

Closed Loop Contracts

An integrated 'closed loop' arrangement occurs when one party (e.g., a wholesaler) controls one, or all, aspects of the supply chain from which another party (e.g., a farmer) accesses goods or services. In the agricultural industry, a closed loop contract places restrictions on what a grower can (and cannot) do. These restrictions may relate to how, where, and with whom a farmer does business.

An example of a closed loop contract

Jane Grower purchases apple trees from Jay's Fruits. Under the Grower Agreement, a closed loop contract, Jay's Fruits will control every aspect of the supply chain related to the apple growing process. This includes:

- the packaging of apples by approved packers;
- the selling of apples by approved vendors; and
- the exporting of apples by approved exporters.

Why use a closed loop contract?

In the horticultural sector, closed loop contracts may be used to:

- control the quality of the supply chain;
- maximise returns on produce;
- protect and capture end point royalties; and
- ensure product integrity.

Possible legal implications

There are a number of possible legal implications of using closed loop contracts. This fact sheet will focus on three key areas: competition law, contract law, and plant breeder's rights.

1. Competition law

Increasingly, growers independently negotiate the terms of commercial agreements with wholesalers and retail outlets. This direct dealing entails both opportunities and risks, which the Australian Competition & Consumer Commission (ACCC) has attempted to address in part through its Horticulture Code of Conduct, which came into effect in April 2018. The

Horticulture Code is mandatory for growers and sellers when they buy and sell horticulture produce which is defined as 'unprocessed' fruits,

vegetables, nuts, herbs, and other edible plants. The Code does not apply to nursery products and to purchasers of horticultural produce who sell directly to consumers. However, the Code mandates that a farmer growing fruits or vegetables who sells this produce through an agent must have a written contract that contains certain terms, including how price is calculated and when payments are due.

The Horticulture Code sets out a series of obligations to which horticultural growers and traders must adhere. These include the requirement that traders cannot act as both agents and merchants, and that traders must accept horticulture produce delivered under a horticulture produce agreement, except where the agreement permits them to reject it.

The Horticulture Code stipulates that agents must act in the best interests of the grower when selling horticulture produce and not sell the produce other than on 'an arm's length basis'. If parties do not comply with the Horticulture Code, the ACCC could take court action to seek a financial penalty for breaches, or to issue an infringement notice.

One possible consequence of using a closed loop arrangement is that the contract may infringe the Trade Practices Act 1974 (Cth). The Trade Practices Act prohibits certain anti-competitive practices, which may include anti-competitive agreements (e.g., price fixing, market sharing); misuse of market power; or exclusive dealing.

Exclusive dealing occurs when one person trading with another person imposes some restrictions on the other's freedom to choose with whom, in what, or where they deal.

Exclusive dealing is against the law only when it substantially lessens competition. Exclusive dealing can be divided into two broad categories: third-line forcing and full-line forcing.

Example 1: Third-line forcing

A contract may provide a product to a grower on the condition that the grower buys another product from a third party. For example, Jay's Fruits will sell you propagating material on the condition that you buy fertiliser from Tom's Fertilisers. Under the *Trade Practices Act* this conduct is unlawful. This is because although it is lawful to recommend the product of a third party to a grower, it is unlawful to force third-party products on growers.

Example 2: Full-line forcing

Charlie's Fruit will only sell you propagating material for stone fruit if you agree not to buy goods from a competitor. This is an exclusive supply arrangement but is only unlawful if it substantially lessens competition in the relevant market. A substantial lessening of competition occurs when the ability of buyers to shop around for a deal is significantly diminished.

2. Contract law

One of the fundamental principles of contract law is that parties are free to contract on whatever terms and conditions they see fit. This is known as 'freedom of contract'. The law has always taken the view that it would not invalidate contracts whose terms appear overly

restrictive for one or more parties. However, courts may be prepared to set aside contracts on the grounds of fraud, misrepresentation or unconscionability (i.e., if the agreements are unfair, unreasonable, or oppressive).

In addition, statutory law has altered the notion of freedom of contract under certain circumstances. These include granting protection to consumers, and in some cases, businesses where these parties lack bargaining power, and as such, the resulting contract may be unfair or unconscionable.

3. Plant breeder's rights

In Australia, the Plant Breeder's Rights Act 1994 mandates that a grantee of plant breeder's right must take all reasonable steps to ensure reasonable public access to the protected plant variety. This is important because in some circumstances, onerous closed loop contracts may prevent growers from easily obtaining propagating material.

Under the Plant Breeder's Rights Act, compulsory licenses may be granted to ensure reasonable public access to a plant variety covered by plant breeder's rights. This is triggered if the variety is not reasonably publicly available after two or more years have elapsed after the grant of plant breeder's rights. At this time, a person who believes that their access to a plant variety has been unduly restricted may seek a compulsory licence. The affected person would need to demonstrate that there is not reasonable public access, and that his or her interests are being affected. This requirement would be satisfied if a reasonable quality of propagating material were not available to the public at reasonable prices and in sufficient quantities.

Fact Sheet 19: Closed Loop Contracts September 2022

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