering the severity of the breach, a regulator may consider providing an explicit prohibition of side-selling and the resulting consequences in legislation. To increase effectiveness, legislation prohibiting side-selling may be extended to penalize also the third party that buys the product from the producer, rather than just the producer.

In Chile, contractors who have registered their contract in the voluntary registry can rely on specific sanctions with respect to the producer who sells their goods to a third party. In case a third party acquired the products covered by the contract, s/he will be jointly liable with the producer for any damages caused to the registered contractor. What is more, the registered contractor is granted the right to sue for damages in a summary judgment with shorter deadlines than an ordinary judgement.¹⁶³ In Zimbabwe, the relevant law explicitly holds that contracted grains and oilseeds shall not be purchased by any person other than the contractor, and that any buyer who purchases contracted grain or oilseeds shall compensate the aggrieved contractor with an equivalent volume and quality of such grain

162 El Salvador. Ley de la producción, industrialización y comercialización de la agroindustria azucarera de El Salvador, (Decreto N°. 490), Article 37.

163 Chile. Ley crea un registro voluntario de contratos agrícolas, (N° 20.797), Article 17.

or oilseeds as well as with a price determined by the Committee¹⁶⁴.¹⁶⁵

Inspection and acceptance

Prior to accepting the delivery, the contractor may often need or want to inspect the final product, to ensure its conformity with the agreed quantity and quality. Inspection is a common source of dispute in contract farming, as it often establishes how much the producer will be paid for the goods. While contracts serve to reduce the degree of arbitrariness in inspections, to avoid disputes and to facilitate mutually beneficial relationships, the legislation may provide the parties with default or mandatory rules on how to establish their inspection of the final goods.

One good practice identified by the 2015 Legal Guide is to allow the producer the right to be present or represented at the inspection, which may be enshrined in legislation, and made mandatory for inclusion in the agricultural production contracts. Possible fraud (such as manipulating produce weight) is a recurrent issue. However, the likelihood of fraud is reduced when both parties participate in the inspection, and when an independent third party also participates, or when the contract provides for a certification procedure or arbitration clause for disputes arising from quality establishment. Simply put, the legislation should guarantee the producer's ability to verify the process by which the determination of the quality of final goods is made (UNIDROIT/FAO/IFAD, 2015).

In the State of Rio Negro, Argentina, the producer in a fruit production contract shall always have the right to supervise the process of classification of the delivered fruits, as well as to receive, within seventy-two hours of completion of the inspection, a receipt following the form and content requirements set in the applicable rules.¹⁶⁶ In El Salvador, representatives of sugar cane producers may appoint delegates to verify the weight and determination of the quality of the sugar cane delivered to the sugar mills, as well as any other data or process which affects the determination of the price to be paid.¹⁶⁷ In France, producers in integration contracts have

164 Committee is a body set under the law, formed from representatives of the state, producers and contractors, tasked with the promotion of the development of the grain and oilseed industry among its other responsibilities. Zimbabwe. Agricultural Marketing Authority (Grain, Oilseed and Products) By-laws, (Statutory Instrument 140 of 2013), Article 4.

165 Zimbabwe. Agricultural Marketing Authority (Grain, Oilseed and Products) By-laws, (Statutory Instrument 140 of 2013), Article 7 (5) and (10).

166 Argentina. Regimen de transparencia para la vinculacion entre la produccion, empaque, industria y comercializacion de frutas en Rio Negro, (E 3.611), Article 7.

167 El Salvador. Ley de la produccion, industrializacion y comercializacion de la agroindustria azucarera de El Salvador, (Decreto N° 490), Article 38.

the right to require their representative to be present in the weighing, counting or classification of the final goods and services.¹⁶⁸

Particularly when regulators have chosen to create contract farming specific rules for certain commodities, they have the possibility to take into account any particularities related to the commodity. As discussed above in the context of sugar cane, some agricultural products can be subject to rapid deterioration after harvest. In these cases, any delay in inspection and acceptance can have an effect on the final quality of the product and consequently on the producer's profits. Thus, it may be useful to impose set time limits on inspection of certain agricultural goods in the legislation, to ensure that the delays in inspection and the subsequent degradation of quality are not used against the producer.

In addition to the El Salvador example above, the Punjab Contract Farming Act provides a clear example of this. Under the Act, the contractor is responsible for weighing the delivered products immediately upon delivery. After the weighing is completed, the contractor shall take the delivery of the product and provide a receipt with the details of sale proceeds to the producer. By law, the contractor shall be considered to have thoroughly inspected the product at the time of delivery and have no right to retract the product.¹⁶⁹

As the measuring of weight and quality of the final product in contract farming can often be a source of dispute, legislation may place extra attention on the issue by providing specific standards for measurement equipment and its use, as well as provide inspections to ensure that these standards are followed in practice. In El Salvador, the Salvadoran Council of Sugar Agroindustry may, through its Board of Directors, determine the minimum equipment that sugar mills must have to establish the weight and quality of sugar cane, as well as order audits on sugar mills, distributors, packers and warehouses in order to verify their adherence to the legal framework.¹⁷⁰ Similarly, in Costa Rica, at least for sugar¹⁷¹, rice¹⁷²

168 France. Code rural et de la pêche maritime, Article R326-1 (4).

169 Punjab, India. The Punjab Contract Farming Act, (No. 30 of 2013), Article 5.

170 El Salvador. Ley de la producción, industrialización y comercialización de la agroindustria azucarera de El Salvador, (Decreto N° 490), Article 11.

171 Costa Rica. Decreto Ejecutivo 28665: Reglamento a la Ley Orgánica de la Agricultura e Industria de la Caña de Azúcar N° 7818, Article 270.

172 Costa Rica. Reglamento a la Ley N° 8285 de Creación de la Corporación Arrocera Nacional, Poder Ejecutivo de la República de Costa Rica (Decreto Ejecutivo 32968), Article 7.22.

and coffee¹⁷³, the appropriate authorities may elaborate and enforce rules related to the measurement of the weight and quality of the final product.

Regulators may also choose to rely on rules related to inspection and acceptance in their general contract laws and laws related to sales contracts. While these cannot take into account the specific nature of agricultural goods, requiring or allowing the contractor to inspect the product after delivery still helps to establish the actual quality of the final product, and thus clarify how well the producer has fulfilled its related obligations.

In Uganda, the contractor may require the producer to give it a reasonable opportunity to examine the goods to ascertain whether they are in conformity with the contract. The contractor will be deemed to have accepted the delivered goods after it has had a reasonable opportunity to examine them, whether or not such an examination has taken place.¹⁷⁴ In Finland, the Sale of Goods Act places an obligation on the contractor to inspect the goods, failing which they lose the right to rely on any potential defects in the goods. The inspection should take place when the risk is transferred, which in general would mean an inspection upon delivery.¹⁷⁵ In Minnesota, the contractor has the right to inspect the delivered goods before payment or acceptance.¹⁷⁶

Price determination

Price is often considered an essential term of a contract, and contracts lacking a price term may be considered unenforceable under some legal systems. Therefore, the legal framework for contract farming should be clear in requiring the parties to include a price clause in their agricultural production contracts. Legislation normally will leave parties free to determine the price or the price determination mechanism but, in exceptional circumstances, the government may have an influence on how price is determined, especially for particularly sensitive commodities. The actual price to be paid does not necessarily have to be set in monetary

173 Costa Rica. Ley sobre el regimen de relaciones entre productores, beneficiadores y exportadores de café, (Ley 2762), Article 13.

174 Uganda. Sale of Goods Act 1932, Section 27 and 34.

175 Finland. Sale of Goods Act, (355/1987), Section 20.

176 Minnesota. Uniform Commercial Code, § 336.2-310.

terms, but it may also consist of in-kind contributions.¹⁷⁷ Thus, the legislation may want to leave this option available for the parties.

Allowing the parties to choose the price for their contract gives them greater control over their relationship. With this condition, the parties are freer to negotiate the price to be paid, which may allow them to take better account of the particular features of their relationship, but it may also allow the stronger party to set prices that are unfair. To minimize this risk, the legislation may require the price to be set not just between individual parties, but either between their representative organizations, or in dedicated fora for negotiations, designed to redress the power imbalance. As this approach increases the time and resources needed to enter into a contract, it should only be used when a regulator has identified situations of clear and permanent imbalance between parties, which has led to unsatisfactory or unfair prices. For example, in Morocco, the law requires the parties to fix the method of pricing within the text of the contract, making price one of the mandatory clauses in an agricultural production contract.¹⁷⁸ In Brazil, it is mandatory for all contract farming schemes to adopt the price as set by negotiations in CADECs, which are collaborative units formed by representatives of both parties.¹⁷⁹

Allowing the parties to choose the price themselves does not preclude the legislation from providing default rules that become applicable if the parties have not included a clause on price determination in their contract. Regulators can often rely on existing general contract laws, which commonly already include these default rules and require a reasonable price to be paid, which may take into account factors such as the properties of the goods or the prices paid for similar goods in the market. In Russia, when the parties have not included a price clause and the price cannot be deduced from other clauses in the contract, the price will be determined by taking into account what is usually paid under the comparable circumstances for similar types of commodities, works or services.¹⁸⁰ Malawi has adopted a similar approach, where in the absence of a price term a reasonable price

177 As an example, a contract farming scheme practiced in the Lao People's Democratic Republic functions without any money changing hands. Under the scheme, the contractor provides a pregnant cow to producers. The producer has the responsibility to return the first- and the third-born calves to the company, free of charge, while they are allowed to keep the second and the fourth calves for themselves. The contractor is responsible for the inseminations. At the end of the contract duration, the original cow becomes the property of the producer.

178 Morocco. Loi relative à l'agrégation agricole, (n° 04-12), Article 9.

179 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvopastoris, (N° 13.288), Article 4 (VIII).

180 Russia. Гражданского кодекса, Article 424.

should be paid.¹⁸¹

Another way to redress the imbalance in bargaining power between the parties, or to attempt to ensure fair and stable prices for either the producer or consumers, is for the legislation to provide minimum or maximum prices for certain commodities which have to be adopted in the parties' contract. On the other hand, it can be very difficult to pick a "right" price for commodities. Price levels that are too high or too low can be costly to the economy (Anderson and Roumasset, 1996) and make contract farming less viable for the parties. On a more general level, by supporting or stabilizing prices well above market price levels, governments can encourage overproduction and discourage consumption (consumers buy less at higher prices). Public price stabilization schemes may also create disincentives to innovation in credit and insurance markets and discourage investment in food storage facilities (World Bank, 2005; Cummings et al., 2006 in Demeke et al., 2009). In Uganda, the law governing coffee production holds that exporters cannot sell coffee below the minimum price set by the Price Committee under section 8(2) of the Uganda Coffee Development Authority Act.¹⁸² In Malawi, for meat and meat products, as well as for milk and milk products, the respective Minister has the right to set minimum or maximum prices.¹⁸³ Argentina has comparable rules for the price to be paid to wine producers.¹⁸⁴ Moreover, in the European Union, where all sugar beet production must be through contract farming, the applicable regulation sets a minimum price.¹⁸⁵

Rather than setting minimum or maximum prices, and depending on the particular context, one option would be to require the parties to agree on a base price reflecting production costs, and then allow them to negotiate on any potential margin above it. This could ensure the financial sustainability for the producers. Legislation may also require the parties to tie the price to an existing price index. The price of the commodity could, for example, be tied to the price as reflected in the local commodities exchange at the time of delivery. This would neutralise the imbalance in bargaining power between the parties, and ensure that the price to be included in the contract

181 Malawi. Sale of Goods Act, (48:01), Section 10.

182 Uganda, Coffee Regulations Statutory Instruments No. 261 of 1994, Regulation 25, Section 8 (2).

183 Malawi: Meat and Meat Products Act (67:02), Article 4(e); Malawi. Milk and Milk Products Act (67:05), Article 3 (b).

184 Argentina. Contratos de elaboracion de vinos, (Ley 18.600), Article 4.

185 European Union. Regulation (EU) no 1308/2013 of the European Parliament and of the Council, of 17 December 2013 establishing a common organisation of the markets in agricultural products and repealing Council Regulations (EEC) No. 922/72, (EEC) No. 234/79, (EC) No. 1037/2001 and (EC) No. 1234/2007, Article 135.

mirrors the product's market value. On the other hand, linking the price to markets increases risks of price volatility, leaving the profit of both the producer and contractor subject to market price fluctuations. In France, the criteria and modalities of price determination reference one or more public indicators of the cost of agricultural production that reflect the diversity of conditions and systems of production, and one or more public indicators of the price of agricultural or food products. These indicators can be defined by any structure that gives them a public character and they can be local, national or regional.¹⁸⁶

Price payment

General contract law often provides default rules for the method and timing of payment. In addition to these general rules, there may be circumstances in agricultural production for which the legislation may need to provide more detailed requirements, so as to discourage late payments or to take into account the financial capabilities of the parties. Default rules in general contract law often require the payment to take place immediately after the delivery or at the demand of the producer, given that the producer has fulfilled its corresponding obligations. As with default rules in general, this allows the parties to draft payment clauses that best suit their situation, but may allow the stronger party to draft the clause to their own advantage. In Finland, if the time of payment cannot be determined from the contract, the contractor must pay the price on the demand of the producer. This is qualified with the requirement that the producer must have made the goods available to the contractor before requesting payment.¹⁸⁷ In Malawi, the payment should be concurrent with delivery.¹⁸⁸ Similarly in Chile, the payment is tied to the delivery of the goods and must be paid at the time and place of the delivery of the goods, unless the parties have agreed to an alternative payment schedule.¹⁸⁹

Legislation may also contain more specific rules aimed at agricultural production. For example, legislation may require or allow the parties to stagger the payments so that the contractor does not have to make the whole payment at once, or to provide a more stable source of income to producers, rather than a one-off payment at the end of production cycle. When these are set up as mandatory requirements, the drafting must carefully consider the interests of both parties and provide clear guidance.

186 France. Code rural et de la pêche maritime, Article L631-24 (I).

187 Finland. Sale of Goods Act, (355/1987), Section 29.

188 Malawi. Sale of Goods Act, (48:01), Section 29.

189 Chile. Código Civil (16 Mayo 2000), Article 1872.

Setting up and enforcing these more complex systems may imply significant costs and can greatly limit the parties' freedom to contract. Regulators may need to carefully consider an appropriate balance between the potential benefits of such systems and the resulting increased rigidity. Costa Rica has established a system of staggered payments for different commodities. For coffee bean growing contracts, the applicable law provides a system of provisional and final payments. Provisional payments are made every three months and are calculated based on the sales of the previous trimester. Once a year, a Board of Payments – an organ of the non-state public entity in charge of enforcing the Statute – calculates the final payment that the contractor owes its producers for delivered coffee. The system takes into account various factors, including the contractor's total sales and expenses.¹⁹⁰

Both late payment, or payment through an inconvenient method, may be problematic for rural producers, who may have limited resources outside the contractual arrangement. To ensure that the payment terms are respected, and payments are executed on time, legislation may contain penalties for late payments, such as application of higher interest rates. These may be useful to encourage the contractor to honour its contractual obligations. The US State of Minnesota has introduced such rules for contracts of fresh fruits and vegetables, milk and cream products and poultry. Under the contracts for any of these commodities, payment must be executed either as specified in the agreement or within ten days after taking delivery. A payment received after the due date must include an extra amount of 12 percent annual interest prorated for the number of days past the due date.¹⁹¹ In the State of Punjab (India), the parties may agree on a payment modality, but if the payment is not made immediately after delivery, then it must be made with interest for the late payment up to thirty days. If the payment is not made within these first thirty days, it will be finally recovered as an arrear of land revenue with interest.¹⁹² For livestock production contracts in Belgium, payment must be made in the month of the end of the obligation. After this deadline, the amount due by the contractor will, without the need for a formal request, be increased by the amount of legal interest.¹⁹³

190 Costa Rica. *Ley sobre el regimen de relaciones entre productores, beneficiadores y exportadores de café*, (Ley 2762), Articles 52, 53, 54, 57.

191 Minnesota. *The Minnesota Wholesale Produce Dealers Act*, (§ 27.03 (4)).

192 Punjab, India. *The Punjab Contract Farming Act*, (No. 30 of 2013), Article 5.

193 Belgium. *Loi relative à l'intégration verticale dans le secteur de la production animale*, (1976-04-01/32), Article 9.

An alternative, or complimentary, option for the regulators to protect the producers from late payments, is to either provide the producer with a lien against the goods or to set up guarantee funds through public financial institutions, insurance schemes or payment guarantees to protect producers against insolvency. These are often mandatory obligations for the contractor that cannot be waived (UNIDROIT/FAO/IFAD, 2015). For trade in livestock, meat, poultry and dairy industries, the United States of America has established a statutory trust for the benefit of all unpaid cash sellers until full payment has been received¹⁹⁴ “*provided that any packer whose average annual purchases do not exceed USD 500 000 will be exempt from the provisions of this section*”¹⁹⁵. The same exclusion applies to poultry dealers whose average annual sales or value obtained by purchase do not exceed USD 100 000.¹⁹⁶ In Zimbabwe, every contractor in a grain or oilseed contract is required to submit a performance guarantee at the time of their registration, indicating their ability to provide inputs and purchase the final goods.¹⁹⁷

Insurance

Provisions on agricultural insurance may not always be available and affordable in all countries, and thus require careful consideration by the regulator in each national context. The question of insurance can also reasonably be left to the choice of the parties, who may have better knowledge of which kinds of insurance (if any) are needed and affordable for their agricultural production. If included, the regulator may need to ensure that any requirement to acquire insurance takes into account the available insurance market and the ability of parties to procure the insurance.

In Chile, parties who want to have their agricultural production contract registered in the Voluntary Registry should clearly identify in their contract any products that are covered by insurance.¹⁹⁸ Thus, parties do not necessarily have to have insurance, but when they do, the contract must mention it. In Morocco, insurance clauses are amongst the mandatory clauses to be included in the contract, but the law does not provide specific penalties if the parties do not include them.¹⁹⁹ In Belgium,

194 United States of America. 7 U.S.C. § 196-197.

195 United States of America. 7 U.S.C. § 196-(b).

196 United States of America. 7 U.S.C. § 197-(b).

197 Zimbabwe. Agricultural Marketing Authority (Grain, Oilseed and Products) By-laws, (Statutory Instrument 140 of 2013), Article 5(2).

198 Chile. Ley crea un registro voluntario de contractos agrícolas, (N° 20.797), Article 6.

199 Morocco. Loi relative à l'agrégation agricole, (n° 04-12), Article 10.

each party to an agricultural production contract for livestock raising must insure its animals and installations for their full value against the risks of fire and storms.²⁰⁰ In France, when an insurance policy is taken out in an integration contract, the date and number of the insurance policy, the risks covered, the amount of premiums paid, the name of the party taking out the insurance as well as the name of the beneficiary in case of loss, must be indicated in the annex to the contract.²⁰¹

iii. Excuses for non-performance

Agricultural production contracts are particularly vulnerable to external factors affecting the parties' ability to perform their obligations. Agriculture is threatened by natural events, such as floods, droughts, abrupt climatic changes, or exceptionally low or high temperatures. Any of these can destroy part or all of the producer's goods, thus preventing the producer from fulfilling its obligations. Similarly, though less likely, non-natural events may also prevent either party from performing. These events may be the result of governmental actions, such as major changes in legislation, or from social situations, such as strikes, unrest, or wars. The relatively long duration of agricultural production contracts renders them more exposed to unforeseen events that could prevent either party from performing their obligations (UNIDROIT/FAO/IFAD, 2015).

The term "*force majeure*" refers to an event that is unpredictable, inevitable, beyond the parties' reasonable control and has prevented one party from performing. If such an event renders the obligation significantly more difficult to perform – but not impossible – this is known as "change of circumstances." As these kinds of events may have a potentially drastic impact on the survival of contractual relationships, legislation may need to require that the parties include a *force majeure* clause in their agricultural production contracts. In this way, the parties are forced to consider the effects of these unexpected events, increasing the likelihood that the relationship will survive if such an event occurs. This is the choice in the European Union, where, if the Member States choose that deliveries of certain commodities by a producer to a contractor are to be covered by a written contract between the parties, such contract must include a

200 Belgium. Loi relative à l'intégration verticale dans le secteur de la production animale, (1976-04-01/32), Article 11.

201 France. Code rural et de la pêche maritime, Article R326-7.

clause providing rules applicable in the event of *force majeure*.²⁰² Similarly in France, a *force majeure* clause is mandatory in agricultural production contracts where the transfer of agricultural products is aimed at resale or processing.²⁰³

The applicable legal framework generally provides default or mandatory rules for how these kinds of events affect the parties' relationship, even when the parties do not have a clause in their contract. A common choice is to excuse non-performance caused by a *force majeure* event. In a limited number of legal systems, a change of circumstances (involving a radical change in the equilibrium of the contract) may lead to renegotiations. Besides the single performance, the whole agreement can be considered unenforceable, due to impossibility to perform a central obligation. Legislation should also allocate the burden of proof on one of the parties to prove that the alleged event caused the impossibility to perform. This will most likely be the party directly affected by the event (e.g. the farmer in the case of a natural disaster such as flood/drought/pest outbreak), who is then best placed to collect the required evidence.

Germany provides a common example for many civil codes, where a claim for performance is excluded to the extent that performance is impossible to perform.²⁰⁴ In Russia, when parties have not decided otherwise, a person performing a business activity, who has failed to perform its obligations, or has done so in an improper way, shall bear responsibility for its non-performance. This is excused if the party demonstrates that proper performance was impossible because of *force majeure*, which is defined as extraordinary circumstances impossible to avert under the given conditions.²⁰⁵ In Malawi, when goods perish before the risk passes to the buyer, without any fault of either party, the agreement is rendered void.²⁰⁶

Besides providing excuses for non-performance, or for rendering the contract void, legislation may also provide less disruptive solutions in the case of *force majeure* or change of circumstance event. In order to ensure that the original intentions of the parties are respected, legislation can require that the performance affected by an outside event be suspended,

202 European Union. Regulation (EU) No 1308/2013, establishing a common organisation of the markets in agricultural products and repealing Council Regulations (EEC) No. 922/72, (EEC) No. 234/79, (EC) No.1037/2007, Article 168(4)(c)(iv).

203 France. Code rural et de la pêche maritime, Article L631-24 (III).

204 Germany. Civil Code, Article 275.

205 Russia. Гражданского кодекса, Article 401.

206 Malawi. Sale of Goods Act, (48:01), Section 13(4).

in order to allow the affected party time to overcome the event. After the suspension period, the obligation is either performed, excused, or the entire contract can be terminated, depending on the applicable legal system and the will of the parties. In Belgium, the performance of livestock production contracts shall be suspended in the event of *force majeure*. If the performance is truly impossible, and a suspension would not change that, a judge may terminate the contract.²⁰⁷

Finally, legislation may require that the affected party give notice to the other party. Advance notice can help the other party to prepare for non-performance and help mitigate the negative consequences of a disruptive event. A similar approach is chosen in the United States of America, as can be seen in the Uniform Commercial Code where, to rely on the local equivalent of *force majeure*, the seller must notify the buyer that there will be delay or non-delivery, and, when possible, inform on the estimated amount that can still be delivered.²⁰⁸

iv. Remedies

As used in the 2015 Legal Guide and in this Legislative Study, the term “remedy” refers to any legal recourse provided by law or by contract to protect the interest of an aggrieved party against the consequences of another party’s non-performance (UNIDROIT/FAO/IFAD, 2015). Particularly when contract farming rules are adopted for specific commodities, regulators may find it useful to include provisions in legislation that require the parties to include clauses on remedies in their agricultural production contracts, in order to tackle certain common and/or severe breaches. For example, in El Salvador, every sugar production contract must have penalty clauses, which clearly stipulate the agreed penalty for a breach of a contractual obligation.²⁰⁹ The same law also creates a mandatory remedy of damages, if either the producer or the contractor breaches their delivery-related obligations.²¹⁰ In Belgium, livestock production contracts must contain a clause with a detailed

207 Belgium. Loi relative à l’intégration verticale dans le secteur de la production animale, (1976-04-01/32), Article 14.

208 United States of America. Uniform Commercial Code § 2-615.

209 El Salvador. Ley de la producción, industrialización y comercialización de la agroindustria azucarera de El Salvador, (Decreto N°. 490), Article 33.

210 El Salvador. Ley de la producción, industrialización y comercialización de la agroindustria azucarera de El Salvador, (Decreto N°. 490), Article 33.

description of any compensation in the event of a breach.²¹¹

Regulators may choose to rely on remedies contained in general contract law, if they are deemed to be sufficient. Depending on the legal system, different priorities can be given to different remedies such as damages, specific performance, termination, withholding performance, price reduction and restitution. When the remedies are drafted as default rules, the parties are allowed freedom to choose those that most accurately reflect their individual relationship. To avoid abuses by a more dominant position, the use of certain types of remedies, such as unilateral termination and other unfair practices, may be restricted by legislation (see Chapter 2 Section 2 (b)). When deciding whether to rely on existing general contract law remedies, regulators may need to analyse whether such remedies sufficiently take into account the potential imbalance of the contract farming relationship. General contract laws tend to assume a balanced relationship, or may slightly favour buyers who, in contract farming, are often the stronger party.

One way to facilitate the survival of mutually beneficial relationships, regardless of the level of regulation, is to provide different thresholds for the use of different remedies. For example, termination should be reserved for breaches of contract that are serious or of fundamental terms. Legal systems can also provide for more elaborate sequences of remedies. In this way, the regulator may promote or require the parties to use less disruptive remedies before jeopardising the continuation of the relationship as a whole with the threat of termination. For example, in Finland, the Sale of Goods Act requires that if remedy of the defect or delivery of substitute goods is out of the question or not effected within a reasonable time after the buyer has given notice of the defect, the buyer is entitled to require a reduction of the price or to declare the contract void.²¹² Under this rule, the contractor is first required to allow the producer to cure or provide substitute goods, before using more disruptive remedies. Similarly, in Germany, the Civil Code provides the “right to second attempt”; the contractor shall first and foremost demand cure before it can revoke the agreement or reduce the purchase price and/or demand damages. As a cure, the buyer may require the producer to either repair the product or to deliver substitute goods, if possible and without causing disproportionate expenses.²¹³

211 Belgium. Loi relative à l'intégration verticale dans le secteur de la production animale, (1976-04-01/32), Article 3.

212 Finland. Sale of Goods Act, (355/1987), Article 37.

213 Germany. Civil Code, Article 439.

v. Duration, renewal and termination

Duration

There are at least four different modalities for legislating the duration of an agricultural production contract: no requirements for the duration; requiring that the parties determine a duration; requiring that the duration be tied to the natural life cycle of the products; and legislation setting minimum and/or maximum duration for the contracts. Thus, legislation may allow the parties to choose whether or not to include a duration clause in their contracts. When no duration is included in the parties' contract, the contract would often be considered to be of indefinite duration. Such contracts would be valid until all the relevant obligations are performed, or until the contract is otherwise terminated. Care may need to be taken to ensure that the parties have a comparable amount of bargaining power, so that their final choice accurately reflects their mutual will, rather than being imposed by the stronger party.

When legal systems require that the parties include a clause on duration in their contract, the law would not necessarily impose any restrictions on how long or short the duration is, but the parties must have clearly agreed to it in their contract. As with the first option, it allows the parties to choose the duration themselves, which preserves their contractual freedom but may allow a stronger party to impose its will. In poultry production contracts in the United States of America, the contract between the parties must clearly specify its duration.²¹⁴ In Chile, in order for the contract to be registered in the voluntary registry, the contract must have a fixed duration.²¹⁵ The actual duration in both cases is left to the intention of the parties, as long as it is not indefinite.

Requiring that the duration of the agricultural production contract be tied to the life cycle of the underlying commodity may help to ensure that the contract's duration is appropriate in relation to the time needed for the production to take place. It may not be particularly useful for contract farming related rules that are to apply across multiple commodities, as their life cycles may vary greatly. This is the approach chosen in Morocco, where the contract must have a clause on duration, on pain of nullity. To establish the duration, the parties must take into account the nature of the agricultural activities. Further, the law also requires that if the producer

214 United States of America. Packers and Stockyards Act, 9 Code of Federal Regulations § 201.100 (c).

215 Chile. Ley crea un registro voluntario de contractos agrícolas, (N° 20.797), Article 2.

has a lease on immovable property relevant to the production, the duration of the agricultural production contract cannot exceed that of the lease agreement.²¹⁶

Legislation may apply strict minimum or maximum durations on agricultural production contracts, either in general or only for certain sectors or commodities. Clear requirements can prevent the parties from using contracts that are too short to be profitable for the weaker party, or ones that tie the parties together for a very long period of time. The latter becomes particularly problematic if termination of the contract is difficult. This exercise may be easier in singular sectors, where the production usually takes a comparable amount of time. In Belgium, the law related to livestock production under contract allows for indefinite contracts. If the parties conclude a livestock production contract for a fixed period, the duration must not exceed three years, except as to enable the parties to complete on-going service, such as finish raising cattle.²¹⁷ Such legislation in general limits the duration of fixed contracts to a set length, but includes a provision of flexibility, allowing parties to adjust the period to their individual needs. France has set a minimum duration of three years for fruit and vegetable production contracts²¹⁸ and five for milk production contracts,²¹⁹ while requiring that for agricultural production contracts in general, the minimum duration cannot exceed five years.²²⁰

Considering the often long duration of agricultural production contracts, the legislation may also require the parties to revise its content from time to time to ensure that it still matches their intentions as the surrounding circumstances might have changed. These mandatory revision requirements would not provide for an outcome, but merely require the parties to re-negotiate and potentially adjust their contract. The revision requirement may be general, or aimed at certain key clauses, such as price. In Morocco, the legislation applicable to contract farming provides for a possibility for the parties to introduce periodic revision clauses.²²¹

216 Morocco. Loi relative à l'agrégation agricole (n° 04-12), Article 9.

217 Belgium. Loi relative à l'intégration verticale dans le secteur de la production animale (1976-04-01/32), Article, 5.

218 France. Décret n° 2010-1754 for the application of Article L. 631-24 of the code rural et de la pêche maritime in the fruit and vegetable sector, paragraph 5.

219 France. Décret n° 2010-1753 for the application of Article L. 631-24 of the code rural et de la pêche maritime in the dairy sector, paragraph 5.

220 France. Code rural et de la pêche maritime Article L631-24, paragraph 7.

221 Morocco. Loi relative à l'agrégation agricole, (n° 04-12), Article 9.

Renewal

When the contract reaches the end of its duration, the parties may wish to renew it. While strict adherence to the principle of freedom of contract would merely allow the parties to decide whether and how to renew their contract, legislation may provide at least some guidance on how the agricultural production contract can be renewed. These kinds of rules can involve requiring the parties to have a clause on renewal of their contract, regulating the possibility for automatic renewal and limiting the power of one party to unilaterally renew the contract.

By requiring the parties to include a clause on renewal in their contract, legislation can ensure that the parties carefully consider the possibility of continuing their relationship after contract expiry. Merely requiring the contract to include a renewal clause can allow the parties to choose whichever mode of renewal best fits their individual relationship. The Italian law that regulates agrifood markets covers agricultural production contracts and requires that all agricultural production contracts provide for a mechanism for renewal.²²² A similar rule requiring a renewal clause can also be found in the French rural and fisheries code.²²³

As discussed in the 2015 Legal Guide, multiple short-term contracts that are automatically renewed may, in some legal systems, end up being considered a single, long-term contractual relationship. This can lead to uncertainty over the exact nature of the relationship and can have implications on contract termination, obligations and more (UNIDROIT/FAO/IFAD, 2015). One way of countering this uncertainty is to place limitations on the parties' right to automatic renewal, either for agricultural production contracts or for contracts in general. As this limits the parties' contractual freedom, the domestic regulator may need to consider carefully whether the domestic legal tradition and the overall context supports such rules. In Belgium, the law covering livestock production under contract explicitly states that a contract concluded for a fixed period is never automatically renewed. Rather, if such a tacit renewal takes place, by law, the contract is considered one of an indefinite duration.²²⁴ France has chosen to promote renewal by written consent, by requiring that no contract may be renewed by tacit agreement for a period exceeding one year.²²⁵

222 Italy. *Regolazioni dei mercati agroalimentari*, (102/2005), Article 11.

223 France. *Code rural et de la pêche maritime*, Articles L.326-6 and R.326-1.

224 Belgium. *Loi relative à l'intégration verticale dans le secteur de la production animale*, (1976-04-01/32), Article 5.

225 France. *Code rural et de la pêche maritime*, Article L.326-7.

Allowing just one party to decide whether a contract is renewed may be problematic, as it may lock the other party into a potentially unprofitable relationship for an extended period of time. This may be particularly harmful in contract farming, when the imbalance of negotiation power may force the producer to accept such a clause from a stronger contractor. This can be seen as providing the contractor with an excessive advantage without a proper justification, and thus be considered unenforceable in certain legal systems (UNIDROIT/FAO/IFAD, 2015).

Termination

For legitimate reasons, parties may not wish to be tied by their contract for the whole of its original duration. Therefore, they may wish to terminate the contract. For the purposes of this section, termination refers to all cases where the parties can bring the contractual relation to an end, except for when termination is used as a remedy for a breach of contract, or as an outcome for an excuse for non-performance.

It is not always necessary for the regulator to include rules on termination in the rules specifically applicable to contract farming; general rules applicable to termination of contracts of any type can also be applied to contract farming, which may provide sufficient legal basis for termination. Typically, these general rules allow termination by the joint decision of both parties, or as a choice of just one of the parties if certain pre-requisites, such as notification, are followed. Allowing unilateral termination without these requirements may be problematic, particularly if the other party has not yet had a chance to recuperate its investments. In all cases, clear rules related to termination can help the parties to understand the modality in which the relationship can be ended. One way to ensure that the termination of the contract is governed by clear rules is to require that all agricultural production contracts include a clause on termination. Within the framework provided by the legal system, this would allow the parties to decide how and when the contract can be terminated. For example, in France, a termination clause is mandatory for agricultural production contracts,²²⁶ as it is in Spain.²²⁷

Joint agreement by the parties may be considered as the simplest method for terminating a contract, as it flows directly from the universally accepted concept of freedom of contract. In contract farming however, imbalances in negotiation power can in some cases render the existence

226 France, Code rural et de la pêche maritime, Article L326-6.

227 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria, (12/2013), Article 9.

of true consensus into question. Nevertheless, for the sake of clarity and completeness, the legislation may explicitly state that the parties have the option of terminating their contract by joint agreement. Whether this is considered too obvious to be included in the regulatory framework depends on the national legal system. In Chile, for example, the Civil Code holds that the parties are free to terminate their contract when both parties agree to it. The only pre-requisite is that both parties still have pending obligations; otherwise their choice to terminate would be considered a form of debt-forgiveness by the party that has already undertaken all of their obligations.²²⁸ In Cambodia, the parties can voluntarily and mutually agree to terminate the contract at any time and for any cause.²²⁹ In Russia, the Civil Code provides for the parties' right to jointly agree to terminate the contract. The agreement to cancel the contract shall be legalized in the same manner as the contract itself, unless otherwise decided by the parties or provided by relevant sources of law.²³⁰

As with unilateral renewal, allowing one party to terminate the contract at-will may seriously endanger the other party. In particular, the producer may find it very difficult, if not impossible, to complete production or find an alternative buyer if the contractor decides to terminate the contract without notice. Thus, when the choice to terminate is not mutual, it is advisable to place certain requirements on the parties' right to terminate, either in general contract law or in rules specifically applicable to contract farming.

A common requirement is that the party wishing to terminate the contract provides the other party with notice (period to be prescribed in advance) of its intention to terminate. The purpose of the notice period is to allow the other party to prepare for the termination, such as by starting to search for alternative buyers or by adjusting its production methods. It is good practice to require that notice be in writing, as well as to regulate the notice period. Legislation may allow the notice requirement to be waived if there are sufficiently important reasons for the terminating party to do so. In the US State of Minnesota, if the agricultural production contract provides for termination by one party, reasonable notice needs to be received by the other party. Notification is not needed if the termination is based on a specific event, as agreed in the contract.²³¹ In Brazil, the law governing agricultural production contracts mandates that a contract must have a

228 Chile. *Codigo Civil*, (16 Mayo 2000), Article 1567.

229 Cambodia. *Civil Code*, Article 414(2).

230 Russia, *Гражданского кодекса*, Article 452.

231 Minnesota. *Uniform Commercial Code*, (§ 336.2-309).

clause requiring advance notice in case of unilateral and early termination, and provide a term for the notice that takes into account the production cycle and the amount of investments made.²³² Under the German Civil Code, the party wanting to terminate an obligation must provide advance notice unless they have a compelling reason not to do so. There may be a compelling reason if the terminating party, taking into account all the circumstances of the specific case and weighing the interests of both parties, cannot reasonably be expected to continue the contractual relationship until the agreed end or until the expiry of a notice period.²³³

Regulators may also wish to place further requirements for termination in legislation that are of particular interest for contract farming relationships. As the producer may often be required to make sizable investments, or adopt new commodities and cultivation techniques, the applicable rules may prevent the termination of the contract until the producer has made a reasonable profit, or has gained reasonable expertise for the cultivation of the new crops. When adopted, this restriction should be clearly expressed in legislation, and should be limited to as short a period of time as is reasonable, in order to respect the freedom of contract of the parties. In France, in a contract for the transfer of agricultural products for resale or processing, when the contract is for a product that the producer has been producing for less than the past five years, the buyer cannot terminate the contract before the end of the minimum time period of five years, except in cases of non-performance by the producer or *force majeure*. Notification must be sent in case of non-renewal of the contract.²³⁴

vi. Dispute resolution

For disputes arising from a contract farming relationship, alternative dispute resolution (ADR) or “non-judicial” procedures frequently offer more appropriate solutions than the use of courts. As a result, legislation dealing with supplier-buyer relationships in agricultural and food sector contracts, standard contracts, good practices and codes of conduct, frequently encourage or even require the parties to have recourse to ADR methods. Such methods may involve either amicable procedures (such as mediation) or binding arbitral proceedings leading to a final decision that will be enforceable under the law. By providing clear guidance on how

232 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvopastoris, (Nº 13.288), Article 4.

233 Germany. Civil Code, Article 314.

234 France, Code rural et de la pêche maritime, Article L631-24 (I).

controversies will be settled, by whom and on what basis in a particular context, the regulators can increase the predictability in contract farming relationships, which will in turn foster contract compliance and successful relationships (UNIDROIT/FAO/IFAD, 2015).

Mediation in particular can be a sound approach to disputes arising out of agricultural production contracts. One way to facilitate that the parties rely on mediation is to require them to include a clause on the use of mediation in their agricultural production contracts. Legislation may either allow parties to choose a mediation procedure, or refer, on an optional or mandatory basis, to one particular institution, which has authority for such settlements. This may be a mandatory obligation for the parties or a recommended practice. For example, in Morocco, the applicable legislation requires the parties to use conventional mediation prior to bringing the dispute before any arbitration or judicial authority by mandating that their contract contain a clause requiring mediation.²³⁵ Similarly, in the US State of Iowa, the parties are expected to rely on mediation services as specified in their contract as the primary step for dispute resolution.²³⁶

Instead of mediation, legislation may also encourage or impose upon the parties an obligation to resort to arbitration. Arbitration is attracting increasing interest as an alternative to court proceedings because it is seen as combining the advantages of flexible and expeditious proceedings with the enforceability of judicial outcomes (UNIDROIT/FAO/IFAD, 2015). Certain legal systems have chosen either to encourage or impose upon the parties the obligation to resort to arbitration. As seen in the previous paragraph, in Morocco, arbitration is seen as the potential next step following mediation.²³⁷ In Catalonia, Spain, a dedicated Arbitration Board has been created for contract farming. If parties wish to submit their dispute to the Board, they must agree on it in their agricultural production contract.²³⁸

While judicial dispute resolution tends to be slower and more cumbersome than ADR, it too can be used to settle disputes in contract farming. Countries can create faster procedures aimed at increasing justice efficiency, simplifying judicial proceedings and implementing electronic filing and administration of claims, making them more suitable for disputes arising from agriculture. For example, in Chile, the law covering agricultural

235 Morocco. Loi relative à l'agrégation agricole, (n° 04-12), Article 12.

236 Iowa. Producer Protection Act, September 2000, Section 12.

237 Morocco. Loi relative à l'agrégation agricole, (n° 04-12), Article 12.

238 Catalonia, Spain. Ley de contratos de integración, (2/2005), Article 14.

production contracts requires that the interpretation, application or execution of the contracts regulated by it will be solved in a summary procedure under the Civil Procedure Code.²³⁹ In this case, the parties' dispute would be taken to the regular state courts, but would enjoy a more expeditious procedure, as provided in the rules related to summary procedures.

Countries may also create special agricultural courts, when allowed by the legal system. These courts can be faster and cheaper than regular judicial dispute resolution (see Chapter 2 Section 1). Venezuela has set up agrarian courts, which are responsible for individual claims related to agricultural activity in general and to agrarian contracts in particular. The proceedings under these courts shall be ruled by the principles of immediacy, concentration, brevity, orality, publicity and social character of the agrarian process.²⁴⁰

Individual producers may find it difficult to afford the use of judicial dispute resolution processes, or the courts may be physically located so far as to be impractical to reach. Even with the procedural guarantees incorporated into the system, the real difference in power between the parties may discourage the producers from taking their disputes to the court. One way for legislation to combat this is to allow the producers to take collective action, such as through producer organizations, instead of having to file cases individually. France, as an example, has allowed producer organizations to represent one or more of their members regarding disputes arising out of their agricultural sales contracts, given that the members have given the organization the mandate to do so. The suit must be directed against the same buyer and concern the same contractual clause, for the producer organization to be able to represent its members.²⁴¹

vii. Applicable law

The choice of applicable law is an important clause that legislation should require the parties to include in every agricultural production contract, particularly when the parties reside in different countries. As its primary effect, the choice of applicable law clarifies which legal system, including default and mandatory rules and jurisdiction, is applicable in case of

239 Chile. Ley crea un registro voluntario de contractos agrícolas, (Nº. 20.797), Article 18.

240 Venezuela. Ley de tierras y desarrollo agrario, (Nº. 1.546), Article 155.

241 France. Loi d'avenir pour l'agriculture, l'alimentation et la forêt, (nº 2014-1170), Article 15.

international contracts. In the absence of such a clause, the domestic legal system of the producer would most often be applicable.

The 2015 Legal Guide recommends agricultural production contracts to be governed by the domestic law of the producer, as it would ensure that the producer benefits from the protection of the country's legislation. The producers are often only familiar with the legal system of their own country, heightening the importance of allowing contract farming contracts to be regulated under the producer's domestic legal system. Legislation can even require the parties to choose the country's own legislation as the mandatory governing law for agricultural production contracts.

An example of mandatory choice of law for an agricultural production contract can be found in the Iowa Producer Protection Act. The Act makes any condition, stipulation or provision requiring the application of the law of another State, in place of the Act itself, void and unenforceable.²⁴² Similarly, in Cambodia, the sub-decree on contract farming requires that the agricultural production contract be covered by the provisions of the Cambodian Civil Code.²⁴³

b. Regulatory mechanisms to support contract farming operations

This sub-section provides a non-exhaustive list of elements that regulators may wish to consider to support, encourage or maintain regulatory control over contract farming operations. There may be no need for a government to adopt any of the measures discussed here, particularly when contract enforcement is already robust and support for the weaker party already exists elsewhere in the regulatory framework. The choice on whether to adopt these measures or not depends on the existing regulatory framework as a whole, as well as on the prevailing policy objectives sought by the regulator. The variety of potential options and mechanisms is vast and it is not the purpose of this sub-section to provide a comprehensive list. Conversely, the aim is to identify and describe a number of regulatory options and to provide illustrative examples of how countries have decided to regulate in these areas. This subsection should be read in conjunction with Chapter 3 Section 3.

Legislation may introduce a number of regulatory mechanisms to enhance

242 Iowa. Producer Protection Act, September 2000, Section 11.

243 Cambodia. Sub-Decree on Contract Farming, (No. 36/2011), Article 7.

contractual transparency and to facilitate regulatory control. One way transparency can be enhanced is by requiring the parties to share pre-contractual information before entering into a contract. This information, for example on the expected profitability of the project, can help the parties decide whether the relationship is likely to be mutually beneficial, allowing them to make more informed decisions on whether to join in the contract or not. The extent of information to be shared should be clarified in the legislation, so that the parties know what information will be exchanged. Requiring one or the other party to provide too much information, particularly pertaining to their business practices and models, may diminish their interest in participating in contract farming. In Brazil, in a rule that specifically applies to contract farming, the contractor is obliged to present the producer with a pre-contractual information document. That document must contain information about the production system, such as an estimate of investments required by the producer, health and environmental requirements, estimated levels of compensation for the producer, and inherent economic risks. The document aims at greater transparency even before the contract is signed, by providing the producer information about the risks and potential profits of the project.²⁴⁴

In combination with pre-contractual information, or as an alternative, the legislation may contain provisions allowing the producer to re-consider their decision to enter into a contract for a set period of time after signing the contract. This can allow the producer to seek professional assistance to review the contract in detail, and to withdraw from a signed contract without repercussions. For example, in the US State of Wisconsin, a producer may cancel a vegetable procurement contract by mailing a written notice of cancellation to the contractor within 72 hours after the producer receives a copy of the signed contract, or before a subsequent cancellation deadline if such is specified in the contract.²⁴⁵

As discussed in Chapter 3 Section 3(a), some countries opt to set up a system for the registration of contracts. Registration, whether mandatory or voluntary, can contribute to transparency of the system as a whole and to legal certainty. One of the primary aims of registration may be to bring the parties' transaction under the regulatory framework and to ensure that they abide by form and formation requirements.

244 Brazil. Lei sobre os contratos de integração vertical nas atividades agrossilvipastoris, (Nº 13.288), Article 9.

245 Wisconsin. Vegetable procurement contracts, (Chapter Department of Agriculture, Trade and Consumer Protection 101.02) Section 2.

Legislation may also be used to provide incentives, monetary or otherwise, to facilitate the contract farming sector. An example of non-monetary incentives was discussed in the context of incentives to encourage registration in Chapter 3 Section 3(a). Contract farming legislation may also include other forms of state aid through taxation levies, facilities to access agricultural inputs (such as land), subsidised insurance schemes, or other mechanisms. Regulations and other subsidiary legislation could be used to specify the details on the amount and type of financial incentives. This is the approach in Spain, where the law covering contract farming makes references to “*rules governing aid and grants relating to food and food supply*” when it discusses incentives for the parties, rather than providing the details in the main law itself.²⁴⁶ Similarly in Costa Rica, the implementing regulation for the law covering contract farming in rice production provides that the National Rice Corporation, which is a non-state public actor, is responsible for providing financial support to both producers and agribusinesses.²⁴⁷

Viet Nam has a particularly far-reaching financial support mechanism in place to support both producers and contractors in contract farming, and has opted to include the details directly in the main instrument covering contract farming. **Table 2** summarizes the kinds of financial and other support that the Decision 62/2013/QĐ-TTg envisions (Dang et al., 2014).

246 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria, (12/2013), Article 17.

247 Costa Rica. Reglamento a la Ley N° 8285 de Creación de la Corporación Arrocera Nacional, Poder Ejecutivo de la República de Costa Rica, (Decreto Ejecutivo 32968), Article 7.26.1.

TABLE 2
Viet Nam's financial support mechanism for contract farming

Types of support	Amount
Land	Entrepreneurs and farmers are exempted from fees and rent for lands used for processing factories, store houses, or worker accommodation.
Export and trade promotion	Entrepreneurs and farmers are prioritised for export contracts and temporary storage programs of the government.
Land field planning and improvement	Entrepreneurs receive partial financial support for transport, irrigation, electrical systems.
Plant protection cost	Farmers receive support for 30% of total cost in the 1 st year, 20% of total cost in the 2 nd year.
Technical training cost	Entrepreneurs receive support for 50% of the technical training cost, farmer organization for 50%, and farmers for 100% for one time.
Seed	Farmers receive 30% financial support for seed cost in the first crop.
Storage	Farmers receive 100% financial support for storage for maximum 3 months.

Source: Dang et al., 2015

Beyond incentives, there is a great variety of mechanisms that regulators may choose to use to facilitate contract farming in their country. Through an inclusive legal drafting process, regulators can identify and develop novel solutions for the facilitation of contract farming (see Chapter 3 Section 3(a)). Some examples further analysed in this publication include model contracts (see Chapter 2 Section 1) or private participation in setting up the regulatory framework, through co-regulation (see Chapter 2 Section 3).

c. Enforcement

Regulatory frameworks benefit from efficient enforcement. To achieve an enabling environment for responsible contract farming, regulators should

make certain that contract farming legislation contains provisions ensuring that the rules put in place are also followed and that any infractions are disciplined. A similar sentiment can be identified in the report on contract farming by the Special Rapporteur on the right to food, which finds that governments “*should ensure that regulatory oversight keeps pace with the level of the expansion and the complexity of business models, including small-scale farming*” (de Schutter, 2011, p.20).

Legislation may thus need to specify the consequences of non-compliance with legal provisions that dictate the content and form requirements of the contract. This increases the legal certainty for the parties, and provides them with an incentive to comply with the requirements set in the legislation. A strong incentive for legislative compliance would be to render void any contracts that do not contain mandatory clauses; but this would entail a very harsh consequence in countries with a low level of legal compliance. If this choice is made, the list of clauses may need to be limited to only those that are the most crucial, in order to ensure that parties retain as much of their contractual freedom as possible while simultaneously protecting the interests of the weaker party. Alternatively, legislation may require non-compliant parties to pay fines, or to suffer other administrative penalties. While not as strong as the penalty of nullity, these may sometimes be considered more proportionate penalties. In opt-in regimes based on incentives, the consequence of failing to comply with content requirements would simply be the denial of access to the benefits under the law.

In Morocco, under the penalty of nullity, contracts used in contract farming must contain a number of clauses identified in the law. Also in Spain, the law governing contract farming includes a list of clauses that must be included in the agricultural production contract, although merely meeting formal requirements does not guarantee the existence or validity of the contract. Failure to draw up a written contract and/or failure to include at least the minimum required details in the contract are considered minor offences under the law. The commission of two or more minor offences within a defined time period is considered a serious offence, and the commission of two or more serious offences within a defined time period is considered a very serious offence.²⁴⁸ Depending on the severity of the offence, the penalties range from fines up to EUR 3 000 for minor offences to fines between EUR 100 001 – EUR 1 000 000 for very serious offences.

248 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013), Article 23.

Further, the public administration responsible for the imposition of the fine may also publicise very serious offences as a deterrent.²⁴⁹

To ensure enforcement beyond merely the content requirements in the contracts, the legislation may include provisions related to inspections and monitoring activities undertaken by a public actor to enforce the legislation. Inspections and other monitoring activities may be expensive to undertake, and thus the frequency with which they are used should be carefully considered. On the other hand, a credible threat of inspection, combined with appropriate sanctions when discrepancies are found, can be a strong motivator for the parties to follow both the letter and the spirit of the law. These inspections may be contingent on a complaint by one of the parties, or the public actor may be given the right to launch inspections on its own initiative. Inspections may naturally be extended to any facet of contract farming, and the applicable legislation may require the parties to grant public inspectors access to certain, well-defined, locations or documents. In Punjab, India, the Punjab Contract Farming Commission has quite open-ended powers, which allows it to begin an inquiry into any matter arising out of the provisions of the Punjab Contract Farming Act on its own initiative.²⁵⁰

When these inspections, or other legal means, uncover violations of the regulatory framework, the next step is to provide penalties for these infractions. Commonly, these penalties include different levels of fines to be paid by the infracting party. The more serious the infraction, the higher the fine to be paid. Fines can also be combined with other penalties, such as publicising the name of the company or individual who breached the law. As an example, the Spanish scheme of penalties discussed above, applies also to offences other than failure to include certain clauses in the contract.²⁵¹

Finally, the law should allow the persons subjected to enforcement or penalties a possibility to appeal against the decision, and designate an institution which is responsible for handling such appeals. These institutions may be the same ones as those created to regulate contract farming (see Chapter 4 Section 2) or the regulator may rely on the general or administrative courts to hear the appeals. In the State of Punjab (India),

249 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria. (12/2013), Article 24.

250 Punjab, India. The Punjab Contract Farming Act (No. 30 of 2013), Article 20.

251 Spain. Ley de medidas para mejorar el funcionamiento de la cadena alimentaria (12/2013), Article 23.

any person aggrieved by any order passed under the Act or any of its subsidiary legislation, may appeal to a Commission established by the Act. The Commission shall dispose of the appeal within thirty days after giving the parties a reasonable opportunity to be heard. The decision of the Commission shall be final and enforceable and have force of the decree of the civil court.²⁵²

d. Final provisions

Final provisions of laws generally aim at regulating and facilitating their implementation, including provisions on the issuance of regulations; a provision on derogation of former legislation superseded by the proposed law or amendment; financial provisions; and an indication of the date on which the law will enter into force. These provisions should be drafted according to national legislative practices and the policy objectives of the law as a whole.

252 Punjab, India. The Punjab Contract Farming Act (No. 30 of 2013), Article 24.

Chapter 5. Conclusions

This Study is aimed to provide guidance for governments on how to assess and improve their regulatory framework for responsible contract farming. Responsible contract farming can facilitate the marketing of agricultural products by smallholders and thus create economic wealth, contribute to supply chain efficiency, and help achieve food security objectives. It can function as a tool for rural economic development and support the capacity development of agricultural producers. It can also allow both producers and contractors to sign a contract that is truly mutually beneficial and sustainable, from a financial, social and environmental perspective.

Contract farming has several distinctive features separating it from other forms of contracts used in agricultural production (see Chapter 1). Most important is the contractor's active participation not only in marketing but also in the production phase, which separates contract farming from sales agreements. Other distinctive features of contract farming include the independence of the parties from each other – differentiating it from employment, joint ventures and agreements between cooperatives and their members – and the interlinked nature of their obligations – distinguishing it from contracts for land use. These distinctions, and their associated benefits as discussed in the previous paragraph, justify the consideration of contract farming as a separate and distinct legal field.

In order to do so, regulators need to have full knowledge of and understanding of the legal framework covering contract farming (see Chapter 2), which may or may not involve any specific contract farming legislation. The legal framework includes existing legislation that covers contracting in agriculture and may be found in a variety of sources including general contract law, agricultural laws, commodity-specific legislation, supply chain legislation and specific contract farming legislation, among other sources. In addition, legal frameworks cover other legal areas, which may not necessarily have a direct effect on the contract itself, but may still affect contract farming operations or how they may be regulated (Chapter 2 Section 2). Finally, the private sector itself can and should participate in the creation of contract farming regulatory frameworks to ensure stakeholder participation. It is only by understanding the existing legal framework covering contract farming, that governments can begin to assess the best ways to support contract farming in their own country context.

Governments may support contract farming through a variety of different initiatives, from incentives to direct contract intervention (see Chapter 3). There is no universal need for specific legislation or regulatory reform to support contract farming, but legislation is one of the mechanisms available to governments to create a better regulatory environment for contract farming. In fact, legislation can contribute to achieving certain public policy objectives which may be hard to achieve without a regulatory intervention (see Chapter 3 Section 2). Legislation also facilitates enforceability and gives parties greater legal security and certainty.

Depending on the specific public policy objectives which the government wishes to pursue, the legal reform process may differ in scope and incorporate different elements. For example, legislation may introduce elements that enhance the government's understanding of national contract farming practices and increase transparency by creating a registry for contracts, of the parties, or both (see Chapter 3 Section 2 (c)).

In many contexts, it is often useful if regulatory frameworks for contract farming, whether or not specific legislation exists, contains provisions related to the main elements of the contract farming relationship (see Chapter 4). It is in fact useful for legislation to include a reference to the minimum content or provisions that a contract should incorporate to be considered as a complete agricultural production contract. As identified by the 2015 Legal Guide, these provisions include the parties to the contract, quality and quantity requirements, input supply, price determination and payment, delivery, applicable law and dispute resolution. Alternative dispute resolution mechanisms in particular can be effective as they support the parties access to justice. The substantive elements may also include regulatory mechanisms to support, encourage or maintain regulatory control over contract farming operations. Further, it should always be required that agreements be made in writing.

Well-drafted legislation can also facilitate enforcement. For example, legislation can include consequences for non-compliance with its provisions, such as fines and administrative penalties. Through legislation, inspection and monitoring powers may also be given to appropriate authorities, allowing for a better control of the sector (see Chapter 4 Section 3(c)).

This Study discussed all these elements in detail in Chapter 4, and has provided regulators with ideas and examples from a variety of countries representing all the major legal systems and language families. It is important to remember, that the Study did not analyse the actual impact

of the quoted legislation in the countries, nor did it identify possible issues with enforcement. Therefore, all of the above can only provide general guidance for the domestic regulator interested in revising their regulatory framework for contract farming. An in-depth analysis of the national context by qualified experts is always required, before any of the lessons of this Study can be applied in practice.

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FAO's previous contribution to the development of contract farming saw the publication in 2015 of the UNIDROIT/FAO/IFAD Legal Guide on Contract Farming, which focused on the bilateral relationship between an agricultural producer and a contractor. This Legislative Study develops that research and focuses on the regulatory frameworks for contract farming, aiming to highlight different possible approaches for different contexts.

Responsible contract farming can be a powerful tool for small scale farmers in developing countries to move towards larger scale commercial production. It can create economic wealth, contribute to supply chain efficiency through the production of higher quantities of better quality products, and contribute to achieving domestic food security objectives. Maximizing these benefits while minimizing the inherent risks of contract farming is reliant upon the forging of an enabling environment, a key part of which is the domestic regulatory framework. This Legislative Study provides guidance to domestic regulators and other interested readers on how to appraise and potentially reform domestic regulatory frameworks to achieve responsible contract farming. Recognising that different countries and contextual realities may benefit from different regulatory solutions, this Study provides several examples, supported by representative case studies, on how contract farming can be regulated, without promoting a single solution as the most appropriate.

Please visit FAO's Contract Farming Resource Centre, <http://www.fao.org/in-action/contract-farming/en/>, which is a regularly updated website hosting a variety of material on contract farming both from FAO and from other recognized authors.

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