
**RELATIONAL CONTRACTS, INCOMPLETENESS AND
OPPORTUNISM BETWEEN CITRUS INDUSTRY AND ORANGE
GROWERS IN SÃO PAULO STATE.**

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Abstract

The contract is a usual governance in transactions between citrus industry and orange growers since the 80's. In this transactions are also common disputes in the contractual design that can protect parties, ensuring the agreements terms and preserving business gains over time. This paper is motivated to understand how incomplete contract can increase or not actors' opportunism behavior, special between citrus industry and orange growers. The research problem is how citrus contracts are negotiated and adapted over time? The key issue is whether relational contracts are design, how safeguards clauses can guarantee their property rights? Is used a quality method with a contracts multi-case study, as ten (10) orange growers' samples are taken and a documental analysis of twenty six (26) contracts with some citrus industries will be done. The contractual relation between citrus industry and orange growers are a historical construction by a private ordering, which initiates in the 80's with the standard contract and is modified in 1995, then from there time with specifics contracts. The institutional environment change in 90's, associated with the backward vertical integration of citrus industry; increase his bargain power in the following contracts. These work research reach to do an analysis of these contracts designs over time between citrus industry and orange growers, in different periods, to understand why the conflict has increased. The expected result of this research is to understand how the citrus industry power has influenced the resulting governances with orange growers; it means that the incomplete contractual design had begun complex and self-interested, increasing opportunism action behavior and also the transaction cost.

Key words: citrus, contract, incomplete, opportunism.

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1. Introduction

Purchase and sale agreement, based in a formal and written contract, is the main type of governance between citrus industry and orange growers transactions, because is a way of parties to guarantee the business gain and also the orange specificities, trying to decrease uncertainty and set frequency. All of these governing elements are written in the contract's safeguards clauses.

The contractual design used between citrus industry and orange growers was not done just in one instant of time, but the contract model have changed several times since the 80's, with the aim to reduce conflicts, decrease transaction risks and protect parties involved.

The contract model in this transactions have modified in 1996, with the end of standard contract one year later. These new contracts from 1996 were written according to the citrus industry negotiation process with each orange grower, and were following the institutional environment at this time.

The new institutional economy understand contracts as a hybrid form of governance that predominates in agri-food chain, and in most studies try to understand how contracts are: negotiated, designed, maintained, adapted and assured over time (Zylbersztajn, 2005).

The governance structures (market-spot, contract and integration) have an endogenous nature of changing (Williamson, 1991) because it depends of production agents' decision and their interactions, but governance have also an exogenous nature, based in the institutional environment that influences the organizational forms and also the contract.

In this paper is considered that the contractual analysis should be dynamic and based in the agents historical relation and the experience constructed trough them (Azevedo, 2006) and also oriented by the game's rules or contractual regulations in the period.

On the other hand, the contract analysis should consider also the information and power asymmetry problems in the citrus agri-food chain (Azevedo, 1996) (Paulillo, 2000) that influences the resulting formal contract and is not the expected one.

It's emphasize here the informal agreements importance that assure the future parties gains in the relationship, which is the relational contract (Macneil, 2000a; Baker et.al., 2001) that involves how contract is designed to prevent and anticipate future problems because of it's incompleteness.

This paper aims to describe how formal contracts between citrus industry and orange growers have evolved over time and why some conflicts still happen.

The approach of relational contract used to analyze discrete contract, or neoclassical type, is a way to understand the importance of residual rights (Hart, 1988) using at the same time the economic organization and law theories of relational contract interpretation (Mouzas; Blois, 2008), in a post-fordist context.

This view can open a window for understand how *ex-post* opportunistic actions, as moral hazard can occur and how prevent it. It is not the purpose here analyze how contract are assured by a public and juridical mechanisms, but the self-enforcing mechanisms: formal (neoclassical) or informal (relational).

The contract resulted in the negotiation process of citrus industry and orange growers it was never the expected agreement, because the contractual design are always incomplete and it gives to the agent a chance for opportunistic action.

The idea is discuss residual rights (Hart, 1988) and relational contract beyond a formal contract analysis (Scott, 2000), considering formal contract transaction as relational too (Poppo; Zerger, 2002). Is considered that contract have internal mechanisms of constraint or self-enforcing, and also external mechanism of constraint, but they are not enough to decrease uncertainty or transactions risks, special moral hazards, described here as opportunistic action.

This paper does a multi-case (Yin, 1989) contract analysis, through a quality research of twenty six (26) contracts between citrus industry and ten (10) citrus growers, since 90's until 2011, trying to indicate changing in the contracts safeguards over time and their results and implications in transaction relation.

The results found and the conflict between agents are discussed, because the main argument is that the inclusion and exclusion of some safeguards in the contractual design instead of give stability in the transactions increase the opportunistic action by the agents. This opportunistic actions conducted actors to juridical litigation, but these juridical problems are not discussed in this paper.

In this first section there are conceptual arguments for hybrid form as intermediated governance between market and integration, and how their written and unwritten terms in the contract influence the resulting contract, understood as type of relational contract. The second section is analyzed twenty six (26) purchase and sale orange box contracts, divided by three periods' blocks agreements, and their safeguard clauses that implicate changes in the relation and opportunism actions.

Finally, there are some considerations of how these private ordering institutions in the contract have impacted in orange chain.

2. Hybrid governance: relational contract.

Services or products purchase and sale contracts are classified in new institutional economy as a hybrid governance structure (Williamson, 1996; Menard, 2004), intermediate between hierarchies and spot-market transactions (Williamson, 1979; Powell, 1990); because contracts are not oriented by fiat's power of commands and control, and nor by market forces of prices fluctuation.

The modern organizational theory understands a firm as a contractual nexus (Boltanski; Chiapello, 2009), in this case between several productive and service actors.

The organizational theory is fragmented in several schools of thought, from economic to management and passing through political science to sociology (Scott, 1995; Fligstein, 2001); these views should converge to understand complex organizational forms, specific hybrid forms as the contractual nexus.

Is used here, to understand contract design, the transaction cost economic approach to have a better comprehension hybrid forms governance, as significant part of economic organization theory.

The hybrid or contractual governance form is based in a type of tie, formal or informal, established between one or more parties in a way to guarantee their interest in a specific transaction (Zylbersztajn; Sztajn, 2005).

Contracts are all incomplete (Klein *et al.*, 1978) in the economic organizational theory interpretation, because of bounded rationality assumption (Simon, 1982), and need residual

rights (Hart, 1988) or adjustment clauses to their adaptation over time and risks reduction to all parties involved in the agreement.

When contract incorporate residual rights into their safeguards it begins to have more terms flexibility to its adaptation in different conjunctures and also to preserve parties' gains, special when it's necessary. This contracts' adaptation capacity for economic conjuncture can gives a long life to the agreement and a better actors' relationship.

Contracts' flexibility is important in a post-fordist economic production system, as it is important unwritten elements in contracts, that's relational contract role (Macneil, 1985, 2000b).

There are at least two principal scholars of relational contract theory, one is the norms-based approach from law and other is the incomplete contracts approach from organizational economists (Mouzas; Blois, 2008).

Usually organizational studies suggest that relational contracts are just based in informal agreements that preserve future relations and important in hierarchy and hybrid governances (Baker et al., 2001) and other view, like law approach, shows also the importance of open or more flexible safeguards terms in a formal and written contracts (Macedo, 2003).

Relational contract in this study consist of a long term agreement based in an open terms of exchange that preserve future relationship, different from discrete or neoclassical transaction contract, based just in formal, strictly and inflexible bargain terms (rigid clauses).

In new institutional economy approach is important understand relational contract as a long and opened terms' construction where historic transactions matter (Azevedo, 2006). That means, if contractual design should taken the old ones, a type of path dependence, then new formal contracts will ever be better than the old ones, because it is complemented by a relational governance (Poppo; Zenger, 2002).

Relational contract as the essential contract theory (Macneil, 2000a) is important governance mechanism between firms, especially in a lean production line that incentives specialization and flexibility processes in all organizations.

Contracts, as relational, could incorporate formal and informal elements that could manage the products and services flow over time, for instance given more flexibility for production transactions and stability in bilateral relation.

Contractual arrangements, or more specific the safeguard clauses, are important when firms do investments in specific assets, then the negotiation is done and terms are written to govern the production or service flow. These internal rules are the safeguards of the signed agreement, a normative pillar in the institutional analysis (Scott, 1995) and a private ordering for parties.

It means that contractual design have an endogenous nature, normative institutions, made by asset specificity, uncertainty, frequency and parties experience, but oriented by an institutional environment which represents its exogenous nature, the regulative pillar, based in game's rules of what each actor can do or not to design safeguards contract.

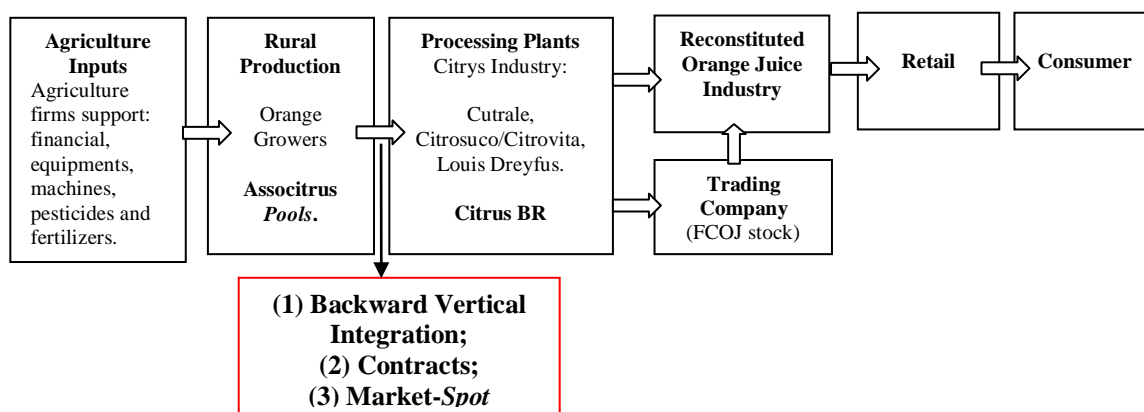
These clauses are contractual norms based in regulative and normative pillars, an according to Macneil (2000, p.432) there are ten (10) common norms present in all agreements: role integrity, reciprocity (mutuality), implementation of planning, effectuation of consent, flexibility, contractual solidarity, restitution/reliance/expectation interest (linking norms), creation and restraint power (the power norm), propriety of means and harmonization with social matrix.

So these main norms shows that contract is embedded (Granovetter, 1985) in relations and behavior assumptions can impact it, like opportunism action.

In citrus chain are also common plural forms of governance (Mello; Paulillo, 2008), citrus industry have a backward integration, with their own orange farms and also buy orange boxes with contracts and through spot-market transaction.

Citrus industry have constructed multiple forms of governing transactions to reduce risks, but also to be possible to them have more control over resulted contract from orange growers negotiation. They have created through plural forms of governance more bargain power, as they can provide his plants capacity with a minimum of their own oranges boxes.

FIGURE 2: Plural Forms of Governance in Frozen Concentrated and No-Concentrated Orange Juice Chain.



Source: Based in Mello&Paulillo (2008).

Plural forms of governance in citrus chain are a part of citrus industry strategy in the negotiation process with orange growers and also a better operational management program for orange processing, decreasing uncertainty.

In the next section is discussed how contracts between citrus industry and orange growers were designed over time and its safeguards implications for long-term inter-firms relationship possibility.

3. Relational contracts in citrus chain

Formal contracts are classified in organizational theory as neoclassical or discrete, because they have a specific time or period for their occurrence and parties' obligations have to be signed and must be followed.

In other hand, contracts should be relational, based in a long-term tie, not with just written terms but opened for improvements, with residual rights for better mutual gains distribution and shared risks. That's the reason why some contracts are done, to preserve parties' financial returns and to keep future relationship.

In frozen concentrated and no-concentrated orange juice chain is common contracts between citrus industry with orange growers and also with reconstituted orange juice industry, the contract safeguards are the way to foresee all future contingences.

Between citrus industry and orange growers the agreement is necessary because of their specific investments done by two parties involved: processing plant industry and orange trees seedlings. These mutual investments create actors' dependence and long-term inter-firms contracting necessity.

However, most of mutual agreements between citrus industry and orange growers were done for short-time period and not giving the clear method for orange box prices, this creates a conflict along the decades and a worst contractual relation.

To have a better citrus industry and orange grower commitment comprehension it is necessary to see how contracts were negotiated and designed and after how it were maintained and adapted over time.

All contract negotiation process initiates with citrus industry visiting orange growers in citrus chain's upstream. Orange buyer, from citrus industry, visit orange farmers asking if they want to do an orange box purchase and sale contract with the processing plant, and that is the contract design startup, where it is offered a price and a possible contract for orange grower.

If orange box price and some conditions are accepted, the second step is the contract design or to write down the formal rules, that will govern transaction, and there will be several safeguards of: ownership, harvesting, transport, fruit quality, product/service price, shared-risks, penalties if parties breach the commitment, constraints and self-enforcing instruments.

Finally there is an institutional support for agreements implementation, where is done in public notary's office, where the signed documents (contract) is validated.

This paper analyzes some of this citrus industry and orange growers' agreements (contracts) along a specific period between 1978 and 2011, where are emphasized main agreements characteristics, specially related with: residual rights, orange box price transmission mechanism and uncertainty (shared risks).

Then is done an exploratory analysis of twenty six (26) agreements between citrus industry and ten (10) orange growers, these documents are divided by periods in three specific blocks: fixed price contracts (1978 to 85), standard contracts (1986 to 95) and specific producer contracts (199 to 2011) (Araújo, 2006). All of these distinctions have an overview classification that characterizes the main similarities in contracts design. It is not the goal to generalize contracts, but have a differentiation parameter and period design.

From 1978 to 85, seven contracts are analyzed with jus one orange producer. There were simples mutual agreements, based in a few safeguard constraints of that involve: asset specificity, risk-sharing and transaction frequency. The main contract characteristic is that al agreements are based in a fixed orange box price.

Because of orange growers claims and pressure for an orange box price to be fixed according with international frozen and concentrated orange juice price, in 1986 citrus industry change their contract design and were established a standard contract to decrease citrus chain conflict and to include orange juice price into orange box price formula.

From 1986 to 1995 purchase and sale agreements were done in a standard bases with orange grower, not with orange box fixed price but made with a complex price formula at the cropping end, that was calculated using: orange juice exportation price, orange box yield rate and production/commercialization remuneration (citrus industry costs).

In this period three (3) contracts with two (2) different orange growers were observed. A complex price formula create also a risk for orange producers, as there were implicit and not open transmission price mechanism, as "capital remuneration" present in "Annex A" that was an implicit variable without an explicit value.

Then, pattern contracts beget distrust in citrus chain relations and also distribution conflicts created by this information asymmetry.

In these standard agreements there were no pesticides preoccupations, as fruit quality was measured by its' ° Brix and a good prevention actions against pests and diseases.

Even at this time, orange harvesting was citrus industry duty, but from 1995 with the end of standard contract orange growers began to have this obligation and also the risks involved: transport and workers' assistance rights.

Then from 1996 all purchase and sale contracts was done with each orange grower, not with a pattern model, but including case by case orange grower construction. In many contracts from this period are common that many future risks are not shared. In these purchase and sale commitments orange box prices were oriented sometimes by fixed prices or by simple formula.

Some safeguard clauses lead to contractual breaches identified in this study as opportunistic action or broken relations among partners, and then there isn't incompleteness problem but advantage for of circumstance.

From 2001, citrus industry initiates orange box prices clauses considering exportation orange juice price, but again with a complex orange box price formula.

In table 1 all contracts are characterized by their main similitude and by periods' blocks.

Table 1: Contracts classification: main characteristics and periods.

<i>Contract Type</i>	<i>Fixed Price Contracts (1978-85)</i>	<i>Standard Contracts (1986-95)</i>	<i>Specific Producer Contracts (1996-2011)</i>
<i>Characteristics</i>			
Number of Contracts	7 (seven)	3 (three)	16 (sixteen)
Contract crops	1 (one) harvest	4 to 5 harvest	1 to 5 harvest
Residual rights	No	Yes	Yes
General Safeguards Clauses			
- Harvesting and transport	Citrus Industry Duty	Citrus Industry Duty	Orange grower duty
- Orange quality necessity	No	Yes (° Brix and free from pests and deceases)	Yes (Annex 1- °Brix/Ratio and Annex 2 - pesticides)
Orange Box Price Mechanism	Fixed Price (American dollars US\$)	Complex Price Formula	Fixed Price and Simple Formula Price
Uncertainty (shared risks)	Yes	Some yes and others no	No

Source: Based in documental analysis.

The long-term agreement is not what it is found in the initial purchase and sale orange boxes agreements from 1978 to 1985. According to these seven (7) contracts analyzed from this period they bring a similar characteristic, for instance all of them were done for just one year.

They were citrus-production-oriented in some way, because there were just few safeguards that influenced mutual relation and some citrus industry obligations.

- 1- one year harvest contract arrangement;
- 2- harvesting and transportation are citrus industry duty;
- 3- spraying are orange producer duty;
- 4- price is fixed (government or citrus industry) in currency.

At this time purchase and sale agreements were done just for one crop and orange box price were settled or by federal/states government (CACEX/FAESP) or by citrus industry, it means a type of discrete contract based in a short-term relationship and orange box fixed price method.

Since 70's the relation between citrus industry and orange growers are around discussions about orange box price safeguard that led them to create standard contract formalization in 1986.

These short-time contracts can be considered as discrete transactions, not relational, but oriented for punctual and one harvest purchase and sale mutual obligations.

From 1986 to 1995 the standard purchase and sale agreement relation becomes' better, for more than one crop and the principal improvements were:

- 1) 4 to 5 years harvest contracting arrangements;
- 2) the harvesting and transport still were done by the citrus industry;
- 3) orange box prices were based on frozen concentrated orange juice exportation price.

These new safeguards clauses give more stability for citrus industry and orange growers' relation, but some clauses improvements should be done, as a clear orange price formula.

Pattern contract models were efficient to include all producers, since small to big farms, into the same agreement umbrella and to solve in part orange box price conflict.

At the oranges' harvest end there was an final orange box price based in juice price and citrus industry cost that can be considered a residual right or adjustment clause for provisional price given at the harvest' beginning.

In other hand, pattern contracts were extensively detailed with several safeguard clauses that denotes more preoccupation for future contingences, different from fixed price contract that had around seventeen (17) clauses without sub clauses.

Standard contracts had around seven clauses (7) and thirty nine (39) sub clauses, not including annexes: A (production/commercialization remuneration – citrus industry cost) and B (orange box price transmission mechanism formula).

Standard contract design was formulated to keep mutual gains and for a long-term relation, a type of relational contract. These agreements analyzed were trying to share some transaction risks, like harvesting and transport, and orange box price was based in orange juice price exportation.

However these pattern agreements bring some external and internal risks just for orange grower responsibility like: orange perishing by natural or climate change and industry workers strike.

This type of standard contract model could give more transaction stability and reduce conflicts, but some safeguard clauses brought mutual divergences and new contractual design improvements were necessary. Then an agreement change occurred, for a producer specific contractual schema, a type of citrus industry-processing-oriented agreement.

These new contracts model used from 1996 until nowadays bring different challenges and characteristics, the special design changes were:

- 1- 1 to 5 years harvest contracting;
- 2- harvesting and transport became an orange grower duty;
- 3- orange box prices follow different methods: price fixed and simple formula.

The first change in the new contracts from 1996 were variations in agreements' time, for short and long periods depend on which was orange producer and citrus industry relationship.

Other important change was the harvest and transport responsibility that change hands and forced orange producers for this task. From there transport, workers' costs and specific risks involved were orange producer duty.

From that period pests and deceases became worst in oranges' plantations, orange box costs increased and many producers left citrus activity (Vieira, 1998; Paulillo et al., 2006).

There were an adjustment price safeguard at the oranges' harvest end, but just from 1996 to 2000, based in dollar exchange variations. From 2001 price adjustment clause' was not needed because of Brazilian monetary stability.

Some contract breach occurred and this can be observed by several changes in citrus industry and orange growers' supplier contracts, each orange grower changed more than one time orange production contracts' destination.

Even taken adjustment clauses the contractual design conflicts became evident and Associtrus, an orange growers' collective organization, tried to intermediate a new standard contract believing in a common way.

Citrus industry, represented by Citrus BR, and Associtrus didn't find a new standard contractual consensus. They are working for an orange growers and citrus industry council called Consecitrus that will carry on agreements negotiation process and also the future new standard contract.

Formal contracts between orange growers and citrus industry are important in orange juice chain coordination, but conflicts should be reduced and exchange has to be seen as relations more than simple transactions.

4. Final Considerations

Contractual design that should be relational becomes restrict and discrete after 1996, because of: some missing terms, mix of short and long-term agreements, orange box price formula and no shared risks clauses (future uncertainty).

The standard contract idea that could be made as relational model startup didn't find a citrus industry support and small orange growers were helpless again.

After pattern agreements' end between citrus industry and orange growers the conflicts and power asymmetry became evident. The contractual design followed citrus industry orientation and these create inflexible clauses and non shared risks.

Internal or external transaction uncertainty could be shared in the contract design to be fair with mutual dependence of investments done, but agreements bring safeguards that incentive contract breach and no risk-sharing supply contracts under price uncertainty.

Contracts can guarantee property rights when safeguards clauses share transaction risks, what is not observed in all analyzed historical agreements just some of them like standard ones.

Some questions in these historic contractual relations still remain, special because quality researches do not analyze impacts of orange production cost in orange box price formulas.

The intension of this working paper is to discuss citrus industry and orange growers contract, was found a type of relational contract during the standard contract period but the specific orange growers agreements do not reduced conflicts.

Consecitrus is a possible way to extend agreements' period and to create a trusty relationship between citrus industry and orange growers, for a relational contracts construction and implementation. The idea is to keep mutual gains distribution over time and also share risks in an uncertainty environment, everything based in a fair exchange relation.

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