



After everyone else has grabbed their share, there's little left for our farmers.

IT'S TIME TO BACK
OUR DAIRY FARMERS



Milk contracts – what do farmers need from Government?

There is an overwhelming amount of evidence available to suggest that the dairy supply chain is not working properly. This is despite the British dairy industry possessing many distinct advantages ranging from a large, affluent population and growing demand to efficient milk producers and a good climate for producing milk.

The price of dairy commodities has soared over the past 12 months, while prices paid to dairy farmers in the UK have stagnated. Any recent farmgate price rises have been far behind the rate determined by market conditions and are out of line with farmgate prices paid elsewhere in Europe. In fact, the average UK farmgate milk price is among the lowest in Europe despite the UK being a net importer and having a strong fresh-product market.

Many of the challenges the industry faces can only be tackled by the supply chain itself. These include developing a more competitive manufacturing sector, pursuing greater added value markets and building better relationships across the whole chain.

The NFU believes the key problem for many dairy farmers resides in the way that their milk contracts work. To address this problem farmers need the help of Government.

What's wrong with milk contracts?

A milk contract is critical to determining the business relationship that exists between farmers and milk buyers setting out the terms and conditions of sale for raw milk.

Contracts should be freely entered into by both parties. All too frequently, however, milk contracts are one-sided documents. Specifically, we would highlight the following significant shortcomings in milk contracts:

- The majority of milk contracts offer dairy farmers absolutely no certainty or clarity about the price they will be paid from month to month. They allow changes to milk prices to be made unilaterally by the milk buyer at short notice. Dairy farmers have no exit clause in their contract to move to another milk buyer if a better price is available elsewhere.
- Dairy farmers are locked into contracts with notice periods of up to 18 months. Therefore, the potential to create a competitive market for raw milk, where farmers are able to switch buyer, is very limited.
- Milk contracts are mostly exclusive, requiring farmers to sell all their milk to one buyer. This reduces competition for milk.
- Milk is a perishable product that has to be collected daily and so dairy farmers have little choice but to sign the contracts they are offered. Being all of a similar type there is little freedom to negotiate the terms of contracts that are offered.
- As can be seen above, milk contracts exploit the fundamental weakness in the position of dairy farmers obliging them to shoulder the greatest risk, for the smallest reward.

What has been done to improve contracts?

Farmers are looking for much greater clarity and certainty about the terms of their contracts, especially the price that they will be paid. In 2007, the NFU developed a standard template milk contract to be used between milk producers and milk buyers to demonstrate how contracts could be improved.

While there have been some positive developments in the types of milk contracts offered to a selected group of dairy farmers, generally milk buyers have proved very reluctant to improve milk contracts. This is largely because doing so would reduce the power they currently have to adjust raw milk prices. No individual buyer wants to put themselves at a competitive disadvantage by reducing their ability to change prices.

The EU dairy package – what it offers

The EU Commission recognises that contracts are a key problem for the industry and with milk quotas due to be abolished in 2015 has tabled a set of proposals to strengthen the position of dairy farmers in the supply chain following the recommendations of a High Level Group.

The Commission proposals include:

- the price to be paid, volume, duration of the agreement and termination rights
- Permitting Producer Organisations to be established that allow dairy farmers to come together (subject to quantitative limits) to improve their negotiating power with milk buyers.
- Introducing greater market transparency in the dairy supply chain.

The Commission's proposals don't address all of the shortcomings in milk contracts since they do not tackle the problems caused by exclusive contracts which lock farmers into selling to one buyer. But the NFU believes they go some way towards helping dairy farmers in the UK establish a more balanced business relationship with their milk buyer. If the proposals were implemented by member states, they would require contracts to contain a degree of certainty and transparency over the way prices are determined. Simply knowing how the milk price is determined would represent a major step-change in milk contracts and go a large way towards addressing the lack of clarity on prices that are offered to dairy farmers in milk contracts currently.

What can Government do?

In the same way that Government has taken the decision to introduce an adjudicator to enforce a Groceries Supply Code of Practice to eliminate abuses of power by retailers, we believe that government involvement is needed to ensure fair dealings between dairy farmers and milk buyers.

The NFU would like government to raise the benchmark for all by setting out certain baseline requirements for milk contracts. This would go some way towards eliminating unreasonable contractual practices and create fairer and balanced contractual terms prior to the removal of milk quotas.

Specifically, we would like Government to:

- Back the Commission's proposals to provide a new baseline standard for milk contracts that is compulsory across all milk buyers and milk deliveries. At this stage all that the Government needs to do is indicate its support for the proposals. This may be sufficient to encourage change voluntarily across the industry. If not, the government should consider implementing the requirement for mandatory contracts as specified in the proposals once the EU regulation has been agreed
- Work with the industry to draw up a contractual code of practice to promote fairer dealings between farmers and dairy companies. This could have a broader scope than the Commission's proposals and encompass a wider set of common contract clauses such as price variation, termination, exclusivity and assignment.
- Examine whether the operation of Rural Development Programmes can be improved to assist farmer representatives by enabling the employment of professional support for negotiation.
- Investigate the possibility for producing more transparent information on the distribution of margins and wholesale prices in the dairy supply chain.