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Position Paper

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EDA SUBMISSION TO AMTF ON CONTRACTUALISATION AND CONTRACTUAL RELATIONS

Introduction

The EDA welcomes the examination by AMTF of contractualisation and UTPs. However, if the AMTF is to come forward with recommendations that will contribute to the development of the European dairy industry then it must have a clear conception of the problems facing the sector.

In large part the AMTF has been created following concerns about the impact of downward price volatility on farmers. Price volatility is clearly a normal part of functioning agricultural commodity markets. Milk purchasers are affected by price volatility, but dairy farmers inevitably incur the greater burden of downward price adjustment. However, this is counterpointed by the fact that dairy farmers are equally the main beneficiaries when prices rise.

The root cause of this situation is not inadequate representation of dairy farmers in the supply chain. EU dairy farmers are powerfully represented by co-ops which account for the majority of the raw milk purchased in the EU.

The underlying cause of the exposure of dairy farmers to price volatility is in the commodity nature of the raw milk produced by the majority of EU farmers. Most raw milk is completely undifferentiated and near perfectly substitutable. Prices are therefore driven by the marginal use. This creates the commodity pricing dynamic.

The prescriptions that flow from this analysis are clearly different to those that would follow from the view that there are structural imbalances in the supply chain. Seeking to address perceived structural imbalances would result in initiatives that would interfere in the operation of the market which would undermine the international competitiveness of the EU dairy sector.

The EU dairy sector has already been subject to regulation by the Dairy Package. The option opens to dairy farmers to create Producer Organisations to negotiate with private dairy companies will take some time to have an effect.

We strongly believe that further regulation is not required in producer/purchaser relations in the dairy sector. Any further regulatory initiatives would also have to address the dilemma that regulation affecting all milk purchasers would interfere in farmer run dairy co-op businesses, whilst focusing only on private dairy companies would be discriminatory.

We believe a better approach would be a focus on the competitiveness of the EU dairy sector. This would translate by ensuring the proper development of competitive EU markets whilst assisting dairy farmers to continually improve their international competitiveness. This would ensure the industry would be able to make the fullest possible contribution to EU growth and global food security.



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Questions from the AMTF

Contractualisation

1. Is the current balance between mandatory and voluntary contracts for specific sectors/products as laid down in the CMO Regulation appropriate? Is there a need to consider mandatory contracts for additional sectors/products? If so, what is the justification (e.g. specificity, organisation/structure of the sector, geographical considerations)?
 - › The current framework provided by the CMO for the dairy sector is appropriate. The importance of freely negotiated contracts to the development of the industry means there should be no further efforts by the EU to interfere in contractual relationships in the dairy supply chain.
 - › Contracts between milk purchasers and dairy farmers should not be made mandatory across the EU. The decision on whether or not to regulate contracts should remain with individual Member States. The diversity of industry arrangements in each member States and the different experience of those states that have regulated means there can be no presumption that further EU regulation would be uniformly beneficial.
 - › Commercial relationships between farmers and milk purchasers are evolving rapidly in the EU. The process of market de-regulation arising from CAP reform and the abolition of the quota regime has required purchasers to develop a new basis to manage relationship with farmers. Opportunities for market development have also encouraged milk purchasers to develop an even closer engagement with their supplying farmers. Contracts now tackle issues ranging from price volatility to farm management practices.
 - › The impact of regulation in assisting the evolution of contracts has been mixed. Regulation may have accelerated the evolution of commercial relationships in some of the Member States that elected to use this option. In others it led to the development of voluntary codes of practice as an alternative to regulation. In other cases, regulation has been of little relevance, particularly in those Member States where co-ops are predominant.
2. (i) Are the terms of the current framework for contractualisation (i.e. Articles 148 (milk) and 168 (general) CMO) sufficient? Should additional provisions, be envisaged? If so, which?
 - › The current terms for contractualisation in the dairy sector are sufficient. There should be no further effort by the EU to prescribe the content of dairy contracts.
 - › The interpretation of whether a new contract is required if any of the components of the contract are changed should remain at Member State level. Article 148 of regulation 1308/2013 covering the content of contracts has been interpreted to mean that new contracts are required any time any component of the contract is changed, such as price or price formula. This has made the continuation of open ended evergreen contracts (open ended without time limit) that give producer security of outlet problematic and exposed farmers to contract insecurity.
 - › As long as their statutes contain provisions having similar effects, co-ops should remain exempt from the requirement to offer contracts if a member state does decide to regulate. The precise manner in which such 'similar effects' could be achieved should be left to dairy farmer co-ops members to decide how to manage their affairs within their own businesses.
 - › Production costs are independent of milk price. However, any arguments by some stakeholders that contracts must take account of production costs should be rejected as inconsistent with a market orientated agriculture and wholly incompatible with ensuring the competitiveness of the EU dairy sector.



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- › How the contractual element concerning volume is fulfilled should not be prescribed. Voluntary and individual measures by milk purchasers, which are intended to mitigate volumes, should in no way be seen as a solution to regulate supply at national or European level by public authorities. It should be left up to individual milk purchasers to determine their own strategy with respect to supply management.
- › Article 168, paragraph 5 of Regulation 1308/2013, which would allow Member States to establish a mediation mechanism to cover cases in which there is no mutual agreement to conclude a contract, should not be extended to the dairy industry. This would effectively end the market orientation of the dairy sector and institutionalise or even politicise the conflict over price setting.

2. (ii) Do contract conditions always have to be symmetrical for parties or could differentiated rules, e.g. for termination of contracts, cater for different risk profiles and vulnerabilities?

- › Asymmetrical contracts in the dairy sector cater for the different risk profiles of the parties involved. Contracts in the dairy sector are normally evergreen (open ended without time limit) and give purchasers, whether private dairy or co-op, discretion to change the price according to the income generated from the market, whilst requiring both parties to give long notice periods. In this arrangement farmers exchange uncertainty over price, for the benefit of security of outlet, i.e.; they are confident their milk will be collected and marketed. Purchasers obtain security of supply and the flexibility over raw material costs they require to remain competitive in volatile markets.
- › Seeking to impose upon the industry symmetrical contracts through dairy farmers receiving fixed price contracts would potentially expose farmers to considerable insecurity. Volatile markets inevitably mean that processors do not know the returns that they will receive. Consequently, they may only be able to provide fixed price contracts of short duration, which would expose farmers to the risk of not having an outlet for their milk should processors feel unable to renew the contract. On the other hand, longer fixed contracts would only reduce prices.

3. Is there merit in extending the sugar system comprising compulsory individual delivery contracts and collective written agreements within the trade to all or some sectors?

- › The extension of compulsory contracts to cover all sector could potentially disrupt the functioning of the internal market. Every agri sector has its own specificities which cannot be streamlined. Also, as stated above the decision on whether to make contracts mandatory should be left to individual Member States.

4. (i) To what extent is the effective organisation of a sector (e.g. through POs/cooperatives) essential to inducing more constructive/empathetic trading relationships within the supply chain?

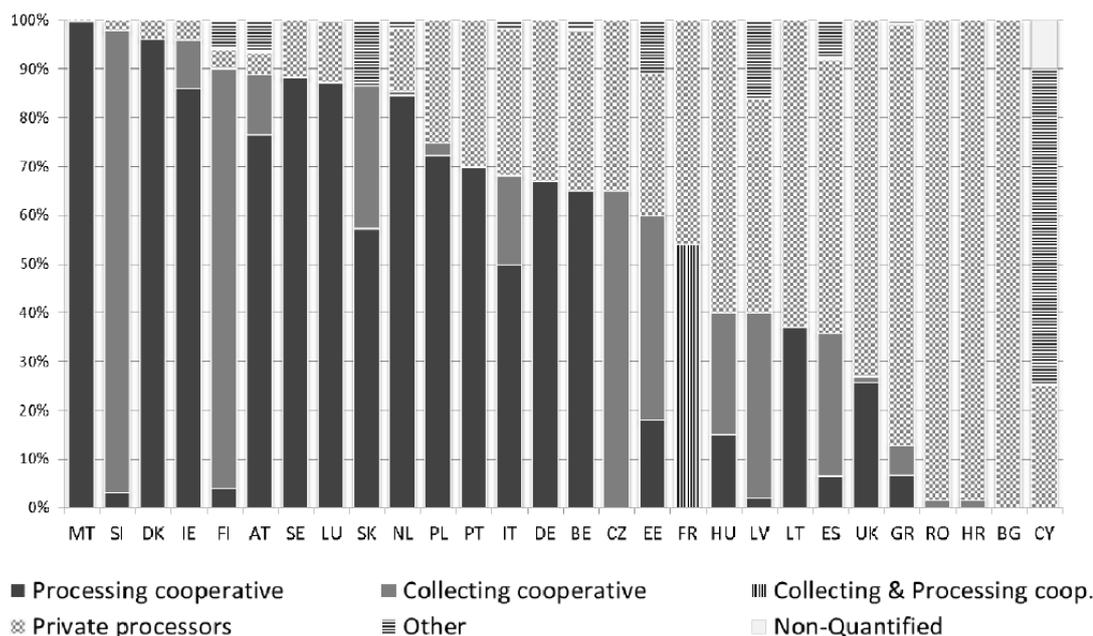
- › The dairy sector is already well organized with coops and private dairies with strong links between the farmers and their dairies. Some farmers prefer to supply a private dairy; others prefer to be member a dairy coop. Both systems have their benefits and constraints.
- › The proportion of milk accounted for by dairy co-ops and the strength of the relationship between dairy farmers and many private dairy companies means that constructive/empathetic relationships within the supply chain are already widespread through the dairy sector.
- › The majority of all EU milk is processed by dairy co-ops. Co-ops also account for the majority of milk processed in the majority of EU Member States. A co-op is de facto a producer organisation but also more than that. The difference is that co-ops, beside vertical integration of farmers, have processing facilities and the responsibility for the farmers' future income through development of the dairy company.



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Share of cow's milk deliveries by type of contractual arrangements (2012)



Source: European Commission¹

4. (ii) Would there be an interest in having such organisations negotiate certain risk and profit sharing mechanisms which the different operators in the food supply chain integrate into individual delivery contracts? Could this improve the distribution of the value added in the chain?

- Co-ops are essentially a profit sharing mechanism by which means producers determine the income they wish to take from their investment in processing balanced against retaining profits in the co-op for investment to secure future income. The role of producer organisations in negotiating prices with dairy companies means they are involved in the process of risk sharing.

5. Should Member States play a more active role in promoting/recognising POs/IBOs and tailoring their statutes accordingly?

- The creation of Producer Organisations inevitably has to be left to the initiative of dairy farmers. There is already widespread knowledge of the availability of this option by dairy farmers. The creation of POs requires leadership, trust, sustained communication, administrative expertise, a willingness of farmers to commit their own financial resources and time.
- In considering options for the further development of POs and APOs it is important that their creation should remain at the discretion of dairy farmers and that individual dairy farmers supplying a private dairy company should not be compelled to join them if they do not wish to do so.
- Farmers owned co-ops are another way for collectively market their products. There is no room for POs within co-ops. It is vital that the integrity of the farmer owned co-ops is not disrupted by the operations of producer organisations.

¹ Without questioning the Commission's overview, our assessment would show some differences.



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6. How can contract compliance and enforcement be successfully achieved/ensured? To what extent is a functioning futures market considered essential to a successful system of contractualisation?

- › Contract compliance is not an issue in the dairy sector. EU milk purchasers and dairy farmers generally honour their contractual commitments.
- › A functioning futures market would represent an opportunity for some elements of the EU dairy industry supply chain to mitigate the impact of price volatility. However, it is not a prerequisite to the further development of contractual relations in the industry. A futures market is not central to the operation of contracts in the dairy sector, because the dairy products traded in the futures markets (SMP, industrial butter, whey...) are not agricultural products coming from dairy farms but some specific final dairy products coming from some dairy processors.

7. Is it considered that producer organisations, associations of producer organisations, cooperatives or IBOs can play a specific role in drawing-up and promoting the use of standard forms of contracts and contract terms and publishing certain types of contract information?

- › The ability of IPOs to draw up standard contracts is already included in the CMO (Article 157, paragraph 1 v). However, their use should remain to the discretion of the partners. Flexibility would help to adapt their contract to the specific market of the dairy and the specific conditions of production of the region or the type of farmers of the dairy.

Contractual Relations:

1. (i) Distribution of value added: Is the value added fairly distributed between the different operators along the food chain and have these shares changed significantly over recent years?

- › The term 'value added' has now attracted a range of connotations and meanings. However, as a matter of principle the distribution of the benefit of value added in the supply chain should be according to the contribution made towards its creation.
- › The overwhelming majority of EU dairy farmers produce an undifferentiated product (raw milk), which, because of its near perfect substitutability, has the characteristic of a commodity. This means that the trend in raw milk prices is determined by the marginal use of raw milk, which are the commodity products such as bulk butter and skimmed milk powder. The investment by processors in product differentiation and branding will increase the added value.
- › Producers can obtain a greater share of the value added created by the industry by direct investment in processing through co-operatives, or by finding ways of differentiating raw milk at the farm level that generates additional value further along the supply chain. The latter route is a particularly demanding challenge for dairy farmers.
- › Distorting the distribution of value added by altering the negotiating power in the supply chain would simply reduce the incentives for its creation.

1. (ii) Is the price transmission from the producer to the consumer satisfactory?

- › Milk farm gate prices are linked to wholesale markets but there is no necessary link between farm gate prices and retail prices. Retail prices of dairy products may move entirely independently of changes in farm gate prices.
- › Dairy products are an essential part of the EU diet. During a recession, retailers may respond to the competitive pressure created by greater consumer focus on maximising value by price discounting on dairy products in order to drive footfall through their stores.



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- › It is not evident that a link with farm gate prices and retail prices would be desirable. Cyclical upward fluctuations in retail prices may only erode long term consumer demand for dairy products.
 - › Of concern to dairy farmers is the transmission of cost changes to consumers. However, in a market orientated agriculture prices reflect the supply/demand balance and are independent of costs in the short term. Given the integration of the EU into the world dairy market then the trend in prices reflect the global supply/demand balance.
2. Unfair Trading Practices: Do Unfair Trading Practises exist in the food chain and is it a common problem? If yes:
- to what extent?
 - are UTPs concentrated at certain stages of the chain?
 - are UTPs concentrated at certain product categories?
 - are UTPs limited to certain Member States?
- › When UTPs occur in the dairy industry supply chain they predominantly occur at the retail level.
- › The majority of raw milk in the EU is purchased by dairy co-ops. As such the trading terms between the co-op and its members are under the control of dairy farmers. Competitive pressures ensure that private dairy companies broadly operate the same commercial practices with their supplying farmers as dairy co-ops. There is no evidence of any substantive difference in the treatment of dairy farmers between co-ops and private dairy companies. Arbitrary changes to contract terms or the disregard of contractual commitments that characterise UTPs are not a common occurrence between dairy farmers and milk purchasers, either co-op or private dairy company.
3. Functioning of the food supply chain: Can the functioning of the chain be improved by addressing UTPs? If yes:
- via a continuation of the development of the existing voluntary initiatives (SCI and its national platforms)?
 - via a targeted approach where the Member States adopt- and enforce measures adapted to national/regional challenges (i.e. national legislation, national enforcement)?
 - via an EU approach with framework legislation and national enforcement?
 - via EU legislation, targeting the whole chain and enforcement at EU level?
- › The food chain structures in Europe are far too different for a “one size fits all” approach to be successful. The ideal way to deal with the issue is to ensure it is addressed at national level through a stronger enforcement of current rules. Voluntary supply chain initiatives and national platforms will need time to take effect.
4. Is the CAP an appropriate tool to address UTPs?
- › The CAP already addresses an enormous diversity of policy objectives ranging from income support to farming to bio-diversity. Amending any element of the CAP may prompt interested parties to seek amendments in other areas which would delay the legislative process. Any initiative on UTPs should ideally be through a separate policy instrument.