

## Reform of 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 that the farming unions receive 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 found that there is an uneven distribution of power within the dairy sector. This led Defra and the Devolved Administrations to announce that they would launch a consultation on contract regulation aimed at improving fairness in the dairy supply chain. The UK Farming Unions (The NFU, NFU Cymru, NFU Scotland and Ulster Farmers' Union) are supportive of this approach and will be providing a response to the consultation. We have developed ideas over the last few years in consultation with our members which will be further enhanced over the consultation period.

### What's wrong with contracts now?

Contracts are critical to determining the business relationship that exists between farmers and milk buyers. However, most milk contracts in their current form do not create mutually balanced business relationships between buyers and sellers and often rights and obligations 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, even to 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 recent Covid19 crisis has seen many of these scenarios play out. Farmers were hit with price cuts at no notice, unilateral implementation of A/B quotas, a lack of transparency over pricing and delayed payments. **Farmers in the dairy supply chain ultimately bore a disproportionate amount of the cost of CV19** as others sought to rapidly pass risk down the chain at breakneck speed.

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. This is not about creating a tool for farmers take advantage of processors with; it is a rebalance of risk, and **an opportunity to address some major issues in the dairy supply chain** to create a better future for the entire industry.

### What needs to change?

The 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 mechanism**
2. **Relationships and farmer representation**
3. **Exclusivity and volume**
4. **Elimination of unilateral changes and one-sided contract terms**
5. **Consequences of breach**

These points are explained in detail on the next page.

We see that there 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 is consulting on this topic, especially as many faults in the dairy supply chain have been highlighted by the recent Covid19 crisis.

We would urge any dairy farmers to get involved in the discussion and feedback to the consultation either directly or via 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.

For more details and questions on contract reform, please also see our Q&A document.

## Reform of Dairy Contracts – 5 key points

### 1. Pricing mechanism

We want to rebalance the risk between farmers and processors, so that there is a **greater sharing of risk** along the supply chain. Discretionary pricing (whereby a processor can unilaterally vary the price at their choosing) should be ended and prices should be transparent and have a clear mechanism which is objective and verifiable. At present, discretionary pricing, in different forms, is almost ubiquitous, and allows for much of the risk in markets and supply chains to be 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 a culture of 'follow the leader' especially with price drops. When farmers are tied in to long term contracts, the market forces cannot operate effectively thus creating imbalances. Ultimately, **price should be market focussed**. We do not believe that we should move away from market forces. Bonuses and deductions can be acceptable, however, they must be made clear and not unilaterally varied subsequently.

### 2. Relationships and Farmer representation

We believe that **relationships are crucial** to the improved working between farmers and processors. The rise of co-operatives and farmer groups in the UK has seen greater farmer collaboration which has massively 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, penalties or bonuses **should be agreed between the parties**, and there is a huge role for **Producer Organisations, Co-ops and farmer groups**.

### 3. Exclusivity and volume

A key mechanism for developing more sustainable contracts is the structure which allows for farmers to supply more than one business. Almost all contracts are currently exclusive, which means you have send every single 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 issues over volume either restricting volumes or changing payment schedules to heavily penalise overproduction which may limit expansion or productivity gains. We are aware that some may prefer exclusive terms, and where this is the case then this should remain an option. For a Co-op or a Producer Organisation. this is choice for them, but we believe that this should be choice. Pricing mechanisms and volumes should logically be mutually managed by farmers and processors.

### 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, a payment schedule may be changed overnight so that the farmer gets paid for a different profile.

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 sometimes 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 jointly by the farmer or their representatives.

### 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 that of 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.