NORTHERN IRELAND DAIRY INDUSTRY VOLUNTARY CODE OF BEST PRACTICE ON CONTRACTUAL RELATIONSHIPS

December 2012

INTRODUCTION

This Code of Practice has been developed by Dairy UK (NI) in association with the Ulster Farmers' Union (UFU). It is recognised that adherence to the Code is voluntary, and is designed to set out good practice for contracts between producers and purchasers. Adherence to the Code of Practice does not equal compliance with competition law and businesses remain individually responsible for compliance as regards their own particular contractual agreements.

It has been developed following development of a similar voluntary Code of Practice in GB, and recognises the significant differences between the dairy supply chains in GB and NI. In particular:

- In contrast to GB, the majority of milk in NI (of the order of 80%) is supplied to farmer owned co-ops. Co-ops of this nature are largely exempt from the principle requirements of the EU Dairy Package.

- In contrast to GB, NI has a land border with another MS. Approximately 30% of the NI milk pool is purchased by co-ops that have their main operations in ROI, and at the time of drafting this document, it is not clear how the Dairy Package will be implemented in ROI. Therefore, this agreement is not intended either to undermine the position of NI based purchasers, or to create impediments to ROI based purchasers continuing to source milk from the NI milk pool.

- In contrast to GB, where the majority of milk is used in domestic markets, NI has an export orientation. This means that the NI dairy supply chain is much more dependent on returns from global commodity markets, and, therefore, is much more exposed to the volatility in these markets. As a consequence, the practice in NI is to provide suppliers with retrospective price notification.

1. GUIDING PRINCIPLES

The process of supply and purchase of raw milk in NI is, in effect, a free market. This Code is not intended to place restrictions on the ability of suppliers, either individually or collectively, and purchasers to establish and develop a contractual relationship that is to their mutual benefit.

2. Volatility is a feature of the dairy supply chain, particularly for regions like Northern Ireland that are largely dependent on international markets. This Code is not intended to restrict the flexibility of the relationship between suppliers and processors, or the ability of both parties to minimise the risks associated with volatility, to their mutual benefit.

3. For some suppliers operating in this free market a priority is to have a relationship with a purchaser that maximises their ability to move to another purchaser at any time and with minimal constraints. In these situations this Code recognises that a written contract may be an impediment to such flexibility, and where it can be demonstrated that there is clear understanding of the contractual relationship between both parties, a written contract may not be required. A relationship of this nature must be agreed by both parties, and if a supplier requests a written contract at any time in their relationship, then the purchaser must provide this. In the remainder of this document, reference to "contracts" is based on this understanding.

The remainder of this document sets out the framework for the contractual relationship (either written or verbal) between a supplier or supplier group, and the purchaser.

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).

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.

Changes to the base price may be notified to the supplier retrospectively, but no further downward alteration may be made to the price for any given period once it has been notified.

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

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 variation 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 the pricing mechanism or price notification process 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 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 be 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 provided may 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 may be 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, or, if a co-op, such amount as is agreed by the members of the Society. 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 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.

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 EU legislation 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.

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Mr. Chris Osborne	Dr Mike Johnston
(on behalf of UFU)	(on behalf of Dairy UK(NI))
Date: 3/12/12	Date: 3 December 2012.

Supplementary Agreement on the Voluntary Code of Practice between the UFU and Dairy UK (NI)

A. Review Process

The review process will be undertaken as follows:

- The Code will be reviewed once the detail of the implementation of the Dairy Package in ROI is known.

- The Code will be reviewed again after the first annual review of the Code in Great Britain.

- Unless there is a significant change to the operation of the dairy supply chain, it is not envisaged that there will be regular reviews of this Code. However, if either UFU or Dairy UK (NI) has reason to believe that there is substantive change in the dairy supply chain to warrant a review, this can be requested.

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.

While it is acknowledged that UFU has the majority of dairy farmers in NI within its membership, there is a number outside its membership. It is understood that in developing this Code, and in any future discussions about it, UFU will strive to represent the views of all dairy farmers.

B. Governance

Whilst it is recognised that each co-op is responsible for its governance, it is acknowledged that the UFU intends to establish a best practice guide to good corporate governance of co-ops and producer group efficacy and democratic accountability.