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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

## **FORMULATING INTERNATIONAL LEGAL GUIDANCE ON CONTRACT FARMING**

### ***The UNIDROIT/FAO Legal Guide on Contract Farming***

Project Note

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## **WHAT IS CONTRACT FARMING?**

Contract farming developed and became common in industrialised countries several decades ago, especially in the livestock production sector, and is now used for a broad array of agricultural commodities in many countries around the world. Contract farming has also recently spread very significantly in many developing countries, especially as a consequence of trade liberalisation and the opening up of these markets to foreign investment. As living standards rise and demand for agricultural products increases, and with consumer markets growing ever more sophisticated, contract farming is expanding as a tool to organise and link production capacities and market needs, to increase and diversify the availability of products on local and global markets, and to improve value chain efficiency. Developing countries have considerable potential as suppliers of sought-after agricultural products at an attractive cost for export markets. They are also final consumer markets with a growing need for large quantities of products to feed their expanding populations, especially in urban areas. For small-scale producers, contract farming offers opportunities to access competitive markets based on the services provided by companies which help to modernise their production capacity.

Under contract farming arrangements entered into with agricultural producers, food processors and distributors secure a supply of a specified produce (vegetables, tree crops, grain, husbandry and dairy products, fish, etc.) in the required quantity and quality, at a future designated time and at a predetermined price. Depending on the type of agreement, the contractor very often provides inputs (seeds, fertilisers or young animals) and may also manage the production process by requiring the producer to apply designated technology and growing or raising methods. This enables the contractor to coordinate production and ensure efficiency gains without holding equity in the producer's activities and without bearing the financial and legal constraints that full vertical integration would entail. Independent entrepreneurs, medium-scale firms, and cooperatives may all participate as contractors. In general, major transnational corporations in the food processing and marketing industry play a prominent role either as direct contractors, or indirectly as the leading managing party in the supply chain.

For farmers, contract farming offers the opportunity of a more stable revenue stream through guaranteed market access, in particular to specialised segments which offer the opportunity of higher prices. Generally, contracts work as a credit vehicle when inputs are provided by the firm or the contract proceeds may serve as collateral to obtain funding from a banking institution. Higher yields and better quality derive from the extension services and technology supplied by the contractor. Sustainable contracts enable farmers to share production risks, promote stable relationships and contribute to improving farmers' capacities. Producers that are parties to a contract farming arrangement may vary widely as to economic power and legal structure, from independent producers to cooperatives, and from smallholder farmers and producer organisations to medium-scale agricultural companies.

The advantages of contract farming are generally widely recognised, given its potential to sustain and develop the production sector by contributing to capital formation, technology transfer, increased agricultural production and yield, and economic and social development. Final consumers may also draw substantial benefits from varied and stable sources of supply and well-functioning processing and marketing chains. Governments are increasingly mindful of the role that contract farming can play in agricultural development and enabling policies are put in place to attract private sector investors and to coordinate ventures with local producers, sometimes under public-private partnerships.

## **THE IMPORTANCE OF THE LEGAL FRAMEWORK**

Contract farming arrangements reflect multiple commercial practices and their success depends on many elements. One key element is the capacity of the parties to build stable, commercially sound and fair relationships, based on clear commitments and mutual compliance. For both parties, major interests are at stake in ensuring a mutually beneficial relationship based on collaboration and trust.

Ensuring fair relationships is all the more important in view of the imbalance of economic power between the parties which generally characterises agricultural contracts. Typically, large processing or marketing companies with sophisticated management capabilities deal with large numbers of small or medium-scale producers, thereby spreading their risks of loss, while producers engage in an exclusive relationship with the firm and may have little or no opportunity to contract with another potential party if the contract fails or is not renewed. Producers are largely dependent upon natural factors and financial constraints, and may generally lack the skills or information needed to operate in the larger economic or business environment; for example, market data may have direct implications for the contract terms, in particular the price.

The cornerstone of the relationship is the agreement. When the contract is concluded, ensuring clear and fair allocation of risks, liabilities and economic returns, and predictable conditions regarding both performance of the contract and possible non-performance events is essential to sustainable relationships and financial benefits in the long term. How the parties organise the many aspects involved in their future dealings plays a crucial role in their ability and willingness to meet their commitments and to find solutions when performance is hindered. In this respect, the legal framework is essential to give legal effect to the parties' stipulations and to supplement them, as the case may be. Also, depending on each legal system, legal provisions may apply to certain aspects of the contractual relationship, excluding the parties' ability to derogate from such provisions. The legal framework regulates a vast number of aspects relevant to the contract farming relationship, such as the legal capacity of the parties, third party rights, tort liability, regulatory prescriptions regarding, for example, labour and food safety matters, etc.

Understanding the interplay between the terms and practical implementation of the contract and the applicable legal provisions certainly increases the security of the parties by making them aware of possibly critical issues regarding their rights and remedies throughout the life of the contract. However, in view of the particular nature of the relationship involved in agricultural production, contracts where parties are linked through a variety of reciprocal obligations which may be seen as falling under different legal categories, determining the legal regime applicable to one or another aspect of the relation or to the contract as a whole may not be straightforward. Different approaches would apply depending on the legal system and what types of contract are available under domestic law. In some countries, *ad hoc* legislation has been enacted to create a special type of contract and applies specifically designed provisions to certain aspects of the relationship. Although different in scope, such legislation generally imposes minimum requirements as to contract form and content, essentially to ensure that producers are fully informed of their future obligations, and establishes dispute resolution mechanisms intended to provide adequate enforcement of contracts and enhance voluntary compliance.

## PROJECT OVERVIEW

**History:** Based on consultations with the Food and Agriculture Organization (FAO) and the International Fund for Agricultural Development (IFAD), and building upon the contributions made at a colloquium organised by UNIDROIT in Rome in November 2011 on "Promoting Investment in Agricultural Production: Private Law Aspects," the UNIDROIT Governing Council, at its session held in Rome in May 2012, agreed that UNIDROIT could usefully contribute its contract law expertise to the development of contract farming by preparing a legal guide on contract farming operations.

**Objectives:** The forthcoming Guide has three broad objectives. First, it will provide a legal analysis of the type of arrangement upon which the contract farming relationship is based, as well as information and advice on good contract practices with a view to promoting the legal empowerment of agricultural producers during the negotiation and drafting of contracts. Second, the Guide also aims at providing advice for law makers and public authorities dealing at a public policy level with contract farming, in particular in the context of law reform. Last, the Guide is intended to serve as an additional tool available to international organisations and bilateral cooperation agencies, as well as nongovernmental organisations and farmers' organisations, engaged in strategies and capacity building programs in support of contract farming, especially in developing countries. Accordingly, the Guide will offer a thorough analysis of substantive law issues in different kinds of arrangements or for a particular type of contract to be precisely defined, and it will identify problem areas and possible solutions in light of current trade usages and legislation.

**Project Partners:** The International Institute for the Unification of Private Law (UNIDROIT) is an intergovernmental, Rome-based organisation specialising in the harmonisation and modernisation of private law rules at the global level, through international treaties and soft law instruments in various areas. UNIDROIT has earned widespread recognition from its activities in the contract law area, in particular with the *UNIDROIT Principles of International Commercial Contracts* which are being used in commercial practice and arbitration and as a reference in domestic legislative reforms.

In view of its expertise and extensive field work in the area of contract farming, *FAO* has decided to join UNIDROIT as a partner and co-author of the Guide. *FAO* devotes considerable resources to contract farming by implementing national and regional development programmes, issuing publications and running a Contract Farming Resource Centre on the *FAO* website which gives access to bibliographical references, contract samples and general legal documents (<http://www.fao.org/ag/ags/contract-farming/index-cf/en/>).

*IFAD* mobilises and deploys resources to alleviate rural poverty; in this context, promoting the inclusion of small-holder farmers in agricultural value chains and access to markets is one of the priority objectives to which contract farming can significantly contribute. *IFAD* has provided support through the sharing of expert knowledge and the participation of delegations of experts providing comments and inputs on the drafts. In addition, *IFAD* is providing substantial support to the preparation of the Guide through a grant to *FAO* (recipient).

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

**Publication Drafting:** In accordance with the UNIDROIT Governing Council's decision, UNIDROIT established a Working Group composed of experts representing different regions and legal backgrounds, to ensure the preparation of a high quality and balanced instrument. The drafting process also relies upon the active cooperation of partner multilateral organisations and an appropriate representation of producer and agribusiness interests. The Working Group held its first meeting in Rome from 28 to 31 January 2013, its second meeting from 3 to 5 June 2013, and its third meeting from 3 to 6 March 2014. The Working Group has prepared a rough draft for all chapters, and the UNIDROIT Secretariat is presently revising the full publication. The Working Group will hold its fourth and final meeting in November 2014 to finalize the draft publication. The final version of the Guide will be approved for publication in early 2015.

**Consultations:** UNIDROIT and its partner organizations will conduct a round of consultations during 2014 to present and discuss the prospective content of the publication with the interested communities of agricultural producers and private sector representatives, and broaden the basis of knowledge for use in preparing the Guide. The first consultation event was held during the WFO General Assembly meeting in March 2014 in Buenos Aires, Argentina.

Several additional consultation events will be held in late 2014. First, in late September UNIDROIT will solicit comments on the "zero draft" of the revised Guide chapters by making the documents available on the UNIDROIT website for a defined comment period. Next, UNIDROIT is organizing a consultation event focused on the legal dimension of contract farming in the context of the Asian region. This consultation event will take place in Bangkok, Thailand on 26 September 2014. It will include a broad range of stakeholders from the private and public sectors. The event benefits from kind support by the European Union for simultaneous interpretation in Thai/English.

On 10 October 2014 in Rome, Italy, UNIDROIT will implement a consultation event that focuses on issues and concerns specific to the private agribusiness sector. This event will bring together a range of representatives of agribusinesses from major sectors and regions. It will include sessions on private sector commitments in good contract practices, procurement policies, and special issues in contract farming of particular concern to agribusiness companies.

Lastly and similar to the Bangkok consultation for the Asian region, UNIDROIT will hold a consultation event focused on the legal dimension of contract farming in the context of the African region. The event will be held in Addis Ababa, Ethiopia on 31 October 2014. Sessions at the event will cover an economic and legal introduction to contract farming, the legal framework for producer-buyer relationships, as well as legal topics covered in the chapters of the Guide.

Comments received during each of the consultations will be considered by the Working Group during its fourth meeting in November 2014.

(Updated 1 September 2014)

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