Legal aspects of contract solutions to foster the provision of agri-environment-climate goods

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Summary for stakeholders

This practice abstract is based on the CONSOLE "Report on legal aspects on contractual solutions for the delivery of public goods" (D1.5), and has been prepared with the aim of making available in a nutshell the wide array of issues which the Legal Report has revealed. It is addressed to practitioners, including farmers and forest owners, interested or involved in the design and management of contract solutions directed to the provision of environmental goods and services. Particular focus is placed on result-based and collective contract solutions, both being relatively novel approaches eligible for EU co-funding. Another contract type looked at is the land tenure contract with environmental clauses. With the increasing share of rented agricultural land across the EU, it is likely that such contracts will become more prominent in the future. The fourth contract type is the value-chain contract where the business partners agree on additional environmental or climate requirements going beyond legal standards.

The infographics presented have been kindly provided by the CONSOLE partners Lena Schaller and Theresa Eichhorn from BOKU, responsible for the compilation and assessment of 61 case studies showcasing the diversity of successfully implemented innovative contract solutions, accessible at https://console-project.eu/.

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1 Contract solutions to achieve environmental and climate benefits

CONSOLE addresses innovative contract solutions for farmers as well as forest owners that target the delivery of agri-environment-climate public goods (AECPGs). The term contract solution or contractual solution is used to highlight that the project puts emphasis not only on the contracts themselves, which are concerned with the legal relationship between the parties, but also on their negotiation, support and management. As shown in the over 60 case studies, the successful signing of a contract often requires intensive preparatory work and involvement of many more actors than just the signatories. After a general introduction, four contract types will be tackled in greater depth: result-based payments, collective approaches, land tenure contracts with environmental clauses, and value chain contracts that aim to foster the provision of environmental benefits by farmers.

Contracts across the EU enjoy broad diversity since all Member States have their **national contract law**. However, contractual characteristics common to the EU Member States allow the framing of specific contract solutions for the purposes of the CONSOLE project. A contract is formed by the meeting of an offer and an acceptance and generally specifies the actions each party will take. The common point is the **agreement** to be built on the will of the parties, whether the parties be private or public. In our case contracts are characterized by the delivery of an environmental good or service by one party and normally the payment to be made by the other party, but also gratuitous contracts may be concluded under the law of some Member States. A major principle is the **binding nature** of the commitment between the contracting parties known as "pacta sunt servanda" (Latin for "agreements must be kept", or the principle of good faith). The agreement within the contract might be formulated both in writing or orally; in the case of agri-environment-climate commitments receiving EU or national public funding written contracts are required.

> *"A contract is a legal document that states and explains a formal agreement between two different people or groups, or the agreement itself."*[1]

Contract law encompasses several areas of law, including public and private law. These are linked to Member States' different cultural and legal traditions, but most Member States' legal regimes for contract law have similar concepts and rules. The principle of **contractual freedom** is a core element. The freedom to contract or not, the right to choose the other contracting party and the right to determine the content and form of the contract are all possible within the limits of the law. In no case can a contract violate public order either through its terms or objectives, whether known or unknown to the parties. Often legislation applies **mandatory contract rules** that have to be respected by all contract signatories, in particular where there is an important disparity in bargaining power. In other cases, contracting parties may decide either to apply standard contract arrangements or to agree individual terms instead.

[1] https://dictionary.cambridge.org/dictionary/english/contract

While **standard contracts** spare parties the need to negotiate the contract terms for every single transaction and provide them with a degree of certainty, innovative approaches targeted in the CONSOLE project are likely to require more **individualised contracting**. Still, common principles are seen as being useful for the parties at the drafting stage of new contracts, as well as for their execution. Therefore, we will look into: the nature of the contract and the subject matter of the contract; and the nature of environmental goods and services targeted. In addition, there exist cross-cutting issues that run through any analysis of contractual solutions linked to the provision of environmental goods and services. These include, in particular, questions relating to financing, such as: national and EU public funding, including WTO rules; and sources of private financing.

Frequently contract law rules represent merely one element of a more comprehensive regulation of a specific sector. Such regulation may embrace also public law rules which may be applicable at national level, EU level (as for commitments under the Common Agricultural Policy (CAP)), and sometimes even global level (as for World Trade Organization (WTO) rules). Indeed, if there are to be effective contractual solutions for the delivery of environmental public goods, then a degree of contractual harmonisation at EU level would assist.

In the case of **contracts involving a public entity**, the extent of the obligation is in general already defined, but farmers remain free as to whether or not to enter into the commitment and may have some leeway to adapt standard contractual provisions. In the case of **contracts involving only private persons or companies**, the contracting parties have a greater amount of freedom within the rules imposed by contract law, which aims to ensure the validity of the contract and the legal certainty of the commitment made. Such contractual freedom allows farmers to adopt new perspectives on the environment. An extra boost to contract solutions which involve private financing may come from the increasing awareness of environmental sustainability in the private sector, triggered by the EU Green Deal and subsequent regulations.

For the provision of AECPGs the legal framework of the **CAP** has a prominent position in providing support to farmers through public payments for public goods. While the EU does not contract directly with farmers in the context of AECPG payments, it does encourage the use of contracts for agri-environment-climate measures (AECMs) under the CAP and provides funding. **Pluriannual agri-environment-climate commitments** are designed to be allocated on an explicitly contractual basis under the second pillar of the CAP. Besides action- or practice-based commitments, result-based payments and collective approaches can also receive EU co-financing, this practice being continued in the next programming period lasting from 2023 to 2027. With the new emphasis on environmental performance in the CAP, result-based schemes gain importance as a fast-evolving and distinctive approach. Collective approaches may operate as an extension of many other forms of contract aiming at a more effective delivery of environmental goods and services, e.g. at landscape scale. On the other hand, land policy falls within the competence of the Member States. Therefore, land tenure contracts with environmental clauses are based on national rules that are often very specific. This is, in particular, the case for rural leases.

In the new CAP Strategic Plans Regulation ((EU) 2021/2115)[2], Article 70(1) provides that "*Member States shall include agri-environment-climate commitments*" in their Strategic Plans and Article 70(2) continues that they "*shall grant payments to farmers or other beneficiaries who undertake, on a voluntary basis, management commitments (…)*".

Alongside these pluriannual agri-environment-climate commitments there will be **annual eco-schemes** within the first pillar of the CAP as one of the main novelties of the "green" architecture of the CAP. Member States have to establish a list of suitable agricultural practices for the climate, environment and animal welfare and farmers will be able to make their choice from it. Farmers will have the opportunity to opt in or out from these voluntary schemes on an annual basis.

Article 31(1) states: "*Member States shall establish, and provide support for, voluntary schemes for the climate, environment and animal welfare ('eco-schemes') (…).* " And Article 31(2) further specifies that "*Member States shall support under this Article active farmers or groups of active farmers who make commitments to observe agricultural practices beneficial for the climate, the environment*, (…) ".

Eco-schemes and AECM contracts will need to go beyond mandatory conditionality (today known as cross-compliance) which acts as a floor to unlocking support. Still, Member States have considerable latitude, both in the implementation of contracts under the CAP and under national law. They can adapt contracts under the CAP to national requirements both in relation to AECMs under Pillar II and, in the future, eco-schemes under Pillar I.

When it comes to the level of payment, both today and under the reformed CAP, this is generally fixed as **additional costs incurred and income foregone** by reference to resulting from the commitments made. But Article 31(7)(a) seems to contemplate, as an alternative, **payments additional to the basic income support**. Furthermore, for the first time it is explicitly mentioned in Article 31(7)(b) and Article 70(4) of the new CAP Strategic Plans Regulation that targets have to be taken into account. This extension forces Member States to more closely connect the payment level to the achievement of environmental and climate objectives. AECM payments are considered to fall within the WTO Green Box, being exempt as 'payments under environmental programmes', the criteria for which are set out in Paragraph 12 of Annex 2 to the Agreement on Agriculture. Importantly, all Green Box support must meet the fundamental requirement that it has no, or at most minimal, trade-distorting effects or effects on production. In order to ensure compliance with these rules, support with public funding for agri-environmental schemes has **to be notified to the WTO** by the EU.

There may be further **opportunities for the private sector** to engage in the future with contract solutions involving farmers and forest owners. An example of such an opportunity would be the proposed Directive on corporate sustainability due diligence[3] that requires large companies, including the food industry, not only to effectively protect human rights, but also to have a plan to ensure that their business

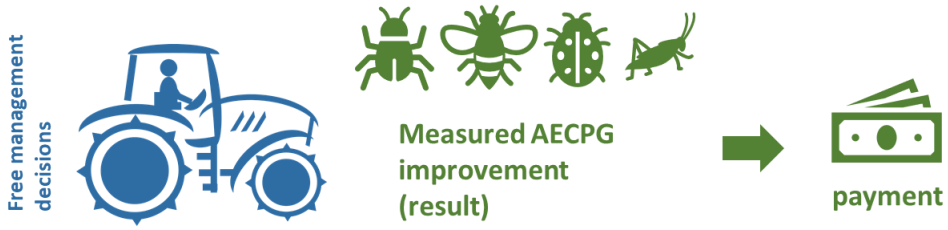
[2] Accessible under: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R2115
[3] Accessible under: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52022PC0071

strategy is compatible with environmental conventions, including limiting global warming. Furthermore, there is also work ongoing on sustainable financing at EU level, with both initiatives flowing from the EU Green Deal.

A particularity in the French farming sector is the concept of '**mutual aid**', defined as a contract for the exchange of services between farmers. The services exchanged generally consist of work (provision of labour) and/or equipment. The exchange must be reciprocal, otherwise it may be considered as undeclared work. A similar concept, but less formalised, is help between neighbouring farmers. Even though not its core objective, it is possible to consider the use of mutual aid for environmental preservation and, more specifically, the provision of environmental goods and services. For example, a farmer could very well ask his neighbouring or a nearby farmer to help him maintain a number of hedgerows that are useful for the preservation of biodiversity and carbon sequestration.

2 Result-based contract solutions

Result-based contract solutions specify an environmental or climate outcome as the reference parameter instead of prescribing management practices to farmers or forest owners. This requires measurable AECPG indicators. The payment is triggered when the thresholds which have been set are met or exceeded. While those contracting are free in their management decisions, they are often supported by management recommendations or external advice.



Such result-based contracts would include stipulated environmental or climate outcomes, which depend on the agreement of the parties to the contract and the area concerned. In addition, they need to involve a specific mechanism to monitor whether or not the agreed outcomes are being reached.

Result-based schemes are designed for **environmental performance by requiring specific environmental results** as opposed to just carrying out pre-defined agri-environmental management practices. Accordingly, if the agreed environmental outcomes are not achieved, the farmer would be held contractually liable.

At the same time, an important consideration is to **fix the floor which must be exceeded** in order to unlock payment and therefore result-based contracts have to be based on sound measurement of environmental baselines and the monitoring of changes in these baselines. This floor has as a general rule been calibrated by reference to the level of 'good agricultural practice', or more specifically by the mandatory cross-compliance / conditionality rules as set in the CAP at EU level and specified by the Member States. Farmers and other land managers should therefore

not receive support for activities which they would be obliged to undertake by virtue of existing legislative frameworks and, in any event, they ought not be 'paid to pollute'. When designing contracts, it should be kept in mind that the higher the floor, the less will be scope to earn remuneration for achieving targets; and, the lower the expected payments, the less likely it is that farmers and other land managers will engage voluntarily in such contracts.

In a preparatory document instigating the most recent round of reform, The Future of Food and Farming (COM(2017) 713 final), it was stated that there should be "*a greater focus on high standards and actual results*" and, more specifically, that there should be "*a result-oriented delivery of environmental and climate public goods*". In the new CAP Strategic Plans Regulation as enacted, the same ongoing policy shift is again reiterated, it being confirmed in Recital 71 of Regulation (EU) 2021/2115 that: "*[s]upport under payments for management commitments may also be granted in the form of (….) result-based interventions*".

In the context of the delivery of AECPG, however, **payment by results faces specific governance challenges**. Four aspects may be of particular relevance, these being: the target setting; the consequences of failure to meet targets; the creation of mechanisms for the monitoring of compliance; and, in the case of public funding, WTO compatibility.

In the context of setting targets for result-based schemes, it is particularly important to identify the degree to which farmers and other land managers must **demonstrate improvement in the environmental condition** of the land in order to receive remuneration. Where the environmental condition is poor at the inception of the commitment, targets which require improvement are uncontroversial. Where the land is already in good environmental condition, perhaps through participation in earlier AECMs, the situation is more complex. In this case, there is an argument that the 'targets' should simply be set at the level of maintaining the existing condition of the land. In any case, an AECM contract needs to be designed in such a way as not to create an incentive for participants to deteriorate the condition of their land prior to entering into commitments with a view to maximising the opportunity for improvement and, thereby, remuneration.

A significant distinction between payment for actions and payment for results is that in the latter case the farmer or land manager is exposed to the risk that, notwithstanding having managed the land appropriately, the environmental outcome may not be achieved through reasons beyond their control. The **fear of failure to meet set targets** may cause more risk-averse farmers and land managers to refrain from participation. Targets which are demonstrably achievable and which do not involve great financial outlay are likely to reduce risk aversion. In addition, it is recommended to include so called **force majeure clauses** to deal with circumstances laying outside the control of the contracting party, such as extreme weather events or other natural calamities. Force majeure provisions are already familiar in EU law, including the agricultural context. Regulation (EU) 1306/2013 on the financing, management and monitoring of the CAP provides that no administrative penalties should be imposed where the non-compliance is due to force majeure which encompasses, inter alia, a severe natural disaster gravely affecting the holding or an epizootic or a plant disease affecting part or all of the

livestock or crops of the beneficiary. Such provisions have already found their way into AECMs at national level.

As highlighted above, any workable contract with payment by results must be based on sound measurement of environmental baselines, together with any changes in these baselines; and there must be the **monitoring of outcomes**. In this regard, a challenge is presented by the fact that the monitoring of outcomes is inherently more complex than monitoring compliance with prescribed actions, consequently giving rise to cost implications. In the case of a number of results indicators, the difficulties may not prove insuperable, e.g. by a careful choice of result indicators combined with appropriate information and advice. In the context of result-based payments with EU or national funding, monitoring is frequently carried out by a national control body or with input from an expert ecologist. Also, self-assessment by farmers and land managers may prove a viable way forward, as long as there is expert oversight. For example, effective use could be made of evidence in the form of photographs (together with precise location) taken by the farmer, whether as agreed in the contract or on demand. Alternatively, proxies could be employed in respect of more complex environmental targets, e.g. for biodiversity measures when dealing with mobile species.

A payment on the basis of results would seem to present particular challenges in respect of the criteria for securing **compatibility with WTO rules**. Paragraph 12(b) of Annex 2 to the Agreement on Agriculture stipulates that "*[t]he amount of payment shall be limited to the extra costs or loss of income involved in complying with the government programme*", wording which is not apt to capture receipts on the basis of outcomes achieved. In this light, as indicated, an interesting development during the recent reform process has been that Member States are to take into account the targets set when determining the level of payment for AECMs, an amendment which will provide greater scope to meet policy objectives through result-based schemes, but which may sit uneasily with Paragraph 12((b). In this context, another option to ensure an element of compatibility with WTO trade rules would be to make payments in respect of 'general services', which are likewise exempt under Annex 2 to the Agreement on Agriculture (Paragraph 2), these including 'research in connection with environmental programmes', 'training services' and 'extension and advisory services'. All would seem well-suited to result-based initiatives in light of the extensive research which is being undertaken, and also the great emphasis already placed by pilot studies on the importance of training and advice to farmers. In addition, there may be the opportunity to craft bespoke result-based contracts in such a way as to secure exemption under Paragraph 5 of Annex 2, but a material problem would be meeting the condition that "*[n]o production shall be required in order to receive such payments*". This would not work if the result indicators require, for example, the presence of specific crops which could only be realised through some form of production.

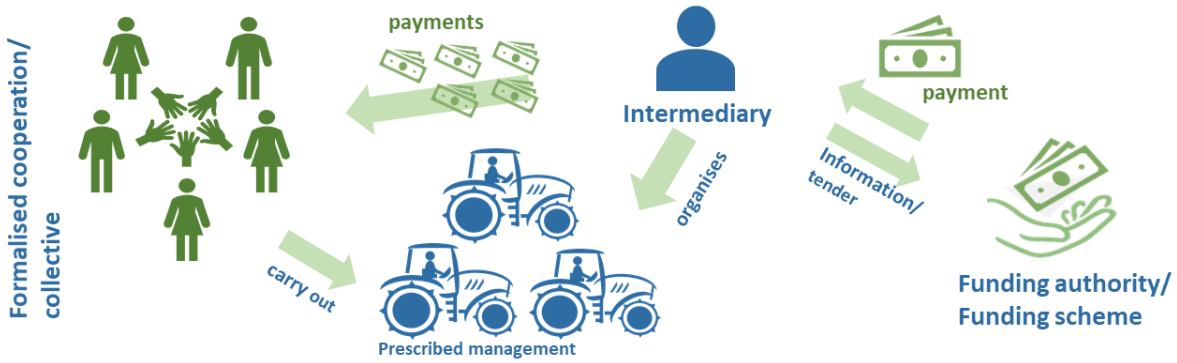
In order **to overcome some of the difficulties** encountered with result-based contracts, a possible way forward may be to implement a **hybrid approach** combining action-based payments with a top-up result-based element to reward higher-level achievement. This option is currently discussed in the case of result-based carbon farming mechanisms in the EU. Another way forward could be to operate a result-based scheme through **a points system or staggered payments** so

as to reduce the financial risk from poor performance. Staggered payments in this way prevent farmers being confronted with the possibility of facing 'all or nothing' in the calculation of their remuneration, partial performance generating proportionate payment. Alternatively, **up-front payments** – not possible with CAP funding unless through a one-off payment per unit in duly justified cases - may also incentivise participation, in particular when environmental outcomes become visible only at a later stage (as opposed to directly after farmers have adapted their farming practices to ecological needs).

3 Collective approaches

Collective action is typically defined as: "*the action taken by a group (either directly or on its behalf through an organisation) in pursuit of members' perceived shared interests*". When referring to environmental efforts undertaken by farmers the OECD describes it as "*[a] set of actions taken by a group of farmers, often in conjunction with other people and organisations, acting together in order to tackle local agri-environmental issues*"[4].

Collective contracts have developed as a reaction to individual contracts carrying risks of fragmentation of environmental or ecosystem protection, since they may address specific environmental issues according to the interests of the parties, but less the needs of a specific region or ecosystem. Both the size of area and strategic choice of the precise location of interventions are important factors in delivering environmental goods and services. Collective contracts targeting the delivering of AECPGs form the basis for **formalised cooperation** among farmers/landowners/other actors, these often being structured through a separate entity operating as an intermediary. But there may also exist cooperation between farmers/landowners/other actors without any collective contracting to pursue 'shared interests'.



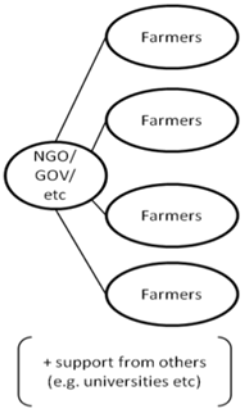
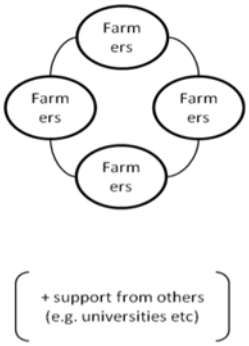
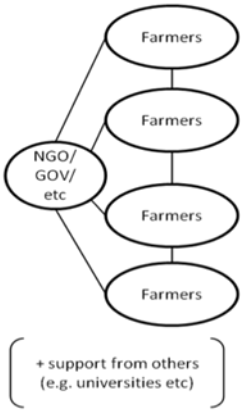
Two or more farmers/landowners/other actors **working together towards the achievement of a common goal** constitutes cooperation or collaboration. In the figure above, individuals agree together the management practices beneficial for the environment or climate to be carried out on the basis of individual or collective management plans. An intermediary then sits between the funder and the

[4] OECD, Providing Agri-environmental Public Goods Through Collective Action, OECD, Paris, 2013, p. 11

participating farmers; he can either be part of a farmers' group or a separate legal entity. His role is to help with the organization of the measures and to distribute the payments. In the example, the payment is given by the funders as a total sum and then distributed via the intermediary among the members of the collective proportionate to their individual efforts.

Collective approaches to provide environmental goods and services can take **many forms, with different degrees of formalised collaboration**. The willingness to embrace collective actions, however, may be culturally nuanced across the EU and affects their concrete design. While the Netherlands have a longstanding tradition of farmers' cooperation in respect of natural resources, e.g. water cooperatives, in other countries collectives have negative connotations due to enforced collaboration by farmers in the past.

Typology of collective action

Type 1: Organisation-style collective action	Type 2: External agency-led collective action	Type 3: Non-organisation- style collective action	Type 4: Co-operation between external agency and farmers
Farmers and other participants form organisations and act collectively as members. To manage organisations, rules and governance are very important.	External agencies organise farmers (usually in the same geographical area) and act collectively. Co-operation between farmers is not necessarily a feature.	Farmers collaborate with other farmers (and non-farmers), but do not form independent organisations.	Combination of Type 2 and Type 3. Although external agencies take strong initiatives, Co-operation between farmers is an essential part of the action.
			

Source: T. Uyetake (2013): "Managing Agri-environmental Commons through Collective Action: Lessons from OECD Countries", OECD Trade and Agriculture Directorate[5],

Cooperation can take different forms according to its structure and level of interaction between the parties. It may range from a **joint liability approach**, with a high degree of responsibility on the part of each member for the whole group, to a structure with no formal hierarchy where **each member is individually responsible** toward the paying party. The chosen structure has relevant effects on transaction costs, monitoring and enforcement. While in the first case transaction costs might be relatively high due to the necessary establishment of formal structures at the

[5] accessible under: https://dlc.dlib.indiana.edu/dlc/bitstream/handle/10535/8988/UETAKE_0791.pdf?sequence=1

beginning, enforcement is easier due to the enhanced mutual responsibility that might prevent 'free-rider' behaviour.

One reason for collaboration by farmers may be that it allows the **sharing of transaction costs** amongst participants. Another major advantage for the individual farmer may be the reduction of paperwork, which is taken over by the intermediary. In the Netherlands individual contracting by farmers takes place within the cooperatives (the intermediary) and there is one contract between the cooperative and the public authorities. The cooperatives have some flexibility in choosing the measures according to pre-defined ecological priorities for their region and also in their internal organization, so enabling direct involvement of farmers in decision making.

Collective approaches can be instigated from the bottom up (the initiative coming from farmers, other local actors or being community-led), top down (the initiative coming from public authorities) or a combination of both (where actions are coordinated between practitioners and authorities). More recently, farmers seem to have realised the potential for their environmental actions to generate income and are organising themselves to respond collectively so as to increase their voice and, thereby, their bargaining power.

Environmental goods and services collectively delivered may derive from either **horizontal or vertical collective action**. A key distinction is that the former aims to enhance spatial scale, whereas the latter is directed to the production process and deals with the transformation of agricultural products. Horizontal collective approaches typically have a territorial anchoring, e.g. a watershed, a landscape or an administrative region. Such coordinated action at territorial level may be promoted through financial incentives such as 'agglomeration payments' (which are bonus payments to farmers who adopt environment-friendly practices together with neighbouring farms). Horizontal collective action focuses mainly on cooperation between farmers or forest owners in order to offer their services locally in response to local issues, with the farmers or forest owners often being placed at the heart of governance. This differs from the vertical approach which aims to integrate a group of farmers to promote a 'product' or 'process'. They band together in such a way as to create a collective offer, which constitutes a series of links in a chain which brings the products or processes to market. Vertical collective contracts with contracting parties from various stages of a supply chain are today still an exception and are a special form of value chain contract.

The effective implementation of a collective contractual solution requires thinking about how to organize **efficient communication** between the different actors and how to **build up mutual trust**. The willingness of farmers to become party to these contracts is crucial, in particular where the quantity and quality of the environmental goods and services provided depends on the size of the area covered and/or its location. Refusal by a farmer whose land is in a strategic position can jeopardise successful delivery, e.g. when rewetting formerly drained areas for climate and/or biodiversity reasons. An appropriate method of governance to encourage and translate into concrete form the common interest is therefore particularly relevant.

Another aspect to consider is the **delimitation of the relevant territory**. This depends on the environmental objectives that are to be achieved, whether the focus may be water quality, the preservation of a protected species or carbon sequestration.

In most cases farmers are encouraged externally to work together, e.g. by the State, with AECMs under the CAP being part of this approach. More rarely farmers organise their own collective system for the provision of environmental goods and services. Here, **common lands**, notably for extensive grazing, have a long tradition in some parts of the EU, even if they have been losing momentum in recent years. This type of collective action, being closely linked to a particular type of land tenure and often based on special legal rules for land use, has to be seen as an exceptional case, broadly distinct from collective actions by individuals which are specifically designed to generate environmental goods and services. Risks caused by land abandonment, e.g. soil erosion or landslides, have the capacity to renew this collective approach around a common environmental interest.

The **CAP encourages the use of a collective approach** for the delivery of AECPGs. In Recital 83 of Regulation (EU) 2021/2115 it states that: "*[s]upport should enable the establishment and implementation of cooperation between at least two entities with a view to achieving the objectives of the CAP*" and, in this context, express reference is made to "*collective environmental and climate action*". Furthermore, Article 70(5) provides that: "*Member States may promote and support collective schemes (….) to encourage farmers or other beneficiaries to deliver a significant enhancement of the quality of the environment at a larger scale*"; and Article 77 on "Cooperation" generates another option to provide support to farmers. However, this Article covers a broad range of activities, not just environmental, and it is expressly stipulated that: "*Member States may only grant support under this Article to promote new forms of cooperation including existing ones if starting a new activity*".

There are several **factors that may also slow down the development of collective actions**: the absence of a local 'champion', 'facilitator' or 'animator' to kick start the process; the fact that collective contracts require constructive dialogue between the individual farmers and/or the collective which is not always easy to put in place; and the further fact that collective action is often seen as more complicated to organise and facilitate, with still some doubt as to who is the correct party to apply for payments under the RDP. Another point to be taken into account is the general understanding that the collective strength lies in the standardisation of individual actions to realise a genuinely collaborative project at an ecologically relevant geographical scale - and for a similar duration. Yet, this standardisation may be difficult to achieve, especially if the farmers who are entering into the commitments are tenants of agricultural land: the level of their participation is dependent upon the terms of the lease and, in particular, its length.

The risk of failure, be it real or just perceived as such by the farmers, is a great obstacle to joining collective actions. When shaping a collective contract as result-based, the fear is even greater, since participants may receive no payment through no fault of their own, which may act as a material disincentive to participation. Therefore, as noted earlier, a **hybrid solution** may facilitate collective commitment through (i) respecting individual environmental efforts by guarantee of payment

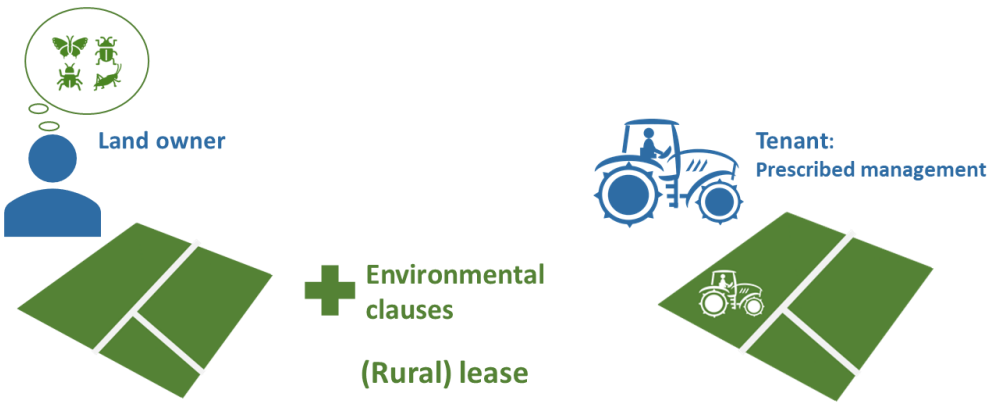
and (ii) offering a financial bonus to reward collective effects. Such a scheme would increase the interest of the contracting parties in committing themselves collectively, while limiting the contractual risk. Further, this hybrid solution may also address, to a certain extent, the difficulty which flows from the time which it takes to realise environment-friendly practices, in that farmers would be encouraged to participate in the long-term so as to obtain the collective financial bonus.

Collective implementation offers opportunities for **blended finance** or mixed finance (as well as for hybrid approaches). As blended finance – combining public and private expenditure - is liable to increase in policy terms, its demarcation from public funding will need to be clarified. And the issue of 'additionality' has also been significant in that there is no logic in making payment for actions that are already legally mandated. As seen earlier, farmer-to-farmer collaboration can be more or less formal, but blended finance requires more robust structures – in particular when going beyond pilot schemes.

4 Land tenure based contract solutions

According to an FAO definition, land tenure is "*the relationship, whether legally or customarily defined, among people, as individuals or groups, with respect to land*."[6] There are several types of land tenure: (i) private; (ii) communal; (iii) state; and (iv) open access. All of these are relevant for agricultural and forest land.

Member States do not only retain powers in the areas of land regulation, land taxation, inheritance law and planning law; they also have competence to provide a legal framework for the relationship between an owner and an agricultural tenant. Since this legislative competence leads to variations from Member State to Member State, general principles and core aspects are here presented.



The inclusion of environmental clauses in land tenure arrangements leads to environmental and/or climate efforts going beyond mandatory requirements for the lessee. The landowner as **lessor agrees on particular management prescriptions with the lessee**, the tenant farmer. In return, the farmer usually receives a reduced rent.

[6] Accessible under: https://www.fao.org/3/y4307e/y4307e05.htm

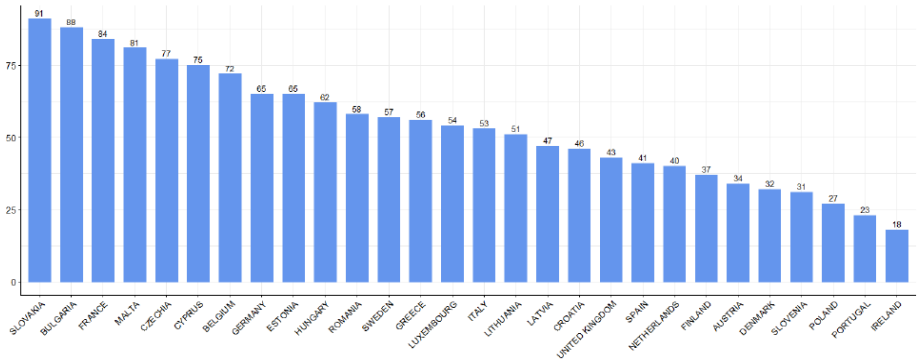
The most prominent land tenure based contract for agricultural land is the 'classic' rural lease which is inevitably concerned with the cultivation practices to be undertaken, and with a focus on production. Leases with environmental clauses appear to be a form of contract that operates as an **exception to such 'classic' rural leases**, reconfiguring the relationship between an owner and a tenant of agricultural land. In principle, environmental clauses can be added to any rural lease and they have the capacity to modify the focus on production of agricultural commodities, either through management practices identified as being favourable to environmental protection or through prohibition of potentially harmful practices. In some instances, although this is not common, a lease may specify environmental results, with these agreed by both parties to the contract. It is possible to incorporate environmental clauses not only when establishing a new contract, but also when renewing a 'classic' rural lease and through contractual amendment during the term of a current lease. It is important to notice that any modification of a lease has to be approved by the tenant and the landowner, so that if one of them does not agree to modification, it will not be applied.

Land tenure based contracts are often designed to **respond to local environmental issues**, such as the presence of a source of drinking water, the presence of animal or plant species sensitive to certain agricultural operations or soil erosion. But the interests of the landlord, e.g. game protection or a preference for organic production, may also be reasons for the inclusion of environmental clauses. More rarely, there may be targeting of global environmental issues, such as climate change mitigation. Land tenure based contracts with environmental clauses may require substantial improvements as well as the maintenance of current practices, with these usually being extensive. The tenant can be limited in his rights by such provisions, especially his right to exercise freedom of cropping.

Although the **EU is, by definition, not competent in land policy per se**, it undoubtedly influences how rights are exercised over agricultural land and how leases operate, not least through the prism of the CAP. With cross compliance/conditionality under the CAP defining the boundaries for agricultural practices eligible for EU payments, it is clear that the EU legislative framework is likely to have some effect on agricultural practices, and in a way which may be reflected in national land tenure contracts. Within the CAP framework, it is up to the Member States to specify their intervention strategy, explaining how they will deploy the relevant instruments, while also taking into account local conditions and rural needs, in order to achieve climate and environmental objectives. In other words, each Member State will have a clear interest in ensuring that these EU instruments articulate well with its own national instruments, including land tenure based contracts.

The **proportion of agricultural land under tenant land management** varies across the EU Member States as shown in the figure. The average proportion of rented land in the EU is 55 % and has increased over the last years.

Figure: Rented UAA as a proportion of total UAA in MS (2016 – UK included) (%)[7]



Growing environmental awareness and expectations are leading to a change in the relationship with land. It is no longer only a question of considering the private goods which it offers; attention must also be paid to public environmental goods. Environmental demands becoming more precise and ambitious, it is important to underline the additional challenges which land tenure based contracts face. Integrating an environmental dimension into a lease of agricultural land that has traditionally been geared towards production is no longer sufficient: instead, a concerted effort must be made to realise the sustainable provision of environmental goods and services. In other words, it is a question of assessing the capacity of these contracts to accommodate or even to adapt to this environmental challenge, and thus to identify their current environmental efficacy, together with how it could be improved. While the protection of a lessee who has developed environmental practices is of great importance, it is likewise of great importance that there be scope for the lessor to insert environmental clauses in the contract.

Examples of agricultural practices that may be included in environmental clauses are: no ploughing up of grasslands; creation, maintenance and management of grassland areas; specified crop rotations, harvesting methods and soil working techniques; limitation or prohibition of fertiliser inputs and/or plant protection products; periodic or permanent plant cover; prohibition of irrigation, drainage and other forms of water management; permission (or prohibition) to set aside land; the establishment or not of landscape features (e.g. hedges, trees); and organic farming obligations. While there is a fixed list in France for practices that can be included in rural leases, in other countries landlords have more freedom. The measures to be undertaken must be stipulated when the contract is signed or subsequently agreed. Failure to comply with these measures may result in the termination of the lease. Landowners regularly opt for the inclusion of environmental actions which are more affordable and simpler to control and monitor than environmental outcomes.

A concern is that preference is given to less productive land when entering into rural leases with environmental clauses so as to avoid the possible loss of output resulting from the environmental practices that have to be adopted. Even though these practices can be compensated for by **a reduction in the rent**, the extent to which this can be achieved depends not least on the demand for land, and thus on the

[7] Baldoni, E. and Ciaian, P. (2021): The capitalisation of CAP subsidies into land rents and land values in the EU – An econometric analysis ; doi:10.2760/404465; accessible under: https://publications.jrc.ec.europa.eu/repository/bitstream/JRC125220/jrc125220_land_capitalization.pdf

bargaining power of the landowners. The more productive the land, the weaker the economic incentive for lessors to use this option - which may undermine the efficacy of such rural leases in the provision of environmental goods and services, so indicating a role for the CAP as a source of support. In principle, lessees can claim CAP financial support for all land, including that under rural leases with environmental clauses. This includes in principle AECMs and in future eco-scheme measures. Some limitations are, however, set so as to avoid double funding, there being potential for overlapping regimes to cause a deadweight-effect, even if Article 36 of Regulation (EU) 2021/2116[8] is directed to precluding this. It states: "*Member States shall ensure that expenditure financed under the EAGF or the EAFRD is not the subject of any other financing from the Union budget*." And in Recital 75 of Regulation (EU) 2021/2115 it is affirmed that: "*Member States should also ensure that payments to farmers do not lead to double funding with eco-schemes while allowing enough flexibility in CAP Strategic Plans to facilitate complementarity between different interventions*." Accordingly, the development of national strategic plans is likely to reconfigure how rural leases with environmental clauses interact with contractualised CAP payments.

In the case of land tenure based contracts, their **duration** is a key criterion for the sustainability of the provision of environmental goods and services, ensuring that one or more environmental practices are maintained over a pre-defined period of time. In some countries, e.g. in Germany, there are no rules on the length of the contract, while for rural leases in France 9-25 years are prescribed. Greater length of lease arguably allows farmers to invest in the improvement of soil quality and more broadly in the implementation of environmental practices. On the other hand, long duration may also be a source of concern for the contracting parties, who might fear that commitments may become too restrictive. A potential incompatibility between the environmental practices contracted under a long-term rural lease and AECM commitments may also occur through the reprogramming of the CAP after the lease is concluded. In addition to such considerations in respect of long-term contracts, difficulties may likewise arise in respect of both short-term contracts and those annually renewed: in particular, there may be problems for the lessee when submitting applications for financial aid under AECMs usually lasting for 5-7 years (Article 70(6) of Regulation (EU) 2021/2115).

As shown, rural leases with environmental clauses, taken in isolation, have **shortcomings in ensuring the sustainable provision of environmental goods and services**. Some of these shortcomings relate to the duration of the contract itself and to limitations within the environmental clauses, while others relate to the level of funding available as an incentive to enter into, and then continue with, the requisite commitments. These gaps can be partly filled by combining such rural leases with other contractual solutions that are also linked to the land: for example, 'offset' contracts, AECMs under the CAP or even 'conservation covenants'.

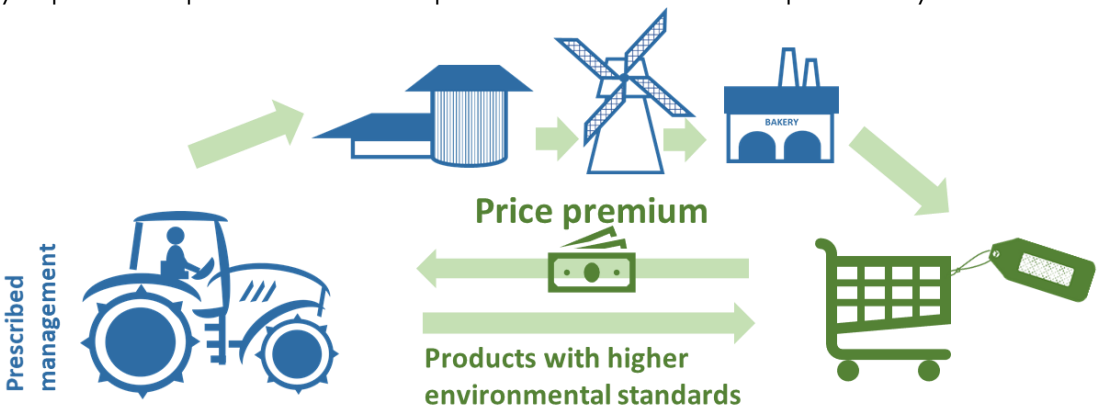
Further, it is clear that land tenure based contracts are a category of contract that is not hermetically sealed from other categories identified within the CONSOLE framework and **can be combined with those other contract solutions**. Thus, by linking land tenure based contracts to collective implementation, the impact of

[8] Accessible under: https://eur-lex.europa.eu/legal-content/DE/TXT/?uri=CELEX%3A32021R2116

environmental measures can be expanded to landscape scale. And, by focusing on result-based schemes, which may require a longer timeframe to implement, greater motivation may be generated among landowners and tenant farmers to implement measures which realize a more comprehensive and more significant positive environmental impact. Importantly, it is revealed that rural leases with environmental clauses are but one option, so promoting consideration of other options which may work in synergy and constitute a 'menu' from which policy-makers and other stakeholders may select.

5 Value-chain based contract solutions

In the fourth contract type, sustainability agreements are introduced into contracts between members of the food supply (value) chain connecting the delivery of AECPGs with the production of private goods. Farmers sign contracts, usually shaped as product contracts, either with the processing industry or directly with retailers where they commit to deliver **environmental or climate benefits connected to the production of selected products**. In such value-chain based contract solutions, payments are usually operationalised via the **product price**, sometimes complemented by sales guarantees for the producers. The farmers are thus compensated for additional efforts in the production of their agricultural commodities, e.g. by carrying out management measures which contribute to water protection, landscape improvement, biodiversity or carbon sequestration. Consumers usually pay a premium price for the final products that are often specifically labelled.



The number of such **business-to-business contracts** is steadily increasing as consumer demand for environmentally friendly products rises and food and retail companies realise their corporate social responsibility. Whilst supporting sustainability outcomes, they provide an opportunity for generating added value, choice and premium prices, alongside business profitability. Often such approaches are part of the food companies'/retailers' marketing strategies, requiring traceability from primary producer through to the final product. The example presented illustrates a vertical cooperation between cereal producers, operators of storage facilities, mills and bakeries. The complexity of the value chain contracts increases with the number of operators involved, making the required relationships of trust more difficult. Therefore, most instances can be found in the fresh fruit and vegetable sector, often combined with quality aspects and regionality. Likewise, in the livestock sector, in particular for unprocessed fresh meat, there is an increasing

number of initiatives targeting animal welfare. In the vast majority of cases value chain based contracts are purely private, but there are examples where they have been **stimulated by players from the public sector** or civil society, in order to improve the provision of a specific AECPG, often alongside protected area branding. A **specific case is the organic sector** where production, distribution and marketing of organic products are governed by a number of rules and regulations at EU level. Only products that have been certified as organic by an authorised control agency or body can be labelled with the organic logo.

While there is **in principle a high degree of freedom for product contracts**, the EU has decided to improve the protection of farmers and to amend competition rules as a reaction to the decline in farmers' share of value added in the food sector and the observed asymmetry of bargaining power in the food chain. **Mandatory rules that outlaw certain unfair trading practices in the agricultural and food supply chain** have been defined (EU Directive 2019/633). This UTP Directive has set for the first time a clear legal basis that defines unfair trading practices, identifying 'black practices', namely those which are in any situation considered unfair, as well as 'grey practices'. Grey practices are prohibited unless they are agreed in advance in clear and unambiguous terms in the supply agreement or in a subsequent agreement between the supplier and the buyer. The Directive sets up a minimum baseline for Member States with a clear focus on fair payment conditions, while also giving them the possibility to go beyond that minimum baseline to reflect their specific national circumstances. Existing contracts needed to be brought in line with the rules by at the latest November 2021.

With the publication of the EU **Farm-to-Fork Strategy**[9] in 2020, a greater responsibility has been given to all actors within the food chain to make food systems fair, healthy and environmentally-friendly. It aims at reducing the environmental and climate impact of primary production by setting targets to significantly reduce the use and risk of chemical pesticides, the use of fertilisers and sales of antimicrobials, at the same time seeking to increase the proportion of agricultural land organically farmed. It also promotes adoption of new green business models. As a reaction to the F2F strategy, food chain actors agreed the **EU Code of Conduct on Responsible Food Business and Marketing Practices**[10] that entered into force on 5 July 2021. The aspirational objective of sustainable value creation in the European food supply chain through partnership is foreseen to be achieved through stimulating sustainable production – and one way to do so is to engage in contractual solutions with farmers. While the application of the code is voluntary, the EU Commission will consider legislative measures if progress is insufficient. Therefore, it is likely that value chain contracts targeting environmental and climate benefits will continue to gain in importance.

Furthermore, as previously indicated, as a follow-up initiative from the F2F Strategy, the European Commission presented on 23 February 2022 a **proposal for a Directive on corporate sustainability due diligence**, to accelerate and make the transition to sustainable value chains easier in the EU and beyond, including for food systems. It is envisaged that companies which exceed certain thresholds (such as a net annual

[9] Accessible under: https://eur-lex.europa.eu/resource.html?uri=cellar:ea0f9f73-9ab2-11ea-9d2d-01aa75ed71a1.0001.02/DOC_1&format=PDF
[10] Accessible under: https://food.ec.europa.eu/system/files/2021-06/f2f_sfpd_coc_final_en.pdf

worldwide turnover of more than 150 million euros) must align their internal policies with the Paris Agreement's goal of limiting the planet's warming to 1.5 degrees Celsius. As a further initiative flowing from the F2F Strategy, a **proposal for a sustainable food labelling framework** is foreseen to be presented by 2024. This proposal will cover the provision of consumer information relating to the nutritional, climate, environmental and social aspects of food products, while ensuring consistency with other relevant EU labels (e.g. organic) and in synergy with other ongoing EU labelling initiatives (e.g., front-of-pack nutrition labelling and animal welfare and green claims).

The correct degree of rigour in setting requirements for farmers in value-chain based solutions is a balancing act. On the one hand, production rules and requirements must be sufficiently transparent, strict and controlled to maintain consumers' trust. On the other hand, the implementation of rules and requirements need to be feasible for the producers.

Also, the **CAP** for the period 2023-2027 supports efforts to increase sustainability in the production and supply of agricultural products through amended support mechanisms and market rules. **Collective initiatives,** either designed as **vertical contractual agreements** between operators at different levels along the food chain or as **horizontal agreements** between different operators at the same level, have the potential to make a significant contribution to a sustainable food system. In order to ensure that these actors can collaborate effectively to deliver agreed outcomes and ultimately contribute to the achievement of the desired goals, the new CAP extends the derogation for sustainability purposes. This is to be seen as a reaction to the huge difference in numbers between primary producers, who are often acting in isolation, and industry concentration, especially in the retail sector. Not least, joint selling and production planning of sustainably produced commodities can be effective tools for farmers to increase their profitability. Therefore, amendment was made to the Common Markets Organisation (CMO) Regulation,[11] in order for Member States to be able to recognise producer organisations that pursue specific aims relating to the management and valorisation of by-products, residual flows and waste, in particular to protect the environment and boost circularity; and similar provision also now applies in the case of interbranch organisations. Furthermore, a **new Article 210a on vertical and horizontal initiatives for sustainability** has been introduced into the CMO Regulation, which stipulates that: "*Article 101(1) TFEU shall not apply to agreements, decisions and concerted practices of producers of agricultural products that relate to the production of or trade in agricultural products and that aim to apply a sustainability standard higher than mandated by Union or national law, provided that those agreements, decisions and concerted practices only impose restrictions of competition that are indispensable to the attainment of that standard*". For this purpose, 'sustainability standard' means a standard which aims to contribute to not only environmental objectives, including climate change mitigation and adaptation, but also, *inter alia*, animal health and welfare. It is foreseen that the Commission will publish guidelines on conditions for the application of the new Article.

[11] Accessible under: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R1308