NFUScotland

Business Guide Update

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DAIRY CONTRACTS – FREQUENTLY ASKED QUESTIONS.

This briefing summarises the questions that are being asked about the Defra commitment to consult on the introduction of regulations on dairy contracts between producers and processors.

What is this all about?

- Defra will consult on regulations on dairy contracts between farmers and processors to address bargaining power, unfair or unclear contract terms, trust and transparency in the supply chain.
- This is a UK Government initiative prompted by evidence and recommendations from the independent Grocery Chain Adjudicator (GCA) review which acknowledged legitimate concerns impacting primary producers as accepted by Defra (see link 1 below).
- The GCA review highlighted the unfair pressures placed on primary producers; for example, through unfavourable contract terms, delays in payments, and short notice of price reductions and specifications. These practices limit the ability of farmers and growers to budget effectively, manage price volatility, and run a profitable business.

- It was identified there was problems with the balance of bargaining power in the groceries supply chain, examples of unfair or unclear contract terms, difficulties caused by late payments, and a lack of trust and transparency that discourages good relationships across the supply chain. These practices limit the ability of farmers and growers to budget effectively, manage price volatility, and run a profitable business.

What is the GCA and what does it do?

- The GCA is an independent adjudicator covering the largest UK retailers and their direct suppliers. While the GCA does not cover primary producers, they agreed there is a need to protect them from bad practices evident in the supply chain.

What is the back story?

- Governments have an obligation to seek fair market conditions for all in the supply chain and particularly concerned about primary producers
- In 2012 the EU Dairy package identified major issues in dairy and introduced regulations on dairy contracts and Producer Organisations.
- Member states could opt out, UK opted for a voluntary Code in the dairy sector.
- It is acknowledged by the GCA that the Voluntary Code is not working; therefore, government are now committed to consider statutory requirements, as stipulated in the Code agreement, at the insistence of the Farming Unions.

What is the voluntary Code?

- In 2012 the EU introduced legislation for dairy allowing member states to introduce mandatory written contracts. The UK opted out, preferring a voluntary code, which was agreed between Dairy UK and the farming Unions.
- This Code of best practice has failed in many ways, as stated by the GCA and the UK government is committed to consider regulation.

What is the GCA view on the voluntary code?

- ‘Since 2012, a voluntary code of practice in the dairy sector was introduced by industry to encourage minimum standards of contractual good practice. There are concerns that “code compliant” processors may be at a competitive disadvantage against those who have not signed up’.

What did Defra say?

- *‘Government will explore the potential benefits of statutory codes of conduct. These could give formal guidance on contractual good practice between processors and producers. This ambition is not solely for dairy, but as dairy already has an underperforming voluntary code government view dairy as an opportunity to set an example’*.

What’s in this for a dairy farmer?

- To consider statutory requirements is an opportunity for farmers and processors to resolve these concerns.
- Dairy farmers are vulnerable due to the nature of raw milk, high costs, thin, volatile margins, lack of buyers, increased consolidation of processors/retailers, and the ‘abuse’ of milk as a ‘loss leader’. Regulation on contracts will not in itself resolve these issues but can make progress.
- There is a need to share risk and reward throughout the supply chain via agreed terms and conditions. This is a major opportunity for dairy farmers to influence their concerns reinforced over decades.

Why is this so crucial to dairy farmers?

- The opportunity to ensure price, pricing mechanisms and all related terms between farmers and processors are agreed through free negotiation and can’t be varied without agreement.
- As much as 90% of a dairy farmers income is from the market (10% subsidy) and while global trends will dictate milk product values, the milk contract terms, and pricing mechanisms will set the price.
- The ability of the buyers to set price and other terms, solely at their discretion is a weakness for all. It allows processors to manage their risk, passing on the major risks to farmers. This does not motivate processors to manage risk in other ways.

- Beyond pricing, volumes, bonusses, penalties, exclusivity, termination clauses, imposed variations are all largely at the discretion of the buyer. This is an opportunity to agree through free negotiation.

Will this get me a better price?

- Not necessarily, but agreed pricing mechanisms e.g. fixed, forward, formula, A/B, will be more efficient, price proportionate to the specific market, options to manage volatility, and hence more clarity and assurance for farmer and processor.
- Where there are examples of best practice pricing mechanisms which are agreed by producers and processors, there are tangible benefits. For farmers there is much less likelihood of dramatic price cuts and missing out on strong markets as processors cannot manage risk and reward unilaterally.

Will farmers still be able to produce as much milk as they want?

- Many producers believe there is role for supply management. Global supply and demand drive price fluctuations - which we have no control of - but individual processors and their suppliers will be able agree mechanisms to manage the impacts of periodic processor specific, imbalance of supply and demand**.**

Non-Exclusive Contracts, can they work?

- Many believe there is a place for non-exclusive contracts for farmer and seller. Could a farmer commit all his milk to one processor or have the option to supply more than one to take advantage of market prices? This is an important consideration!

Will the proposed statutory requirements guarantee farmers better contract terms?

- Not on their own but will require farmers and processors to agree the major terms and conditions, via free negotiation and any agreements e.g. on price, pricing mechanisms, production, etc cannot be varied without agreement.

- However, farmers will benefit from improved collaboration and representation to ensure their ‘right’ to agreement via free negotiation is maximised. This is a very important consideration!

Is this quota by the back door?

- No. Agreed volume management should not be dictated by processor or producer, rather by agreed mechanisms.
- The key is that both parties agree a mechanism that suit them both which can accommodate processors needs and a producer's aspirations.

What does NFUS think?

- NFUS believes contract terms including pricing mechanisms, volumes, exclusivity, duration, termination, variations and dispute resolution will be more effective if agreed and freely negotiated, not imposed.

Should processors be concerned?

- This is an opportunity for processors. Some fear change, some fear losing their discretion on price, co-ops fear they will be compromised, but none of these need be the case.
- With more certainty on volumes, pricing and agreement on other key terms they will be better placed to be more proactive in managing supply and demand. It offers some leverage on retail.
- With well-considered and reviewed contracts, longer term strategies that are agreed, then efficiency will be enhanced.

What about retailers?

The consultation does not cover retail directly.

- Farmers are clearly aware that retail and other end users are a major part of the issues facing them and processors.
- However, the opportunity to regulate contracts between farmers and processors should encourage processors to negotiate with retailers in the knowledge that they must consider the impact of their supplying farmers.
- Processors and retailers may have to consider longer term contracts to react and mirror the agreements between processors and farmers.

If the outcome is a statutory requirement then who oversees it?

- There are several options, but clearly there must be oversight and consequence, whether the outcome is mandatory contract with minimum standards or a mandatory code, as this was one of the weaknesses of the voluntary Code.

- An extension of the GCA is an option, another utilised in Spain, is a so called Interbranch Organisation which is a sector wide body, which is in effect the arbiter of disputes.
- Whatever the body it must be trusted, cost effective and accessible.

What is the position now?

- Due to Brexit there have been mixed messages on the political process. In simple terms the UK can adopt the EU legislation on dairy contracts, but now it is more likely to be a UK version. This is covered in the recent UK Agriculture Bill (see also link 2 below)

  "*support farmers in getting the right price for the food they produce, clamping down on unfair trading practices along the supply chain", proposing Statutory Codes of Practice for contracts between producer and processor.*

- Dairy is viewed as a prime example of the need for some form of statutory requirements as it already has voluntary Code which is not effective
- The consultation we expect to run from sometime late summer for three months.

Links:

1. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/681882/groceries-adjudicator-consult-summary-of-responses-180216.pdf
2. https://researchbriefings.files.parliament.uk/documents/CBP-8405/CBP-8405.pdf