Guiding principles for Milk Supply Agreements

Introduction

In its document titled "Recommendations on the relationship between active shareholders and co-ops in the context of the post 2015 dairy expansion" published at the end of 2011, IFA recommended that co-ops should make arrangements for milk supply agreements with their shareholder suppliers in order to improve each party's ability to plan for the post quota era. IFA also recommended that, in order to increase control by active shareholders, especially dairy farmers, of their co-op, farmers should be encouraged to increase their shareholding. Finally, IFA also warned against excessive reliance on funding from farmers, who will need to prioritise their available resources for significant on-farm investment, and urged co-ops to make jointly the necessary investment to cater for additional milk.

Milk supply agreements are very important for both farmers and co-ops, especially from a milk volume and supply pattern point of view.
They are not about restricting growth, they are about providing clarity for planning both on farm and in the processing industry. On the one hand, they give farmers vital security by guaranteeing that the milk they are planning to produce will be bought, processed and marketed. On the other hand, they give co-ops a clear indication of how much milk they need to provide processing and marketing capacity for.

The agreements can also fulfil additional purposes, including being the instrument through which financial contributions from farmers to the development of their co-ops are secured, and/or through which dairy farmers are encouraged to increase their shareholding in the co-op.

It is essential that the agreements are fair, flexible and well understood and accepted by farmers. It is also vital, especially where there is a broader development/expansion plan which co-op shareholders are expected to co-finance, that there would be extensive debate within the co-op's democratic structure and good communication with ordinary members before they are asked to sign up.

It is with those considerations in mind that the National Dairy Committee is making the following recommendations to co-ops currently devising milk supply agreements.

Guiding principles

- Milk Supply Agreements (MSAs) should be written clearly, avoiding overly legalistic language in so far as possible, and should be clearly explained to and understood by farmers before they are asked to sign up.

- They should be well balanced and provide equally and fairly for the best interest of farmers and those of the co-op.

- They should be fundamentally underpinned by the Co-op's rule book.

- On matters relating to volume
  - MSAs need to be flexible to facilitate expansion ambitions.
  - Where forecasting is expected of producers, it should be strongly supported by the co-op with technical advice
  - Flexible force majeure exemptions must be provided, especially, but not exclusively, where weather, prices or margins make achieving volume targets challenging

- With regards to exclusivity of supply
  - Most/all co-op rules provide that all the milk produced by members is to be collected by co-ops, and this is an important security for producers. Co-op rules also provide for the quid pro quo of exclusivity of supply by the member, though this is generally moderated by an ability to obtain written permission from the co-op to sell milk outside of the co-op.
  - In the context of expansion, this type of written permission will need to be forthcoming more readily where a farmer is planning for milk to be supplied over and above what he has committed to the co-op (e.g. through a forecasting process).
  - Existing dual/multiple suppliers should be facilitated. New multiple suppliers should also be facilitated by the co-op in so far as they meet the volume/supply pattern commitments to the co-op which are expected of all shareholder producers.

- Duration/termination
  - The length of time for which contracts tie the two parties should not be unreasonably long, and should strike a fair balance between the interests of both parties, namely between the individual rights of the farmers, and the common good of the co-op.
  - Reviews and provisions for termination giving both parties an out are essential.
  - Fair notice should be given to/by both parties, and should not be either unreasonably long or unfairly short.
  - Provisions for force majeure must be broad and flexible

- Management of seasonality

- Bonus/penalty schemes aiming at managing peak production and reducing seasonality to optimise processing capacity usage should not add unreasonable cost on farmers.
- They should be preferably postponed until after the end of the quota regime, as meeting some of the targets while avoiding superlevy can prove very challenging, or even impossible.
- Here again, flexibility should apply, especially in years where production conditions (weather) or poor margins interfere with normal production planning.

- Price

  Where the MSA deals with milk price:
  - Provision of fixed price contracts should be maximised where possible, and should be available to farmers on a voluntary basis (no compulsion).
  - Specific price commitments, where they are made, should be based on transparent measurements, which can be easily verified, for example against the KPMG/Farmers' Journal audit.
  - At the very minimum: co-ops should state strongly their commitment to always delivering the best possible return from the market place back to farmers.

- General
  - In general, flexibility and fair dealings with farmer members should be the recurring theme for all provisions.
  - Incentives should be favoured over penalties.
  - There should be no potentially anti-competitive provisions
    - No requirement to source all inputs/feed from a single source (e.g. the co-op, or some other provider), or a disincentive to source inputs elsewhere
    - No absolute exclusivity on volume where the farmer produces more than the milk committed to the co-op (see above for written permission)
  - There should be no unfair/disproportionate provisions
    - No one group of farmers should be catered for at the expense of other co-op members
    - No unreasonable/disproportionate penal clauses should apply
  - MSAs must not be tradable like quotas used to be, to avoid perpetuating an unacceptable additional cost on farmers
  - Where the MSA is intended to be also an instrument to collect financial contributions from farmers to a development plan in the co-op, or where it is to be used for farmers to "share up", the plan should first be fully developed and debated through the co-op's democratic structure and then extensively communicated to members.

Conclusion

As well as providing supply management, milk quotas have offered clarity to both farmers and industry in terms of volumes. From 2015, milk supply agreements will be needed to replace that function, without restricting growth.

Milk supply agreements may also be used as an instrument to influence seasonal production patterns and/or to collect financial contributions from farmers to an already well developed and accepted co-op development plan. This makes it even more critical that the MSAs be robust, well thought out, and well understood and received by farmers.

We urge all co-ops, who are currently devising MSAs for the post 2015 era to take due note of our guiding principles to ensure that their agreements are fair and acceptable to farmers.

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