

Dairy Contracts Consultation

This is a guide to assist NFU Scotland members filling in the Defra dairy contracts consultation. It explains the questions in more detail and gives examples to help you decide on your answers and influence NFU Scotland's response.

We cover an outline of the current NFU Scotland views, informed by members and committees over the recent years, including last year's road shows, and wide-ranging discussions with our fellow Unions and other key industry stakeholders.

NFU Scotland is not starting from scratch having been involved with research and discussions on contracts for many years alongside our fellow Unions, however we will be consulting extensively with our members to develop our position further as we go through the process. We accept that there will be some differences in opinion on some of the details, and to an extent on some of the broader principles. Our desire is to encourage members to play an active and informed role in finalising our response and to encourage as many individual farmers to respond themselves, as Government has a strong desire to engage with all in the dairy sector.

The NFU Scotland comments below are an effort, not to pre-empt our response to the consultation, but do reflect our current thoughts based on committee and wider member discussion, which will of course continue to inform our response and accurately reflect members opinion.

The consultation can be [found here](#) and will remain open for responses until midnight on the 15 September 2020. NFU Scotland, alongside UK Unions have been working closely together to prepare for this long-awaited consultation, which we believe is a golden opportunity for the future of the UK dairy sector. NFU Scotland's dairy team and UK Union representatives will be engaging with members over the coming months through a series of virtual events, in national and regional meetings.

In Scotland:

27 July 7-8pm; 28th July 12-1 pm and 7-8pm; 29th July 7-8pm.

Consultation questions

Question 1:

Have you, your business, or your members, experienced issues with dairy sector contracts, for example where contract terms have not followed the example set by the voluntary code? Please give examples to explain your answer.

Background info:

The voluntary code of practice (VCOP) includes provisions such as 30 days' notice for price drops, 3 months' notice for farmers to leave if there is a price drop, the provision to supply another milk buyer if volumes are capped and 30 days' notice if any changes are made to the contract. A full copy of the VCOP can be found [here](#).

NFU Scotland Comment: our current position based on committee and member engagement

Whilst the VCOP was a good step in improving contractual relations between farmers and milk buyers, due to its voluntary nature it has failed to deliver for most farmers. We often see milk buyers ignore the terms of the code, for example, during the Covid-19 crisis prices and terms were changed unilaterally, at no notice, with farmers forced to supply and prevented from leaving their contracts. Similarly contract terms are often varied at the sole discretion of the processor at short notice leaving farmer with a Hobson's choice of agreeing or resigning with few if any alternative buyers.

Question 2:

Legislation, rather than voluntary measures, is needed to ensure that standards are consistent across the supply chain. To what extent do you agree with this statement? Please give reasons for your answer.

NFU Scotland Comment:

Following on from the previous question, NFU Scotland strongly believes that it is now time to legislate minimum terms for dairy contracts or a mandatory Code of Practice which has been agreed by all parties, as the voluntary approach has failed to deliver and left farmers in a vulnerable position.

Having given the voluntary approach a fair 'trial', it has failed as even a minority of non-conformers undermine the initiative for all.

Question 3:

Should trading relationships between producers and purchasers always be covered by a written contract? Please give reasons for your answer.

Background:

This question may seem strange to many farmers, but there are a handful of examples in the UK, and some other countries where milk supply is not covered by a written contract. Before legislating, Defra needs to make sure that it is appropriate to proceed with this approach.

NFU Scotland Comment:

NFU Scotland believes all agreements should be covered by a well written contract.

Question 4:

Legislative regulations are often applied uniformly across all UK nations. Is there any reason why a different approach should be taken? Please give reasons for your answer.

NFU Scotland Comment:

We believe that it is very important that legislation applies uniformly across the country as we do not want to create trading discrepancies within the UK. NFU Scotland has been working with NFU Cymru, NFU and the Ulster Farmers' Union to develop joint positions on the need to reform dairy contracts.

Pricing Mechanisms

Question 5:

Any future legislation should introduce a legal obligation to include a price/price calculation mechanism in a contract. To what extent do you agree with this statement? Please give reasons for your answer.

Background:

This question concerns the mechanism by which your milk price gets set. Currently most arrangements in the UK allow for 'buyers discretion' meaning that the milk buyer can change the price to whatever they want it to be. Mechanisms do currently exist in the dairy sector such as cost of production models, a fixed price contract or a price which varies based on verifiable market indicators.

For a co-operative model, other payment mechanisms may already exist, for example a milk price based on the performance and returns of the co-op, which is effectively a pricing mechanism and therefore not discretionary pricing.

NFU Scotland Comment:

NFU Scotland is keen to see an end to discretionary pricing. We believe that farmers should know why they receive the price that they get. Discretionary pricing can create a culture of 'follow the leader' when one milk buyer drops a price, others follow immediately behind them.

Buyers discretion means that a milk buyer could pay a dairy farmer unrealistic price whenever they felt the need and the farmer can do nothing about it other than resign in accordance to the contract. It allows risk to be passed down the supply chain rapidly. As we saw in the recent Covid-19 crisis, many milk buyers managed the risk of lost markets by immediately making the farmers pay through the milk price.

We believe processors need more incentive/compulsion to challenge the retail and end users, to look upwards in the supply chain to manage that risk.

While this consultation does not include reference to the retail or other end users most farmers are aware of the significant role this hugely influential part of the supply chain has on pricing both directly (aligned contracts) and indirectly (influence over processors).

We believe that by removing discretionary pricing, the whole industry will be in a more sustainable position for the longer term and drive greater fairness and transparency for dairy farmers. Processors understandably will want to retain this power, but we believe it stifles productivity, confidence, and trust. Where there are exceptional circumstances then we can agree a force majeure facility, which must work for both buyer and seller.

Question 6:

In order to achieve transparency, the methodology behind any price mechanism must be detailed within a contract. To what extent do you agree with this statement? Please give reasons for your answer.

NFU Scotland Comment:

This addresses how the pricing mechanism is detailed in the contract. NFU Scotland believes that transparency is absolutely crucial and therefore the parameters of any pricing mechanisms should be detailed, objective, verifiable and mutually agreed. For example, some milk buyers use readily available Market indicators (AMPE and MCVE), while others may use less well publicised information but pertinent to a particular market, or could be based on the performance of a Co-op; but all should be clear and verifiable in a contract.

To be clear, NFU Scotland is not advocating a one size fits all pricing mechanism, but we are advocating a clear and appropriate pricing mechanism agreed by both parties.

Volumes & Timings**Question 7:**

The volume of milk to be supplied should be fixed in the contract. To what extent do you agree with this statement? Please give reasons for your answer.

Question 8:

If you agree that the volume of supply should be fixed, please include an indication of an appropriate tolerance for variation (+/- X%). i.e. By how much either way should a contracted supply be allowed to vary.

Question 9:

If you agree that the volume of supply should be fixed, on what timescales should volumes be calculated? Please give reasons for your answer.

Question 10:

What options should be available to treat volumes outside these tolerances? Please give reasons for your answer.

Background:

This section of questions asks about how milk volumes should be treated within contracts. Many contracts in the dairy sector will effectively allow farmers to send as much or as little milk as they wish. However, in many cases the volumes are partially controlled by the milk buyer by means of profile, A&B quotas, bonuses, and penalties. Supply and demand balancing within the sector have been a bone of contention for many decades and most believe it needs urgently reassessed.

NFU Scotland Comment:

Volumes are an important part of dairy contracts, and NFU Scotland believes that there needs to be more transparency and coordination. A contract could state that the milk buyer will buy all milk produced by the farmer, or it can stipulate a fixed volume – flexibility and choice is crucial to ensure that this works well for both the farmer and milk buyer.

We feel it is reasonable, if a volume is fixed, it should have a tolerance of +/- 10 per cent or at an agreed per cent to suit buyer and seller.

We also appreciate that in order to run efficient businesses, a milk processor needs to have a reasonable expectation of milk supply volumes. A well managed system of volume control can benefit both parties if done correctly in agreement.

We are starting to see more innovative arrangements appear in the dairy sector, for example fixed price deals for a percentage of a farmer's volume, and we want to encourage more choice within the industry.

We believe there is strong argument that if a processor and farmer prefer an exclusive contract then the agreement should be that there is no limit to supply volumes and all the milk must be priced in the same terms.

Duration of contracts

Question 11:

The terms of a contract should establish a minimum duration for supply arrangements. To what extent do you agree with this statement? Please give reasons for your answer.

Question 12:

If you agree that a minimum duration for supply should be established, please indicate your preference for the length of this period:

Question 13:

Should there be a maximum contract period after which the contract must be refreshed and reviewed?

Question 14:

Where a contract is established using a fixed price mechanism, what should be the maximum length of this contract? Please give reasons for your answer.

Background:

This section concerns the length of contract which a farmer would enter in to with a milk buyer.

Currently, the majority of dairy contracts would be of no fixed term, but rather length is then determined by the termination clauses either party may activate.

NFU Scotland Comment:

We believe there is a need to clarify an evergreen contract which is in essence an agreement to supply and purchase indefinitely. The length of a contract is rarely discussed, but as new arrangements develop it may become more relevant.

NFU Scotland want to see options available for farmers in this respect, and we absolutely want to maintain the right to an indefinite (evergreen) contract, which can of course be varied through agreement from time to time, without affecting the evergreen contract.

Where there may be fixed price contracts, a fixed term is often necessary and so for these arrangements it appears sensible.

In terms of minimum length of contract, we believe that contracts should be at an absolute minimum 6 months in duration, but in most cases will be much longer if on a fixed term.

Termination of contracts

Question 15:

Termination clauses should be mandatory in all contracts. To what extent do you agree with this statement? Please give reasons for your answer.

Question 16:

If you agree that termination clauses should be mandatory, please indicate your preference for the minimum notice period for a producer to terminate the contract.

Question 17:

Please indicate your preference for the maximum notice period for a producer to terminate the contract.

Question 18:

If you agree that termination clauses should be mandatory, please indicate your preference for the minimum notice period for a purchaser to terminate the contract.

Question 19:

Please indicate your preference for the maximum notice period for a purchaser to terminate the contract.

Background:

Termination clauses have historically been a major issue within dairy contracts. The right for a farmer (or milk buyer) to terminate a contract is crucial to the proper workings of the dairy market. The voluntary code made progress towards giving farmers more flexibility by allowing them to leave contracts at short notice (usually 3 months) if the price dropped or terms changed. However, for many farmers, moving between milk buyers is stressful or may not even be possible – for example in some parts of the UK, a farmer may only have one or two possible milk buyers.

NFU Scotland Comment:

The right for a farmer to terminate a contract is a crucial tool in the dairy market as it allows market forces to play out. However, it does work both ways, as farmers want security and long-term arrangements on which to build their business.

For NFU Scotland, the appropriate length of notice period is dependent on other factors, so may be different for certain arrangements. If a milk buyer has full buyers' discretion, whereby they can vary the price at will, then we would argue that a farmer should be able to leave at very short notice. However, if a farmer has more certainty over how their milk price changes, a longer period would be much more appropriate.

It is also important to weigh up the relative risk of a notice period for farmers and milk buyers, respectively. For a farmer, 100 per cent of their milk may be sold through one contract. Whereas that one farmer may only equal to a fraction of a per cent of a milk buyers' total volume.

Therefore, it is entirely reasonable for a farmer to be able to give notice to a buyer at a much shorter time (e.g. 3 months) than a buyer can give to a farmer (e.g.12 months).

NFU Scotland believes that where there is an agreed contract with terms of e.g. pricing and volumes agreed, and the process of variation procedure understood and always in good faith, then the resignation terms become less relevant in many circumstances which should be the ambition with the supply chain.

Variation of agreements

Question 20:

All parties should be able to request changes to the terms of a contract, with that change only coming into force if agreed unanimously. To what extent do you agree with this statement? Please give reasons for your answer.

Question 21:

Before any agreed changes are implemented, what should be the length of a mandatory minimum notice period?

Question 22:

Any mandatory minimum notice period to vary a contract should be set longer than any minimum termination notice period. To what extent do you agree with this statement? Please give reasons for your answer.

Background:

Variations are an important part of any contract, as many contracts will contain a right for the milk buyer to vary the contract. This may be minor changes to things like penalties, bonuses, or antibiotic testing, but they could also be more significant changes, such as changing the whole payment schedule. Most dairy contracts contain provisions for the milk buyer to make changes on a unilateral basis which means they do not need to consult or gain agreement from the farmer.

NFU Scotland Comment:

The ability to vary a contract, especially on a unilateral basis, is incredibly important, because it can undermine rights and obligations which originally were signed up to. In recent times, we saw some very rapid, unilateral changes to A&B pricing enforced on farmers as milk buyers tried to manage the impacts of Covid-19 on the supply chain.

While we appreciate that sometimes rapid changes are required to manage difficult situations, NFU Scotland believe that it should be done in agreement with the farmer. It is crucial in NFU Scotland's view that any variation should not be imposed, nor should there be pressure to agree to variations at short notice and the risk of losing the contract.

Many contracts often also contain 'circumvention' provisions whereby a milk buyer can disregard other provisions in the contract "if the milk buyer, or board directors deem necessary". Again, these clauses can undermine other provisions in the contract and therefore NFU Scotland believe that they should not be allowed. Force majeure clauses should be available and agreed to address unavoidable circumstances which can impact farmers and processors and therefore there can still be provisions to cope with extreme situations.

There should also be suitable notice periods for changes to contracts. For example, if a payment schedule is being changed to reward more fat & protein, it needs to take in to account the changes required on farm to meet new provisions.

Question 23:

A contract must contain, in clear and unambiguous language, all terms and conditions relating to payments and deductions. To what extent do you agree with this statement? Please give reasons for your answer.

NFU Scotland Comment:

NFU Scotland agrees that there should be provision for bonuses and deductions, and that these should be agreed and set out very clearly in the contract. We often take calls from members who are disputing penalties they have received. By having these agreed and very clearly laid out, it can prevent dispute and improve understanding of both party's obligations.

Clarity on seasonality incentives/disincentives must be considered with the impacts on both buyer and seller as there are clearly long-term management consequences.

Question 24:

Exclusivity clauses should be prohibited. To what extent do you agree with this statement? Please give reasons for your answer.

Background:

Exclusivity means that every single litre of milk a farmer produces, has to be sold to a single milk buyer, and the clause is almost ubiquitous in modern dairy contracts, although are very rare in other agricultural sectors. This has become an assumed default position, but in some situations, it can be restrictive for both buyers and sellers.

There is increasing interest in farmers having the ability to supply more than one milk buyer, especially larger farms who have the volume to be able to physically service multiple contracts. Small farmers can also benefit from the flexibility to diversify some of their milk. This system could allow increased flexibility and choice for a farmer but would also need to come with volume stipulations so that the milk buyer could plan for the correct volumes. In many other countries, exclusivity clauses have been removed or phased out to allow a better functioning dairy market.

NFU Scotland Comment:

Exclusivity is an issue many farmers may not have previously considered. When used in conjunction with discretionary pricing it is an extremely powerful tool for a milk buyer. In theory a buyer imposes an unreasonable milk price, the farmer is then obliged through exclusivity to supply the buyer at the price for many months.

NFU Scotland is keen to see non-exclusive contracts become a choice for dairy farmers. We know that many of our members will not want a non-exclusive contract or may not have enough milk buyers in the area to make use of it, but there are many who would appreciate the option.

As many milk buyers look to better manage milk volumes, we may see them limiting the number of litres a farmer can send. In those situations, it is entirely reasonable for a farmer to send the volume of milk requested under one contract, and an excess volume to another buyer.

There is a case to be made for co-ops, or recognised Producer Organisations to agree exclusive contracts with the proviso that there is no restriction on volumes and no pricing mechanism which would differentiate on price e.g. no A/B pricing. As producer owned and run companies this should be agreed by the membership.

Some producers will benefit from the ability to spread risk by supplying more than one processor, while remaining committed to their current milk buyer, removing the compulsion to resign and cause unnecessary disruption.

NFU Scotland is open to finding a solution that allows sensible and progressive options for all, but we do support in principle of the option of non-exclusive contracts.

Question 25:

Are there any additional clauses which should be mandatory in contractual terms?
Please provide details.

Question 26:

Are there any additional clauses which should be prohibited in contractual terms?
Please provide details.

NFU Scotland Comment:

Dispute resolution should be clearly set out in the contract. It should be based on good faith, the context, and details of the dispute and not on power or financial position.

As mentioned previously, NFU Scotland is keen to see an end to the use of 'circumvention' provisions which allow a milk buyer the discretion to disregard other terms in the contract.

Force majeure is an important clause which should be agreed and clearly set out in a contract. It can cover unexpected situations, such as extreme market events or animal disease on farm.

There should be no terms restricting farmers forming a Producer Organisation, or meeting with other representative organisations.

There should be no unreasonable restrictions of a farmer investigating alternative processors or market opportunities.

Question 27:

Should regulations be introduced to cover confidentiality clauses? Please give reasons for your answer.

Question 28:

If you agree that regulations should cover confidentiality clauses, which confidentiality clauses should be prohibited, and which (if any) are acceptable? Please give details.

NFU Scotland Comment:

NFU Scotland has concerns over clauses in some contracts which appear to prohibit dairy farmers from taking professional advice on a contract. Confidentiality clauses are clearly very important to both parties and hence should be agreed between farmers and processors. They should be specific and limited to the minimum required to make both parties comfortable.

A farmer or processor should be able to seek advice whether legal or consultancy without breaching the contract terms. There should be no unreasonable demands made by restrictive confidentiality clauses, which restrict the ability of a farmer to consider market opportunities e.g. where a farmer may be prohibited to speak to an alternative buyer before resigning his current contract. As with many terms in a contract a farmer may feel obliged to agree to some terms which are unsatisfactory as there are few if any options available in his region. Farmers should not be forced to accept inappropriate terms because of this.

There should be reasonable assumption that farmers can express their views in a reasonable manner without fear of reprisals. It is clear to NFU Scotland that many farmers are very stressed and feel pressured by their milk processor or indeed retail obligations. It should not be underestimated how important a trusting, unthreatening relationship is to farming families.

Question 29:

Please provide your views on the most effective means of dispute resolution and whether this should be binding or advisory.

NFU Scotland Comment:

An effective dispute resolution mechanism is a crucial part of contract reform. If contract terms are breached, there needs to be a well-considered, transparent system to hold those responsible to account, and appropriate penalties for breach to ensure compliance. There is case that the process must be CLEARLY SET OUT and proactive, consistent in contracts.

When a dispute arises then there is a clear need for an agreed escalation process; internal discussion between Farmer/DPO and processor in good faith, mediation (has the benefit of non-binding, but if done well should achieve an agreement) and if needed, either (preferably) arbitration or legal route (both binding).

NFU Scotland has researched dispute resolution in Spain with an Interbranch Organisation comprising farmers (Co-ops/DPO), milk buyers and representatives to oversee the contracts. There is a case to be made for the industry stakeholders to oversee dispute resolution at least in the first instance, but this must be based on good faith and recognition of equal powers within the process. Farmers should not be afraid to raise issues for fear of consequences.

This has the merit of the supply chain resolving issues rather than government agencies or a court of law. Another sensible alternative is for the Grocery Code Adjudicator to be the final arbiter, although their remit is based on the fundamental protection for the consumer.

A very important, even crucial, point many farmers feel we need to address is the power of retail and end users, while also recognising that some farmers have aligned contracts with retailers hence the GCA would be well placed to sensibly extend its remit.

Question 30:

The promotion of Producer Organisations should be considered alongside legislation. To what extent do you agree with this statement? Please give reasons for your answer.

Background:

A Producer Organisation (PO) or Dairy Producer Organisation (DPO) is a structure which allows farmers to collaborate and act as one in dealing with a milk buyer. The structure allows exemptions from some aspects of competition law, so that farmers can come together to negotiate on issues such as milk price and volume. Currently there is only one PO in the UK dairy sector, the Dairy Crest Direct PO, who supply Saputo Dairy UK in the South West of England. A limited liability co-op similar in outcomes has been set up in Scotland. A Dairy PO has its own distinctive terms of reference, which differs from PO's in other sectors. Groups of farmers cannot come together to negotiate without official recognition as PO or Co-op.

NFU Scotland Comment:

NFU Scotland has long been supportive of Dairy Producer Organisations and has offered help and advice to members who are interested in forming one. Improving the bargaining position of farmers is just one important role a DPO or similar organisation can play. A DPO can offer specialist professional and legal support for farmers, it can play a vital role in supply chain efficiency, marketing and play a useful role in helping milk buyers develop closer working relationships with farmers.

For larger milk buyers, as we have seen in Spain there is a benefit and preference in negotiating with a DPO than with a large number of individual farmers.

We believe that DPO's and indeed Co-ops, could become increasingly relevant if there are substantial changes to dairy contracts as a result of this consultation. Farmers, we believe, can benefit greatly by representation on their behalf.

We are aware and grateful that the Scottish Government is supportive of Producer Organisation and welcome working with them and other organisations (e.g. SAOS) to develop understanding and support for farmers, who are essentially small businesses who need leadership and trusted structures.

Question 31:

Are you aware of any impacts to businesses which could arise from the introduction of dairy contract regulation?

Please give reasons for your answer, including any additional annual costs or savings for your business and any specific impacts in one or other parts of the UK.

NFU Scotland Comment:

NFU Scotland does not normally seek new regulation, but dairy contracts are long overdue for reform, and we believe in a form of effective but sensible legislation. Farmers have been treated unfairly for decades and we have a huge amount of evidence provided to us by our members which will be submitting into the consultation.

We are sure that the prospect of regulation will cause concern for milk buyers, and undoubtedly there will be areas of disagreement within the industry. NFU Scotland wants to create a more sustainable future for the entire UK dairy sector, and the relationship between farmer and milk buyer needs to improve. The dairy contract has allowed for some abuse of power to occur and we look forward to the opportunity to make changes to this system.

We are also keen to make clear, that we do not want to 'fix anything which isn't broken'. There are a number of successful relationships between farmers and milk buyers and co-operative structures which are delivering results for farmers. We must ensure regulation gets rid of bad practice and unfairness, but without inadvertently impacting the good practice.

We foresee only beneficial impacts on businesses if the regulations can, as we believe, improve efficiency, productivity and sustainability. We are clear that we want to support and work collaboratively with progressive processors, who will benefit from security of supply to match their demands, and outlaw bad practice that undermines not only farmers, but progressive processors.

We do not envisage any significant additional costs, certainly long term, as new contracts, once agreed, will prove to be more sustainable, more readily adapted through constructive agreement and reduce farmers seeking alternative milk buyers.

Question 32:

How much time would you estimate you need to be ready to implement new legislation and enter into new contracts? Please give reasons for your answer.

NFU Scotland Comment:

There is no doubt, that fundamental change to the dairy sector will take time to implement. We need to be aware of the major challenges the industry faces – the impacts of the Covid-19 crisis, possibly heading towards a disorderly EU exit at the end of the year and the uncertainties of the global market.

Therefore, we would be keen to see a transition period that is reasonable, of around 2 years, in order for stakeholders to fully discuss and develop regulations which underpin the progressive positive contract terms which are sensible for all in the dairy supply chain, facing unprecedented challenges.