

Subject: Contractualisation

1. DESCRIPTION OF ISSUE

Contracts, in particular long term contracts, as compared to selling on the spot markets, can provide a measure of assurance for the parties subject to the contractual arrangements and, thereby, form part of an effective risk management strategy for farmers and their customers.

For farmers, contracts can offer increased certainty of a defined level of revenue and, if the contract covers delivery and payment terms, can help to better manage cash flow. Pre-sowing contracts enable crop producers to lock in certain costs in advance of physically planting a crop and, therefore, to better plan future plantings and manage risk.

For processors, contracts offer the possibility of ensuring supplies of raw materials of the right quality and for managing deliveries so as to optimise efficiency and reduce costs e.g. through reduced storage requirements.

If applied properly (e.g. duration/periodicity, conditions adapted to the product), contracts can help improve the efficiency of the whole supply chain, allowing producers and processors to lower transaction costs, better programme production processes by adapting to a concrete demand and reducing the disruptive effect of market volatility. It is well known that integrated sectors¹ are more reactive to market signals. Contracts can be seen as a form of flexible vertical integration that preserves the independence of the parties. Longer term contracts can serve as a means for creating stable relationships.

Compliance with contract terms is important in order for the participants to have confidence in the system. Producers (particularly of perishable products) are ill-equipped to deal with last minute variations in contract terms. Processors are moving to lean, just-in-time business models that demand certainty of delivery. Contract compliance and, if necessary, contract enforcement are therefore key issues for farmers and their customers.

In some sectors, the use of standard contracts is well developed and helps to reduce transactional costs e.g. for oilseed rape and malting barley. In other sectors the existence and use of standard contracts is less advanced. The existence of and reliance on such standard contracts, in particular if developed collectively by producers in conjunction with downstream operators, for instance in an IBO setting, can be beneficial for individual producers. Producer organisations, associations of producer organisations, interbranch organisations and co-ops can play a role in drawing-up and promoting the use

¹ Vertical integration describes a company's control over several or all of the production and/or distribution steps involved in the creation of a product or service, e.g. production and processing. This can be done by merging upstream and downstream activities in one company or by otherwise ensuring control over the various activities. E.g. in agriculture, contract farming, in which the production process is controlled by the buyer of the finished product by imposing certain quality standards, is sometimes described as a form of vertical integration.

of standard forms of contracts and contract terms. Under the CMO regulation such standard contracts can be "extended".

Contracts can be very different in kind, from contracts which offer a lot of flexibility to the parties to very 'complete' contracts which regulate every detail of the sales relationship, to contract farming contracts, where production takes place based on quality and delivery requirements specified by the buyer. Sometimes 'framework contracts' negotiated by producer or interbranch cooperations can form the basis of individual delivery contracts thereby counter-balancing the power of downstream operators in respect of certain contract parameters.

Excessive volatility of agricultural prices can be an obstacle to the agreement of long term contracts. Different formulations have been developed to address this (e.g. by linking prices to an index), but such arrangements do not provide the same certainty of return as would a fixed price contract.

Assurance of quality could be an obstacle to successful contracting as agricultural production in certain sectors is heavily weather dependant. Finally, contracts can act as disincentive to efficiency and competition if such contracts would lead to identical prices and the potential stifling of opportunities for new entrants.

2. HISTORY OF REGULATION/LEGISLATION

In general terms, contract law, regulating any form of contractual relations between (legal) persons, is not an EU competence. Member States provide for national rules in this field and, consequently, rules and practices differ amongst them. Having said this, specific provisions have existed in specific sectors in the single CMO Regulation (sCMO)² for many years.

Sugar delivery contracts

Since the inception of the sugar CMO, the buying of sugar beet has been subject to compulsory pre-sowing delivery contracts (individual) and written agreements within the trade (collective)³. The mandatory elements included in delivery contracts and the elements that could be negotiated collectively are fixed in Regulation 1308/2013. Both elements aim at the smooth delivery of sugar beet under conditions that were clear for all participants.

Hops

Until 2014, it was necessary for contracts for the supply of hops concluded between a producer and a buyer to be registered in the Member state concerned⁴ for the purposes of providing information about the hops market.

Milk Package

² Council Regulation (EC) No 1234/2007 establishing a common organisation of the markets and on specific provisions for certain agricultural products (Single CMO Regulation, sCMO)

³ Article 50 of sCMO

⁴ Article 185 of sCMO

The 2012 "milk package"⁵ introduced the possibility for Member States to make compulsory written contracts between farmers and processors and to oblige purchasers of milk to offer farmers a contract of a minimum duration. Such contracts have to be made in advance of delivery and contain specific elements, such as the price, volume, duration, details concerning payment, collection and rules for force majeure. All the elements have to be freely negotiated between the parties and farmers have the right to refuse an offer of a minimum duration in a contract. Certain exemptions exist for deliveries by farmers to a cooperative of which they are a member.

To date, 14 Member States⁶ (see below) have provided for compulsory contracts.

Country	BG	ES	FR	IT	CY	LV	LT	HR	HU	PL	PT	RO	SI	SK
Contract Offer	C	C+O	C+O	C+O	C		C	C	C	C	C+O	C	C	C
Duration	6m	1y	5y	1y	1y	-	-	6m	6m	-	6m	6m	1y	-
Stage to be covered	1 st buyer	all	1 st buyer	1 st buyer	all		all	all	all	1 st buyer	all	1 st buyer	all	all
National legislation, date planned or adopted	Nov 2013	Oct 2012	April 2011	March 2012	June 2013	Not any longer since 1 April 2015	Oct 2012	June 2013, amended 2015	Dec 2012	Oct 2015	June 2013	Feb 2014	Jan 2015	Oct 2015

2013 CAP reform

As regards contractualisation, in the last CAP reform the Legislator decided the following in the new CMO Regulation⁷:

- to continue to require post-quota that the terms for buying sugar beet, including pre-sowing agreements, should be governed by written agreements within the trade concluded between growers (or on their behalf by growers' organisations) and sugar undertakings (or on their behalf by organisations)⁸. This requirement for mandatory contracts was maintained in order to "ensure a fair balance of rights and obligations between sugar undertakings and sugar beet growers"⁹. The detailed elements to be taken into account were "upgraded" to the CMO Regulation in view of their considered importance. In the collective provisions a standard contract was added. The collective value sharing mechanism that was eliminated during the reform is proposed to be re-inserted in the basic act (Annex X);

⁵ Regulation (EU) No 261/2012 of the European Parliament and of the Council ... as regards contractual relations in the milk and milk products sector

⁶ LV, FR, IT, ES, LT, HU, SK, HR, CY, PL, PT, BG, RO, FI.

⁷ Regulation (EU) No 1308/2013 of the European Parliament and of the Council establishing a common organisation of the markets in agricultural products, CMO Regulation.

⁸ Article 125 CMO Regulation

⁹ Recital 114 CMO Regulation

- maintain the specific provision on contractualisation in the milk sector¹⁰;
- (on a proposal by the European Parliament) provide for the possibility for Member States to make written contracts compulsory¹¹ for the delivery on its territory of products of agricultural sectors (other than milk and sugar) to a processor or distributor, and/or for first purchasers to make a written offer for a contract for the delivery in its territory of those products. In effect, the legal provision extended the milk "model" on a horizontal basis to other CAP sectors, including the exemption for cooperatives. However, unlike milk, the new Article includes a specific requirement that any contractualisation requirements introduced by the Member State shall not "impair the proper functioning of the internal market", as well as providing for a Member State to establish a "mediation mechanism" in cases where there is no agreement to conclude a contract. The Article includes a requirement that Member States notify the Commission of any measures that they introduce. As regards hops, the requirement that contracts concluded between a producer/producer organisation and a buyer must be registered by a body designated by a Member State for that purpose¹² was considered burdensome and discontinued¹³;
- specify that the aims that can be pursued by a recognised interbranch organisation includes the drawing-up standard forms of contract¹⁴.

3. EXISTING USE OF CONTRACTS IN MEMBER STATES

After two years in force, the Commission asked Member States for information on the extent to which they had decided to make use of the contractualisation possibility provided for in Article 168 of the CMO Regulation.

To date, 23 Member States have replied, of which only Italy, Lithuania, Spain and Poland confirmed that they availed of the possibility to make the use of written contracts mandatory. Some of the Member States refer to their codes/legislation on unfair trading practices.¹⁵

¹⁰ Article 148 CMO Regulation

¹¹ Article 168 of the CMO Regulation (1308/2013)

¹² Article 185 of Council Regulation (EC) No 1234/2007

¹³ Recital 141 CMO Regulation

¹⁴ Article 157(1)(c)(v) CMO Regulation, Lit (a) of the same article further specifies that IBOs might publish volumes and durations of contracts for raw milk.

¹⁵ 20 Member States adopted such codes or legislation on unfair trading practices.

Use of Article 168 CMO Regulation ("written offers or contracts") in the MS

Country	Italy	Lithuania	Spain	Poland
<i>Contract/ Offer</i>	Contracts	Contracts	Contract	Contracts
<i>Minimum duration prescribed?</i>	-	-	-	-
<i>Stage of the supply chain to be covered</i>	All stages of the sales of agricultural and food products.	First buyer	All food procurement contracts among all operators along the food supply chain , from production to the distribution of food or food products.	First buyer. "Every delivery of agricultural products, except of direct sales, by producers, producer groups, producer organisations or associations of producer organisations to the first purchaser. "
<i>Scope of the obligation</i>	Not for contracts with final consumer		For contracts with value > 2500 EUR	Not for direct sales to the final consumer.

Note: Portugal mentioned the possibility of future of the provision in the current crisis in some sectors. It refers to the Agricultural Market Task Force and the High Level Forum in this regard.

4. RELEVANT POLICY QUESTIONS

1. Is the current balance between mandatory and voluntary contracts for specific sectors/products as laid down in the CMO Regulation appropriate? Is there a need to consider mandatory contracts for additional sectors/products? If so, what is the justification (e.g. specificity, organisation/structure of the sector, geographical considerations)?
2. Are the terms of the current framework for contractualisation (i.e. Articles 148 (milk) and 168 (general) CMO) sufficient? Should additional provisions, be envisaged? If so, which? Do contract conditions always have to be symmetrical for parties or could differentiated rules, e.g. for termination of contracts, cater for different risk profiles and vulnerabilities?
3. Is there merit in extending the sugar system comprising compulsory individual delivery contracts and collective written agreements within the trade to all or some sectors?
4. To what extent is the effective organisation of a sector (e.g. through POs/cooperatives) essential to inducing more constructive/empathetic trading relationships within the supply chain? Would there be an interest in having such organisations negotiate certain risk and profit sharing mechanisms which the different operators in the food supply chain integrate into individual delivery contracts? Could this improve the distribution of the value added in the chain?
5. Should Member States play a more active role in promoting/recognising POs/IBOs and tailoring their statutes accordingly?

1. How can contract compliance and enforcement be successfully achieved/ensured? To what extent is a functioning futures market considered essential to a successful system of contractualisation?
2. Is it considered that producer organisations, associations of producer organisations, cooperatives or IBOs can play a specific role in drawing-up and promoting the use of standard forms of contracts and contract terms and publishing certain types of contract information?