DAIRY INDUSTRY

CODE OF BEST PRACTICE ON CONTRACTUAL RELATIONSHIPS

Dairy UK

NFU

NFU Scotland

1 INTRODUCTION

This Code of Good Practice has been drawn up with Dairy UK and NFU and NFUS. It sets out good practice for contracts between producers and purchasers. This Code has been agreed to address a number of long standing issues with dairy contracts, such as those identified by the EU High Level Working Group on the dairy supplychain.

The aim of this Code is to address some of these issues in a way that works for both producers and purchasers. The basis of this code is the Dairy Industry Code of Best Practice on Contractual Relationships, Heads of Agreement document agreed and signed by the NFU, NFUS and Dairy UK, witnessed by the Minister for Agriculture James Paice on 23rd July 2012. Whilst adherence to this Code is voluntary, it is designed to set out minimum good practice in terms of dairy contracts. Purchasers adopting this Code should do so in full, so that they can demonstrate their compliance with good practice on dairy contracts.

The code will be subjected to an annual review process to assess its effectiveness and compliance. Not withstanding the review, the parties may raise concerns regarding the adoption, use or interpretation of the code at any time. If, during the review, either party is dissatisfied with the operation of the code, the review will be extended to cover all aspects of contracts, including the range of pricing mechanisms.

2 PRICING (BASE MILK PRICE)

Contracts between producers and purchasers must set out either a clear price, or a clear pricing mechanism (such as a formula) or a price notification process (the process by which the processor notifies the producer of the price), such that at any given point in time, a producer can be certain of the base milk price that will be paid for the milk produced.
Purchasers should provide contracts which either:

(A) have a price or pricing mechanism that is negotiated and agreed between the producer and the processor; or

(B) have a price, pricing mechanism or price notification process that is at the purchaser's discretion.

Whether the purchaser offers contracts under (A) or (B) above, the contracts should at all times comply with the requirements of this Code for each of these options, set out below.

Large purchasers should offer producers two or more different pricing options to enable producers to adjust better their contract to their preference for risk or security. Large purchasers would be defined as purchasers with over 250 producers contracted to them.

In all circumstances, the contract must provide that producers will be given at least 30 days written notice of any downward change to the price, or pricing mechanism or price notification process, and for the avoidance of doubt, the contract should not permit any changes to the price, pricing mechanism or price notification process to be made retrospectively.

2.1 OPTION A: NEGOTIATED/AGREED PRICING

Under this option, the base milk price, or the base pricing mechanism, is negotiated and agreed between the producer and the purchaser in advance. The contract must set out:

(a) what has been agreed by negotiation at the outset, whether that be a fixed price for a period of time, or a pricing mechanism (such as a formula); and

(b) how variations to the price or pricing mechanism are to be negotiated and agreed (including any dispute resolution process).

A price notification process is incompatible with this option A.
The ways in which producers and purchasers may negotiate and agree pricing, and the requirements of this Code in respect of each option, are set out on the next page.

2.1.1 *Negotiation with Producer Organisations*

The EU Dairy Package now permits the creation of Producer Organisations to undertake pricing negotiations on behalf of dairy farmers. Purchasers may negotiate and agree pricing with recognised Producer Organisations, where the Producer Organisation is recognised by Government, and where the producers have given the Producer Organisation authority to negotiate and agree pricing on their behalf.

It is acknowledged that Producer Organisations must be able to either resign some or all of the producer contracts, or adapt volume sales to alternative purchasers, if the Producer Organisation is not satisfied with the outcome of the negotiation.

2.1.2 *Negotiation with individual producers*

Purchasers may negotiate and agree pricing with individual producers. Purchasers using this option must be able to demonstrate that the pricing was individually negotiated, and agreed, with each producer (for example, by maintaining a written record of the negotiation).

2.2 OPTION B: PRICING AT PURCHASER'S DISCRETION

Under this option, the base milk price, or the base pricing mechanism, or the base price notification process, is at the discretion of the purchaser (i.e. the purchaser has the ability to set the price, mechanism, or price notification process.) Contracts under this option must set out clearly at the outset:

(a) the price, pricing mechanism or price notification process that the purchaser has opted for; and
(b) how variations to the price, pricing mechanism or price notification process will be dealt with.

In all cases where the contract is made under this option B, the contract must expressly:

(a) state that no downward variation to the price or to the pricing mechanism or price notification process will be made by the purchaser unless the purchaser has given the producer at least 30 days' written notice of any such changes (and for the avoidance of doubt, no contract should allow the purchaser to make retrospective changes to pricing in any circumstances); and
(b) allow the producer to terminate their contract with the purchaser without penalty on a maximum of 3 months' written notice following notification to the producer of any change made by the purchaser to the price, pricing mechanism or price notification process. Notice by the producer must be submitted within 30 days of receipt of the written notification of any change to the price, pricing mechanism, or price notification process.
(c) state that the purchaser undertakes to put in place a mechanism to engage in dialogue with the producer(s) or the producer's democratically accountable representatives (where such a mechanism has been agreed by the purchaser with those producer representatives), or a mechanism to formally consult with the producer(s) or the producer's democratically accountable representatives (where such mechanism has been agreed by the purchaser with those producer representatives) in advance of any variations to pricing.

In respect of (b) above, producers and purchasers may agree a longer notice period, beyond the 3 month notice period, provided that such longer notice period is agreed through a process of negotiation with properly constituted democratically accountable supply groups.

Specific requirements relating to Co-ops

Co-ops (including non-Co-ops with groups of producers in transition to full Co-op status) who have opted to use contracts under this option B do not have to include clauses covering (b), and (c) above in their contracts with producers who are members of the Co-op, provided that the Co-op can demonstrate that it has governance procedures in place to ensure that the Co-op is under the control of its producer members, and that the Co-op is acting on their behalf (or in the case of transitional Co-ops, that the full Co-op will so demonstrate after the transition. Farmers in transition to full co-op status will be given the option of moving to direct contracts within 9 months of the introduction of the code).

3 PRICING MECHANISMS

Where the contract provides for a pricing mechanism (as opposed to a fixed price or a price notification process), such as a pricing formula, the contract should specify:

(a) the exact pricing mechanism / formula to be used; and
(b) how any variations to the pricing mechanism / formula are to be dealt with; and
(c) the source(s) of any data / indices which will he used in the formula; and
(d) where the source of any data / indices is the purchaser (e.g. purchaser margins), the contract should require the purchaser to make full disclosure* of the data / indices to the producer or the producer's elected representatives.

*any information disclosed in this manner must be treated as commercially confidential and used solely for the purpose of this provision. None of the documents or information providedmay be disclosed beyond named individuals or Board level individuals within the PO who may use the information solely to verify the price and the price mechanism and who will not disclose the information more widely within the PO other than on a need to know basis.

4 PRICING ADJUSTMENTS

Whether the base milk pricing is dealt with under options (A) or (B) above, the actual price paid to the producer may be subject to adjustments, provided that such adjustments are compliant with the requirements of this Code, set out below.

In all cases, any potential adjustments (or adjustment calculations) to the price paid to the producer must be set out clearly in the contract at the outset. Any changes to such adjustments (or adjustment calculations) cannot be made unless the producer has been given at least 30 days' written notice of any proposed changes and for the avoidance of doubt, no changes should ever be made retrospectively.

The contract may provide for the following adjustments, provided that any calculations pertaining to such adjustments are specified in the contract and are clear at the outset:

(a) pence per percentage of any measurable constituent content (e.g. percentage of butterfat content);
(b) seasonality adjustments designed to incentivise a certain profile of production (e.g. pence per litre deductions / additions by month);
(c) transport payments (e.g. deductions / additions for volume loaded into a tanker at collection);
(d) milk quality payments (e.g. deductions / additions for somatic cell counts), in which case the testing methods for such quality assessments, and appropriate appeal mechanisms, should be clearly specified in the contract;
(e) production methods (e.g. conforming to specified animal welfare requirements); and / or
(f) bonuses for continuity of supply.

The contract must allow the producer (excluding co-op members and producers in transition to co-op status) to terminate their contract with the purchaser without penalty on a maximum of 3 months* written notice from the date of notification to the producer of any change made by the purchaser to the price adjustment(s). Such notice may be served by the producer at any time within 30 days of receipt of notice from the purchaser of any price change. *Producers and purchasers my agree a longer notice period, beyond the 3 month notice period, provided that such longer notice period is agreed through a process of negotiation with properly constituted democratically accountable supply groups.

5 VOLUME / EXCLUSIVITY

The contract must allow the producer to supply milk to other purchasers where the producer wishes to expand their production and the first purchaser does not want to purchase the additional milk under the same terms and conditions. This aspect of the Code is to be reviewed as part of the first year review.

6 CONTRACT DURATION

Contracts maybe for fixed periods or may be rolling contracts (often referred to as 'evergreen' contracts).

6.1 *TERMINATION / NOTICE TO TERMINATE*

The contract should specify the notice period under which either party may terminate the contract. The notice period required from the producer (subject to the other provisions of this Code):

(a) should not exceed 15 months except in cases where the purchaser cannot give notice to terminate (i.e. where the producer has indefinite membership of a Co-op), in which case the producer notice period should not exceed 24 months; and
(b) should not exceed the notice period required from the purchaser; and
(c) should not normally be less than 3 months; and
(d) should not be limited to notice served on particular dates or at particular times so as to effectively extend the notice period beyond the maximum periods set out in this section.

The contract should specify how notice is to be served by either party.

6.2 *TERMINATION ON INSOLVENCY*

The contract should allow either party to terminate the contract with immediate effect in the event that either party is issued with a winding up or administration order, or where either party goes into administration, receivership, liquidation or bankruptcy.

6.3 *EARLY TERMINATION ON PAYMENT OF LIQUIDATED DAMAGES*

The contract should allow either party to terminate the contract on not less than four weeks' written notice, on payment by the terminating party of liquidated damages. The payment to be made in such circumstances should be set out in the contract at the outset, but must in all cases represent a genuine pre-estimate of the other party's losses arising from the early termination. The payment to be made by the producer must not exceed in any case a specified percentage of the value of the producer's estimated annual production.

6.4 *TERMINATION ON FUNDAMENTAL BREACH*

The contract must allow either party to terminate with immediate effect if the other party fundamentally breaches the terms of the contract. The contract may specify what would constitute fundamental breach by either party.

7 VARIATION OF CONTRACT TERMS

The contract should set out the process by which variations to the terms of the contract can be made. Unless the Code says otherwise, any changes to any term of the contract which is not specifically agreed with the producer (or the producer's democratically accountable representative) cannot be made unless 30 days written notice has been given to the producer of the proposed change.

The contract should also allow the producer (excluding co-op members and producers in transition to co-op status) to terminate on a notice period of not more than 3 months* if any changes to any of the terms of the contract are made which have significant commercial implications for the producer and which have not been specifically agreed with the producer (or the producer's democratically accountable representatives).

*Producers and purchasers my agree a longer notice period, beyond the 3 month notice period, provided that such longer notice period is agreed through a process of negotiation with properly constituted democratically accountable supply groups.

8 PRODUCER INVESTMENT

Producers may have invested money in their purchaser, whether the purchaser is a Co-op,or a private limited company, or a public limited company. The contract should clearly specify whether or not the investment is to be returned if the producer resigns, and if it is to be returned, over what timescale and whether any interest is payable.

9 COMPLIANCE WITH RELEVANT EU LEGISLATION

As a minimum all contracts should be compliant with all applicable and relevant EUlegislation implemented in the UK.

10 OTHER TERMS TO BE SPECIFIED IN THE CONTRACT

The contract should also specify:

(a) parties to the contract: the legal identity of the parties to the contract and their addresses for service;
(b) volume measurement: the method to be used to measure the volume of milk collected;
(c) timing of payment: either monthly or four weekly and the date in the month on which the payment should be made;
(d) sampling process: the method used to take samples from the milk;
(e) legal obligations: compliance with quota regulations and any applicable EU and national regulations;
(f) purchaser obligations: compliance by the producer with purchaser requirements in respect of any applicable schemes or assurance standards;
(g) force majeure: the contract should specify what events constitute events of force majeure, and how such events will be dealt with;
(h) property and risk: point of transfer of ownership of the milk and risk in the milk;
(i) assignment (assignation): the circumstances under which the contract can and cannot be assigned by either party must be specified but in any event neither party should be entitled to assign their rights and obligations under the contract without the other party's written consent;
(j) provision of insurance: any obligations on either party to insure should be specified;
(k) confidentiality: whether any confidentiality obligations apply:
(l) governing law and jurisdiction: these should be specified in the contract.

Supplementary Agreement on the Voluntary Code of Practice between NFU/S and Dairy UK

A *Review Process*

The review process will be undertaken as follows:

- The code will be reviewed after the first year to assess its effectiveness and compliance.
- Continual dialogue and exchange will take place between the Unions and Dairy UK during the course of the year prior to the initiation of the formal review period
- Subject to agreement by both parties an independent chair will be appointed to facilitate the review process
- If requested by both parties the independent chair may be called upon to:
  - Make non binding recommendations
  - And/or mediate

The review will also consider the issue of the independence of democratically accountable supply groups and their role in negotiation and agreeing pricing with the purchaser, insofar as such a role is compatible with competition law provisions. It will also address the detail regarding exclusivity.

It is expressly understood that the UK Government and Devolved Administration reserve the right and willingness to legislate under the EU Dairy Regulation if they so decide after the review. It is acknowledged that the Governments can do this at any time.

B *Guide on Co-op Governance and Democratic Accountability*

NFU/S will establish a best practice guide to good corporate governance for Co-ops and producer group efficacy and democratic accountability.

C *Legal Clearance*

Adoption and implementation of the voluntary code is subject to full legal clearance by Government and OFT.