

A Mandatory Code for Dairy Contracts – 5 key points

Background:

For most dairy farmers, their contract to sell milk is the single most important piece of paper they have for their business and shapes the relationship with their milk buyer. Unfair milk contracts have been an area of concern for the dairy sector for many years. A significant proportion of the calls the UK Unions dairy teams receives are from farmers with issues which ultimately relate back to their milk contract. In 2018, following an industry wide review of the Groceries Code Adjudicator, it was found that there is an uneven distribution of power within the dairy sector. This led Defra to announce that they would launch a consultation on contract regulation aimed at improving fairness in the dairy supply chain. The UK Unions are all supportive of this approach and will be providing a response to the consultation which has been carefully developed over the last few years. Defra and the devolved Governments support this consultation.

What's wrong with contracts now?

Contracts are critical to determining the business relationship that exists between farmers and milk buyers. As much as 90 per cent of dairy farmers income is derived from the market (only 10 per cent subsidy) so we are heavily dependent on getting a fair share from the market, which is dictated by the terms of the contract. However, most milk contracts do not create balanced business relationships between buyers and sellers and often are heavily biased in favour of buyers.

At times of pressure, when the market is low or a business unstable, purchasers have the ability, through purchaser's discretion, to change contracts terms and pricing mechanisms, introduce retrospective penalties and price cuts without negotiation. A headline milk price is of no value whatsoever if a buyer has the sole right to change it at will.

The UK farming unions want to see freely negotiated and flexible contracts which are tailored to the needs of both buyers and farmers. Fairer contracts should increase transparency and trust, to the benefit of both, and mean that any changes need to be mutually agreed.

What needs to change?

The UK farming unions have developed 5 key points for contract reform, which we believe will lead to a more transparent, fair and well-functioning dairy supply chain. The key points are:

- 1. Pricing mechanisms**
- 2. Relationships and Farmer representation**
- 3. Exclusivity and volume**
- 4. Elimination of unilateral changes and one-sided contract terms**
- 5. Consequences of breach.**

This is a huge opportunity to change the structure of the dairy industry to make it more sustainable, progressive and improve the way farmers and processors work together for common goals. The contract sits at the heart of the future of the British dairy sector and we are pleased that Government are consulting on this topic.

We urge any dairy farmers to get involved in the discussion and feedback to the consultation either directly or your farming union. This is a once in a generation opportunity to gain some real change and secure the future of the British Dairy Sector.

1. Price

We want to rebalance the risk between farmers and processors, so that there is a **greater sharing of risk and reward** along the supply chain. Discretionary pricing (whereby a processor can unilaterally vary the price at their choosing) should be ended, prices should be transparent and have a clear mechanism which is objective and verifiable. At present, discretionary pricing, in different forms, is almost

ubiquitous, with too much of the risk placed on to the farmer which we believe is unsustainable. We also believe that **discretionary pricing does not deliver a true market price** as it creates an easy option for processors who hit problems and evidence indicates a culture of 'follow the leader' especially with price drops. There are several pricing mechanisms that are more effective and can be proactive and reactive, that can be agreed between producer and processors, for mutual sustainable benefit. Many farmers site the influence of the retail sector/end user on prices either directly as in aligned supply or indirectly due to their power in the market. The consultation does not include retail, but we will raise this important factor.

2. Relationships and Farmer representation

We believe that **relationships are crucial** to the improved working relationship between farmers and processors. The rise of co-operatives in the UK has seen greater farmer collaboration which has improved relationships. But for those without a good relationship, it can be extremely challenging and creates a David against Goliath situation. We feel that any changes to contract terms e.g. price mechanism, volumes, penalties or bonuses **must be agreed** between the parties, and there is a huge role **for Producer Organisations, Co-ops and democratic farmer groups** not just for leverage but to facilitate professional representation

3. Exclusivity and volume

A key mechanism for developing more sustainable contracts is a structure which allows for farmers to supply more than one business. Almost all contracts are currently exclusive, which means you have to send every litre to the processor you are contracted with. We believe that **farmers should be able to choose between exclusive and non-exclusive contracts** so that there is flexibility for farmers to **adapt and take advantage of different markets**. In recent times we have seen processors with short term issues over volume either restricting volumes or changing payment schedules, unilaterally at short notice. We believe that by offering a non-exclusive contract, farmers can have the opportunity to take advantage of alternative markets, or indeed be free to commit all their milk to one processor if terms can be

agreed. This can benefit producer and processor. Where an exclusive contract is agreed, there is case that tiered pricing and limits to production are not allowed.

4. Elimination of unilateral changes and one-sided contract terms

Many contracts feature terms which allow the processor to make changes to contracts without the agreement of the farmer or without consultation. For example, pricing mechanisms based on agreed parameters, constituents' schedules or aspects of Quality assurance may be changed unilaterally. Again, the retail sector can have a huge influence on variations and needs to be addressed.

Many contracts also feature one sided terms, such as farmers have to keep supplying a business in administration or circumvention clauses which allow processors to ignore other contract clauses 'if the board deems necessary'.

These types of clauses exist in almost every single contract. They may very rarely or never be used, but can be used in times of severe pressure, thus pushing the risk on to the farmer.

We believe that **these kinds of clauses should be removed from all contracts** and terms need to be agreed by the farmer or their representatives. There is of course a place for Force Majeure, but we believe this must be agreed and clear for both parties.

5. Consequences of breach

A mandatory code is only effective if there are measures in place to ensure it is being followed, and clear consequences for any breaches. We believe that a structure similar to the Grocery Code Adjudicator should be in place to oversee the regulation. There is potentially a role for a structure such as an inter-branch organisation (IBO), made up of processor and farmer representatives, which is used in other countries to enforce mandatory codes.

If any party is found to be in breach of the code, **there should be appropriate levels of consequence** (i.e. financial penalties) so that it deters any actions which may be against the code.