

Contracting agricultural production

The town of Melka Awash is located in Ethiopia's Oromia region, on the banks of the Awash River about 50 km south of Addis Ababa. Since 2005, the Melka Awash farmers have been organized in a cooperative union that now has more than 30,000 members who produce wheat, malt barley, teff and chickpea on individual plots averaging 2 to 3 hectares. In 2012, British beer producer Diageo plc acquired Ethiopia-based Meta Abo Breweries and decided to source its raw materials locally. Diageo-Meta signed production contracts with members of the Melka Awash Cooperative Union to procure 1,000 metric tons of malt barley. Using the seeds and fertilizers provided by Diageo-Meta, the farmers of Melka Awash now have a secure output for their malt barley production, and the brewer can count on a reliable supply of raw materials.

The Food and Agriculture Organization (FAO) of the United Nations, in its *Guiding Principles for Responsible Contract Farming Operations*, defines contract farming as “agricultural production carried out according to a (formal) contract between a purchaser and a farmer which establishes conditions for the production and marketing of a farm product or products.”¹ Contract farming has been used increasingly in both developed and developing countries as globalization, population growth and the development of rural infrastructure have opened new market opportunities for high-value crops, certified crops and livestock production.² In Brazil, for example, 75% of poultry production is under contract. In Vietnam, 90% of cotton and fresh milk, 50% of tea and 40% of rice are purchased through contracts. Governments are also promoting contract farming in China, India, Latin America and several African countries.³

A key feature of contract farming is that it establishes backward linkages, which can involve credit for farming inputs, extension or other services to producers. It also facilitates forward market linkages where producers have a guaranteed buyer for their goods and buyers secure consistent supplies at a reasonable price and desired quality. Such arrangements offer mutual gains to the contracting parties and are a cornerstone of market-led, commercial agriculture.⁴

Contract farming can be a particularly effective approach to increase the participation of the farm sector in the market. Farmers often have limited capacity to produce high-quality products at competitive costs and often lack access to information, skills, technologies and other infrastructure needed to reach urban markets. Well-managed contract farming can help farmers solve many of these bottlenecks, while increasing their profitability.⁵

However, implementing and managing sustainable contract farming arrangements present myriad challenges. Among these is the economic power disparity between contracting parties. The contractor, typically a large processing or marketing company, may be in a position to impose contract terms that favor his or her interests. Meanwhile, the producer, generally a small to medium-scale farmer, may not be in a position to fully understand, negotiate or assess the extent and implications of the contractual obligations.⁶

Another challenge is the possibility of voluntary breaches of contract—opportunistic attempts by either party to obtain benefits or escape liabilities that result in either failing to meet their contractual obligations. The contractor may provide the farming inputs with a delay or in an insufficient quantity, with negative consequences on yields. Disputes can also arise over the grading of products, which can adversely impact the sales price. For their part, producers can divert the contractor's inputs to other uses or sell the production to other buyers in violation of the contract (also known as “side-selling”).⁷

Contract farming arrangements are also subject to compliance with domestic labor laws and standards governing the use of fertilizers and pesticides. The balance, or lack thereof, of bargaining power between large buyers and small producers is also central to the contract farming analysis.⁸

Governments have an important part to play in addressing some of these challenges. Among other supportive interventions, they can put in place policies that aim at attracting private sector investors, coordinate ventures with local producers, and promote cooperation between farmers and the farmer organizations that link them to agribusinesses. In addition, governments need to shape a clear legal framework that

will promote predictability and reduce uncertainties in the event of nonperformance of the contract terms, which is crucial to sustain business relationships. Furthermore, strengthening dispute resolution mechanisms that are quick, accessible and efficient can also encourage broader uptake of contract farming.⁹

What the contracting agricultural production data focus on

The contracting agricultural production data cover laws and regulations that apply to contract farming agreements, whether production contracts or marketing contracts. Four data sets have been developed, as follows:

1. *Regulatory framework for contract farming.* These data identify the laws regulating contract farming agreements. In particular, the data focus on whether or not there is ad hoc legislation with the specific purpose of regulating contract farming agreements and what other laws or set of laws apply to such agreements.
2. *Contract specifications.* These data identify which of a set of contract specifications are regulated by the laws that govern contract farming agreements. The data focus on specifications that are crucial for these agreements: the quality and quantity of the contracted production, the methods for determining prices and making payments, and the delivery of products. The data differentiate between mandatory rules (rules that the parties cannot waive or alter by agreement) and default rules (rules that apply only if the parties decide not to alter them).
3. *Procedural requirements for contract farming.* These data show whether the

laws and regulations establish registration requirements either for the contracting parties or for the contract itself.

4. *Dispute resolution mechanisms.* These data establish whether there is a specialized dispute resolution mechanism for disputes arising from contract farming agreements and whether mediation is required before any arbitral or judicial proceedings.

What the initial pilot results show

The analysis of how contract farming is regulated reveals noticeable variations across the 10 pilot countries. These variations are reflected in diverse rules and requirements regarding contract specifications. Some countries establish specific institutional mechanisms to oversee and monitor the practice of contract farming and address disputes arising from contract breach.

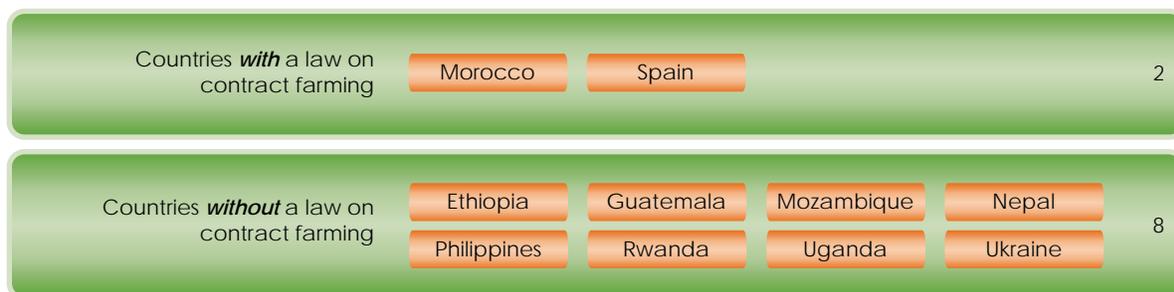
Ad hoc contract farming laws are found in only 2 countries—Morocco and Spain

Countries tend to take 2 different approaches to regulating contract farming, reflecting domestic legal traditions and the period in which the legislation was drafted. Ad hoc laws suggest a view that contract farming agreements

have particularities requiring a specific set of regulatory provisions. By contrast, reliance on the existing legal framework of contracts and obligations signals a perception that broader norms are sufficient to regulate contract farming agreements.

Two countries—Morocco and Spain—have ad hoc legislation on contract farming (figure 9.1). There are, however, noticeable differences between the regulatory environments established in these countries. Morocco has a new law on farming aggregation with detailed provisions covering issues from formulating to implementing a contract.¹⁰ The Law of 2012 is a pillar of the *Plan Maroc Vert (Green Morocco Plan)*. It aims at promoting agricultural projects that group, for a definite time period, several aggregated parties and one aggregator for the production, the conditioning, the processing or the commercialization of agricultural products.¹¹ In addition, such agricultural projects must seek at least one of the following objectives: technical training of producers and pooling of the means of production or inputs; facilitated access to financing and/or insurance; or facilitated access to domestic and export markets, either for direct consumption or transformation.¹² On the other hand, Spain introduced a law on standard contracts in 2000¹³ and a law on measures to improve the functioning of the food supply chain in

FIGURE 9.1: Specific laws on contract farming exist in only 2 countries



Source: *Enabling the Business of Agriculture* database.

2013.¹⁴ These laws, together with the Spanish Civil Code, govern different aspects of agricultural production contracts. The Law of 2000 focuses on standard contracts that are approved by the government and are applicable for marketing and production contracts in a designated sector. The Law of 2013 complements it by regulating all marketing and production contracts, including standard contracts.

Among the remaining 8 countries, only Nepal has demonstrated an intention to put in place specific legislation to facilitate agricultural production under contracts. The Nepalese Ministry of Agriculture and Cooperatives recently prepared a draft law on contract farming that, if passed by parliament, could potentially provide a clearer legal framework for producers, farmer organizations and agribusinesses engaging in contractual relationships. In 4 countries—Ethiopia, Guatemala, Mozambique and the Philippines—agricultural production contracts are governed solely by the civil code. In Uganda, the Sale of Goods Act of 1932 and the Contracts Act of 2010 are the principal laws on contract farming, while in Nepal and Rwanda, it is a combination of the Civil Code and the Contract Act.

In addition, some countries have established product-specific legislation that sets conditions and requirements that have an impact on production and marketing contracts for the targeted commodity. In Uganda, for example, product-specific acts organize the production and commercialization of cotton, dairy, coffee and tobacco, setting requirements for producer, trader and processor registration, input distribution, or product grading.¹⁵ In other countries, agricultural development programs can regulate contract farming for a targeted population of producers. For example, under the Philippines' 2006 Rules and Regulations Governing Agribusiness Venture Arrangement

in Agrarian Reform Areas of 2006, entrepreneurs can contract with the beneficiaries of the Comprehensive Agrarian Reform Program for the production of crops.¹⁶

Different regulatory solutions exist for specifying product quality, price determination, payment and delivery in contracts

Contracts are, by definition, incomplete simply because they cannot consider all contingencies. Default rules established by law are a way to fill in the gaps of an incomplete contract. Mandatory rules, by contrast, limit the parties' freedom of contract with the aim of protecting either the parties or third parties outside the contract.

In Mozambique and Uganda, the law establishes neither default rules nor mandatory rules on whether the contract should specify the quality of the product (table 9.1). Four other countries—Ethiopia, Guatemala, Nepal and Rwanda—have default rules. In Nepal, for example, the Contract Act states that if the contract does not mention the quality of goods, their quality should be of the "current standard." In Rwanda, the 1888 decree on contracts and conventional obligations requires that the seller guarantee that the quality of the goods conforms to their intended use.

In 4 countries—Morocco, the Philippines, Spain and Ukraine—the law makes it mandatory to specify the quality requirements of the goods. In Ukraine, the Economic Code states that a business agreement should specify the quality requirements for the contracted product. In Morocco, under the Law of 2012 on agricultural aggregation, a contract is valid only if it includes the quality requirements set by the buyer. In Spain, Law 2/2000 stipulates that standard contracts are homologated only if they clearly define the quality of the contracted goods.

TABLE 9.1: Default and mandatory rules for contract specifications

Country	Default or mandatory rule exists for					
	Definition of the product's quality	Price determination	Payment time	Payment place	Delivery date	Delivery location
Ethiopia	■	■	■	■	■	■
Guatemala	■	■ (mandatory)	■	■	■	■
Morocco	■ (mandatory)	■ (mandatory)	■ (mandatory)	■ (mandatory)	■ (mandatory)	■ (mandatory)
Mozambique		■	■	■		■
Nepal	■	■	■			■
Philippines	■ (mandatory)	■ (mandatory)	■	■	■	■
Rwanda	■	■	■	■		■
Spain	■ (mandatory)	■ (mandatory)	■ (mandatory)	■ (mandatory)	■ (mandatory)	■ (mandatory)
Uganda		■			■	■
Ukraine	■ (mandatory)	■ (mandatory)	■		■	■

Source: *Enabling the Business of Agriculture* database.

Note: Blanks = no mandatory or default rules.

In all 10 countries, laws applicable to contract farming agreements address price determination. Ethiopia's Civil Code provides for default rules when the price of the goods is determined by their weight, their current price or the price usually paid by the seller. Guatemala's Civil Code requires the parties to a sales contract to agree on a price or on a way to determine it. Determination of the price or the pricing method is also mandatory in Morocco, the Philippines, Spain and Ukraine. In contrast, Uganda's Sale of Goods Act provides that if the price is not determined by the parties, the buyer must pay a "reasonable price." Nepal's Contract Act also refers to payment of a "reasonable price," if the parties fail to specify a price or a pricing method.

All countries but Uganda have either a default rule or a mandatory rule on the time of payment,

and in 7 of them, the law also includes provisions on where the payment should take place. Under Morocco's Law 04-12 and Spain's Law 2/2000, a contract is valid only if it clearly stipulates the payment details. In Ethiopia, the Civil Code states that if no place is fixed in the contract, payment shall be made at the address of the seller. In Guatemala and the Philippines, under their civil codes, the payment is to be made at the place of delivery unless the parties agree otherwise; the same requirement applies in Rwanda, under its 1888 decree.

Mozambique, Nepal and Rwanda have neither default nor mandatory rules on the determination of the delivery date. In Ethiopia, the Civil Code establishes that when no delivery date can be inferred from the will of the parties, the seller should deliver the goods as soon as

required by the buyer. In the Philippines, the Civil Code requires the delivery to take place within a “reasonable time,” if no date is specified by the parties. A similar default provision applies in Uganda, under its Contracts Act and Sale of Goods Act.

In Morocco and Spain, in contrast, the contract must specify a delivery date to be valid. The contract must also specify the delivery location. There is no such requirement in the other 8 countries, though default rules apply. For example, Rwanda’s 1888 decree states that, unless otherwise agreed, delivery should take place where the goods were located when the contract was made. Guatemala has a similar default rule under its Civil Code, while Uganda’s Sale of Goods Act establishes the seller’s place of business or residence as the default delivery location.

Few countries require contract registration

On one hand, requirements to register a contract or the parties to a contract create additional procedures along with associated costs and delays. On the other hand, these requirements may be motivated by an intent to oversee the contract farming practice; they can provide a way to monitor the performance records of buyers and producers with past contract farming arrangements. They can also help in gathering statistics on contract farming to improve policies and regulations. Finally, contract registration procedures can include a contract review by a competent authority to ensure that its terms comply with relevant regulations.

Both Morocco and Spain have regulations concerning contract farming. Morocco’s 2012 law on contract farming requires producers and contractors to register with the Regional Directorate of Agriculture and receive accreditation from

the Agricultural Development Agency before entering into agricultural production contracts. Spain has registration requirements for standard contracts. Once a standard contract is agreed upon for a specific sector, it must be registered with the Ministry of Agriculture, Food and Environment (box 9.1).

In Uganda there is no obligation to register contracts with any statutory body. However, contracts can be registered with the registrar of documents, mainly for potential use in litigation.

Spain and Morocco have specific contract farming dispute mechanisms

Institutions specifically designed to resolve disputes arising from contract farming agreements can help ensure that the necessary competence and technical expertise are applied. They can also guarantee balanced representation of the parties’ interests by including representatives of professional or trade associations or farmer organizations. These institutions may also encourage or require mediation before any adjudicating procedure takes place. Mediation offers a quicker, less costly and less formal option for resolving disputes. As an amicable method of dispute resolution, it can also help preserve or restore the business relationship.

Morocco and Spain both provide dispute resolution mechanisms specifically for contract farming, under their respective ad hoc legislation. In addition, the Moroccan law requires that the parties seek mediation before any arbitration or court proceedings can take place. If the parties fail to designate a mediator, the law sets default rules for the appointment of a representative mediation panel (box 9.2). In Spain, the law also details the organization and functioning of a representative monitoring committee in charge of resolving disputes arising from standard contract implementation.

BOX 9.1: Approval of a standard contract in Spain

Under Spain's Law 2/2000, the Ministry of Agriculture, Food and Environment reviews and approves standard contracts before their implementation. Application for standard contract approval can be submitted by registered inter-professional organizations, representative organizations of producers, representative organizations of processors or traders, or individual companies engaged in processing or trading if representative organizations do not exist.^a

The application must be addressed to the Ministry of Agriculture, Food and Environment, and it can be deposited at any public administration office, at the level of the central government, the autonomous community or the local government.^b Applicants must provide the full text of the proposed standard contract, a supporting memo that indicates the contract's geographical scope and estimates of the volume of the contracted production and the total value of the commercial transaction. All the documents are necessary to establish the agreement of the applicants to form a monitoring committee.^c According to Law 2/2000, an application must be submitted at least a month before the beginning of the agricultural cycle.^d The Ministry analyzes the standard contract's viability, its importance and its impact on the sector. The Ministry also ensures that an agreement exists between at least one representative of the buyer and one representative of the seller.^e

Once approved, the standard contract is valid for the specified product and for one year, and the procedure to extend its validity is detailed in the law.^f

Source: Law 2/2000 of 7 January 2000 regulating standard agri-food contracts.

a. Royal Decree 686/2000 of 12 May 2000, amending Law 2/2000 of 7 January 2000 regulating standard agri-food contracts, article 5.

b. Royal Decree 686/2000, article 2.

c. *Idem*, article 3.

d. *Idem*, article 4.

e. Law 2/2000, article 6.

f. Royal Decree 686/2000, articles 7 to 9.

In addition to its dispute resolution role, each monitoring committee fulfills a data collection role. Within a month after the agricultural cycle ends, the monitoring committee must provide the General Directorate of Nutrition with the number of contracts signed under the standard contract; the quantity of goods produced and the corresponding value; an assessment of the overall performance against the stated objectives; the incidence of conflict in contract execution; and the importance of the standard contract for the larger sector.¹⁷

While most of the other pilot countries have general laws on mediation or arbitration, these alternative methods are rarely used to resolve disputes about agricultural contracts, mainly

because such services are lacking in remote rural areas and because producers cannot easily afford their costs. Individuals and companies tend to use other methods to ensure compliance. In Rwanda, for example, coffee production contracts are sometimes signed in the presence of the local mayor, who will help resolve disputes or noncompliance if and when they arise.

Next steps

This chapter presented the initial results of a pilot data set analyzing the laws and regulations that govern contract farming. The information collected across the 10 countries was reviewed and 30 data points were identified to serve as a basis for a revised questionnaire. After further

BOX 9.2: Mandatory mediation in Morocco

Morocco's new law on farming aggregation makes mediation mandatory for disputes arising from agricultural production contracts. The law seeks to encourage the preservation of the business relationship; the parties must try to resolve a dispute through mediation before turning to any arbitral or judicial proceedings.^a

The contract itself must include a mediation clause.^b If the contract does not specify a mediator or a method of designating one, a mediation panel is assembled according to default rules that are clearly stated in the law. The panel must include the president (or a representative of the president) of the regional chamber of agriculture (from the region where the producer lives), a representative designated by the trade association of the relevant sector, and the Department of Agriculture's regional representative, who serves as president of the panel.^c

The law also establishes a clear time frame to avoid lengthy proceedings. The mediation must take place within a month after the dispute is referred to the mediator or the president of the mediation panel. At the end of a successful mediation, the parties receive a conciliation record summarizing its conclusions. But if the mediation fails, the parties receive a nonconciliation record giving them the possibility to seek redress through arbitration or judicial proceedings.^d

Source: Dahir No. 1-12-15 of 27 Sha'ban 1433 (17 July 2012) promulgating Law No. 04-12 on agricultural aggregation.

a. Dahir No. 1-12-15 of 27 Sha'ban 1433 (17 July 2012) promulgating Law No. 04-12 on agricultural aggregation, art.12.

b. *Ibid.*

c. *Ibid.*

d. *Idem*, art. 13.

consultation with contract farming experts and practitioners, indicators will be designed to better capture key issues.

Two dimensions will be prioritized, as follows:

1. To achieve greater comparability between legal indicators, a more refined definition of contract farming will be used in the next cycle. In the pilot phase, a general definition of contract farming covered a range of contractual and organizational arrangements; in the next phase, an indicator will capture important distinctions regarding the parties' obligations under an agricultural

marketing contract and an agricultural production contract.

2. To complement the alternative dispute resolution (ADR) data, the team will construct a set of time and motion indicators to capture the procedure, time and costs of using available ADR methods. While 2 case scenarios were tested during the pilot phase—side-selling and a grading dispute—more detailed and additional case scenarios will help analyze disputes arising from delayed delivery of inputs, delivery of defective inputs, and delayed payment.

Notes

The underlying research and design of the contracting agricultural production topic benefited from valuable comments provided by Steven D'Alessandro, Dieter Fischer, Damien Shiels and Justin Yap.

- 1 FAO 2012a, 1.
- 2 Setboonsarng 2008.
- 3 Da Silva 2005.
- 4 Eaton and Shepherd 2001.
- 5 Da Silva 2005; Jabbar et al. 2007.
- 6 UNIDROIT Secretariat 2013.
- 7 Ibid.
- 8 Ibid.
- 9 Pultrone 2012; UNIDROIT Secretariat 2013.
- 10 Dahir No. 1-12-15 of 27 Sha'ban 1433 (17 July 2012) promulgating Law No. 04-12 on agricultural aggregation.
- 11 Idem, art. 2.
- 12 Idem, art. 3.
- 13 Law 2/2000 of 7 January 2000 regulating standard agri-food contracts.
- 14 Law 12/2013 of 2 August 2013, measures to improve the functioning of the food supply chain.
- 15 Chap. 30, Cotton Development Act; chap.85, Dairy Industry Act; chap. 34, Tobacco (Control and Marketing) Act; chap. 325, Uganda Coffee Development Authority Act.
- 16 Department of Agrarian Reform Administrative Order No. 09-06, Revised Rule and Regulations Governing Agribusiness Venture Arrangements (AVAs) in Agrarian Reform Areas.
- 17 Royal Decree 686/2000, art. 19.