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Environment, Food and Rural Affairs Committee

EU proposals for the dairy sector and the future of the dairy industry

Eighth Report of Session 2010–12

Volume I: Report, together with formal minutes, oral and written evidence

Additional written evidence is contained in Volume II, available on the Committee website at www.parliament.uk/efracom

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Environment, Food and Rural Affairs Committee

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Summary

The forthcoming abolition of quotas coupled with growing global demand for dairy products creates a window of opportunity for UK dairying: UK milk production is increasing for the first time in nearly ten years. However, despite surging global food prices, farmgate milk prices remain below the average cost of production, threatening the ability of some dairy farmers to continue producing. In order for the UK dairy industry to capitalise on these opportunities, the issues that lead to low profitability must be resolved. These include the imbalance of bargaining power between dairy farmers and buyers; weak investment in processing, particularly of value-added products; and an unsustainable distribution of margins along the supply chain.

The European Commission’s package of measures for the dairy sector, ‘The Milk Package’, contains some good ideas, which we support, but will be insufficient on its own to redress the problems in the UK industry. We were disappointed to find that the Government was not able to offer more concrete or proactive suggestions to improve the state of the dairy sector, nor was the Minister willing to give his full support to the Commission’s proposals.

We recommend that written contracts should specify either the raw milk price or the principles underpinning price, the volume and timing of deliveries, and the duration of the contract. We conclude that it will be essential for the new form of contract to be made compulsory, otherwise there will be no improvement in the system. We agree with the principle of increasing farmers’ negotiating power through enabling producer organisations to jointly set prices. However, we recommend that national competition authorities should be required to approve the formation of producer organisations that cover over 20% of national milk production to avoid distortions of competition.

Defra should take more proactive steps to increase investment in processing and reduce farmers’ production costs, including supporting innovative research and development. Large-scale dairy holdings are a significant future development for the industry and raise issues beyond the responsibility of planning authorities. Defra must establish its position on large-scale dairying.
1 Introduction

Background to the inquiry

1. The UK has a long tradition of dairying. The UK’s climate is well-suited to grass-fed dairy production and this, alongside consolidation of production and investment in efficiency, has resulted in the UK dairy industry being among the most cost-efficient in Europe. Nonetheless, the UK dairy industry’s future is precarious: farm incomes are predicted to fall by nearly a quarter this year, and roughly 5% of dairy farmers choose to exit the industry each year.

2. Uncertainty over the impacts of the abolition of milk quotas in 2015 coupled with a period of intense price volatility in 2007–09 led the European Commission to establish the High Level Experts’ Group (HLG) on Milk in October 2009. The HLG reported in June 2010 and made seven recommendations to the Commission. In December 2010, the European Commission released its proposal on ‘Contractual relations in the milk and milk products sector’ (the ‘Milk Package’), which makes amendments to EU legislation to enact the first four of the HLG’s recommendations. At the time of publication, the Milk Package proposals were at the First Reading stage of co-decision between the Council of the European Union (Council of Ministers) and the European Parliament, with the expectation that they would be adopted in 2012.

3. The Environment, Food and Rural Affairs (EFRA) Committee announced its intention to scrutinise the Milk Package proposals, and associated issues relating to ending of milk quotas, in January 2011. We have taken oral evidence from five organisations representing the dairy supply chain, an official from the European Commission and the Minister of State for Agriculture and Food. We received written evidence from 17 individuals or organisations. We are very grateful to all those who helped us with our inquiry.

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4 Report of the High Level Group on Milk, 15 June 2010
7 The Inquiry Terms of Reference were:
   To consider the potential impact of the European Commission’s ‘Milk Package’ proposals for dairy farmers and the UK dairy supply chain. The Committee will consider in particular:
   
   • Legislative proposals that would provide for written contracts between milk producers and processors, and measures for enhancing transparency in the market. The proposals are intended to boost the position of the producer in the dairy supply chain and prepare the sector for a more market oriented and sustainable future; and
   
   • A report on the dairy market and the conditions for smoothly phasing out the milk quota system. The Commission wishes to end production quotas in 2015 because most countries’ output is well below the levels mandated by the limits. The report also includes proposals to help ensure a ‘soft landing’ when quotas end.

8 A full list of written submissions is given at the end of Volume I of this report.
4. During the course of the inquiry, it became clear that the European Commission’s proposals were unlikely to present a full solution to the particular issues facing the UK dairy industry. Our interest widened to encompass other tools to strengthen and bolster the UK dairy industry. Our conclusions and recommendations are directed primarily at Defra, but also at Members of the European Parliament (MEPs), who will have the opportunity to vote on the Milk Package in the autumn. Much of the evidence that we received referred to the dairy industry in the UK as a whole. Mindful that Defra will be representing the UK in negotiations in Brussels, we have tended to make recommendations for the UK dairy industry; however where appropriate we have restricted our recommendations to the English industry.

**Background to the dairy sector**

5. The UK is the third largest milk producer in the EU after Germany and France, and the ninth largest producer in the world. Dairy is the UK’s largest single sector of agriculture, accounting for 16% of total income from agriculture in 2010. Dairy farming tends to be more profitable than other forms of livestock farming, except specialist poultry.

6. In the UK in 2009, there were 16,400 dairy farmers producing over 12.8 bn litres of raw milk from 1.9m cows. Although producer numbers have declined by a half over the last decade, milk production has fallen by only 9%. This can be explained by both increases in the average herd size (from 84 to 113 cows) and in annual yields per cow (from 6,000 to 7,400 litres) (Figure 1). Milk production in the UK is nominally constrained by EU production limits (“quota”). However milk production was 1.5 bn litres under quota in 2009/10. Dairy production takes place all over the UK but in England has become increasingly concentrated in the grass-growing regions of the west coast.

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9 Dairy industry in the UK: statistics, Standard Note SN/SG/2721, House of Commons Library, June 2011
10 Ibid
11 Defra, Agriculture in the UK, May 2011, Chapter 2. Average farm business income 2006–10 for dairy farms was £50,750 compared to £91,425 for specialist poultry and £17,525 for lowland grazing livestock.
12 Ibid 90
13 Ibid
16 Ev 75
The majority of raw milk in the UK is processed into liquid milk (53%) and cheese (27%), with less than 10% being converted to other commodity dairy products (powders and butter).\textsuperscript{17} This is the reverse of the position in the EU as a whole as about 40% of EU production is processed into cheese and 30% into fresh milk.\textsuperscript{18} Milk processing in the UK is dominated by six large players—three farmer-owned co-operatives (First Milk, Milk Link and United Dairy Farmers) and three private dairies (Arla Foods UK, a subsidiary of the Scandinavian farmer-owned co-operative Arla Foods, Dairy Crest and Robert Wiseman Dairies).\textsuperscript{19} Robert Wiseman Dairies is unusual in that it almost exclusively sells liquid milk while the others make a variety of processed products. In the UK the two largest co-operatives (First Milk and Milk Link) process less than 25% of UK milk production,\textsuperscript{20} whereas in the EU overall, 58% of raw milk is processed through co-operatives.\textsuperscript{21} Liquid milk retail is concentrated in supermarkets, which account for 85% of sales compared to only 7% by doorstep delivery.\textsuperscript{22}

\textbf{Figure 1: Cow numbers, milk yield and total milk production in the UK.}

\begin{itemize}
  \item Size of the UK herd
  \item Milk yield per cow
  \item UK milk production
\end{itemize}

\begin{center}
\begin{tikzpicture}
\begin{axis}[
  title={Cow numbers, milk yield and total milk production in the UK.},
  xlabel={Year},
  ylabel={Milk yield per cow (l/yr)},
  ybar interval=0.8,
  ybar legend,
  ymajorgrids,
  xmin=2000, xmax=2010,
  ymin=0, ymax=8000,
  ytick={0,1000,2000,3000,4000,5000,6000,7000,8000},
  legend style={at={(0.5,1.2)},anchor=south},
]
\addplot+[ybar] table [x=Year, y=Milk yield per cow] {data.csv};
\addplot+[ybar] table [x=Year, y=UK dairy herd] {data.csv};
\addplot+[ybar] table [x=Year, y=UK milk production] {data.csv};
\end{axis}
\end{tikzpicture}
\end{center}

\textit{Source: DairyCo}

\begin{itemize}
  \item \textsuperscript{17} Ev 90
  \item \textsuperscript{19} Ev 90
  \item \textsuperscript{20} Stg Co Deb, European Standing Committee A, Milk, 15 March 2011, col 5
  \item \textsuperscript{21} \textit{The Milk Package}, p 7
  \item \textsuperscript{22} Dairy Supply Chain Forum, \textit{The Milk Roadmap}, May 2008, p 25
\end{itemize}
2 The state of the UK dairy industry

The health and future prospects of the UK dairy industry

8. We received conflicting information on the current health and future prospects of the dairy industry from organisations representing dairy producers, processors and retailers. Kite Consulting concluded that the predicted increase in global demand for dairy provides an opportunity for the UK industry.23 Their report argues that “... with improvements in technical performance and continuing ‘agflation’, as well as the removal of quota restrictions, UK milk production has the potential to reach 15bn litres per annum by 2020 [currently 12.8 bn litres]”.24 Tesco concurred that “there is potentially a bright future for the industry”, partly due to the UK’s efficiency of production.25 In 2009, UK cost of production compared favourably to the USA and EU competitors such as the Netherlands, but fell behind Australia and New Zealand.26

9. The National Farmers’ Union (NFU) agreed that “the prospects for the British dairy industry ought to be positive” but stressed that there were “systemic failures” in the dairy market that needed to be corrected.27 In contrast, Dairy UK argued that “there is no systemic failure of the market”.28 The memorandum from the department also referred to growing global demand providing opportunities for the dairy sector.29 However, the Minister of State for Agriculture and Food’s assessment of the current situation was less positive, referring to “some very real issues” in the processing sector.30 He added that:

Some sectors of the whole supply chain have not yet accepted that there is a problem and say that eventually supply and demand will work themselves out. I think that if we wait until then, it will be too late for countless small dairy farmers.31

10. Farmgate milk prices have not covered production costs for over a year, threatening some dairy farmers’ ability to continue farming.32 Independent research commissioned by the NFU found that between April 2010 and March 2011, UK farmgate prices were approximately 4 pence per litre (ppl) below the cost of production.33 Defra estimates that

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23 Kite Consulting, _World class dairying. A vision for 2020_, 5 July 2011, p 4
24 ibid
25 Q 219
26 Dairy UK, _The White Paper_, 2009, p 56. The White Paper also quotes a separate study by Defra from 2007 that found that UK companies generated higher levels of value added per employee and delivered higher levels of profitability in terms of return on capital employed. However, they also generated lower levels of revenue per unit of milk processed (ibid, p 41)
27 Q 6
28 Q 67. A similar view was expressed by Robert Wiseman Dairies (Q 372).
29 Ev 91
30 Q 296
31 Q 298
32 Kite Consulting, _World class dairying. A vision for 2020_, p 6
33 NFU, _Cost of Milk Production Report April 2010–March 2011 Estimates_, February 2011. The report was based on actual costs for April 2009 to March 2010 and projected costs for April 2010 to March 2011 for 809 dairy units provided by independent consultants. The NFU’s report compared the estimated cost of production to the farmgate price of in November 2010 (25.94 ppl). The updated average farmgate price for the relevant period (April 2010 to March 2011, obtained from DairyCo) is 25.1 ppl.
the Farm Business Income of dairy farms will fall by 25% in 2010–11 compared to 2009–10.\textsuperscript{34} The NFU pointed out that UK farmgate prices for dairy are among the lowest in the European Union despite higher average incomes in the UK than in many other Member States.\textsuperscript{35}

11. Dairy UK claimed that, notwithstanding short-lived imbalances between production costs and milk prices, Farm Business Income figures proved that dairy farming was profitable even when subsidies received through the Common Agricultural Policy were taken into account.\textsuperscript{36} However, Farm Business Income is not an accurate reflection of the profitability of the farm if it does not account for the cost of unpaid family labour. A farmer in Tesco’s Sustainable Dairy Group (TSDG) told us that, referring to farmers that were not in the TSDG, “their cost of production, excluding the cost of unpaid family labour, has been, in the main, higher than what they have been paid”.\textsuperscript{37} In addition, the subsidy provided by the Common Agricultural Policy (the Single Farm Payment) currently adds approximately 1.5–2.5 ppl to farmgate prices. Reforms to the Common Agricultural Policy after 2013 could cause this to fall to around 0.5 ppl.\textsuperscript{38}

12. The number of dairy farmers leaving the industry was a concern to some witnesses. Between May 2010 and May 2011, the number of dairy producers fell by 396 or 3.5%, continuing the long-term trend that has resulted in UK dairy producer numbers falling from 35,741 in 1995 to 15,716 in 2010.\textsuperscript{39} The NFU felt there were “big questions as to whether we are losing critical mass, at least in terms of the long-term capability of British dairying to respond to some of the opportunities that might lie in the future”.\textsuperscript{40}

13. Dairy UK disputed the importance of the drop in the number of UK dairy farmers, arguing that the same trend had been observed globally.\textsuperscript{41} The Minister did not share the NFU’s concern that the industry was losing ‘critical mass’, pointing out that the amount of milk produced had gone up this year despite the fall in the number of producers.\textsuperscript{42} A survey of 1,000 dairy farmers in 2010 found that, although 10% intended to leave the industry within two years, 32% intended to increase production within the same period.\textsuperscript{43} A more serious issue, according to the Minister, was the impact of the loss of dairy farmers on “the rural infrastructure and fabric of the countryside”.\textsuperscript{44}

\begin{footnotes}
\begin{enumerate}
\item Defra, \textit{Farm Business Income by types of farm in England}, 27 January 2011 \item Q 2. In April 2011, the UK’s average farmgate milk price (26.6 ppl) was the lowest price of any nation in the EU-27 and about 4 ppl lower than the EU average (NFU press release, 13 July 2011, based on data from DG AGRI). \item Q 76 \item Q 240 \item Kite Consulting, \textit{World class dairying. A vision for 2020}, p 6 \item DairyCo Datum, \textit{Producer Numbers}, 14 June 2011, http://www.dairyco.org.uk/datum \item Q 2 \item Q 72 \item Q 302. A similar view was expressed by Robert Wiseman Dairies (Q 374). \item DairyCo, \textit{Farmer Intentions Survey}, April 2010 \item Q 302
\end{enumerate}
\end{footnotes}
14. Several witnesses noted that the UK’s substantial trade deficit in dairy indicated that the sector was not reaching its full potential. The UK imports around 40% of the butter, cheese and yoghurt consumed here, generating a trade deficit of around £1.3 billion per year. The Minister questioned why UK products were unable to compete with European imports given that the domestic industry is highly efficient and “we can grow better grass than any other country in the EU, apart from the Republic of Ireland”. Moreover, while global dairy production has increased by 20% over the past decade, the UK has reduced production by 10%.

**Farmgate milk prices**

15. A key test of whether the UK dairy market is functioning properly is the extent to which farmgate prices respond to changes in the commodity market prices for dairy products. The analyses presented by dairy producers and processors came to opposite conclusions on the relationship between market indicators and farmgate prices. The NFU argued that:

...the price that dairy farmers are currently receiving and perceiving is significantly less than market indicators would dictate, and that suggests that there are some systemic problems in the way that the UK dairy supply chain operates.

They provided a graph indicating that, between 2006 and 2011, raw milk farmgate prices were below the expected prices based on processed milk product commodity prices, the AMPE and MCVE, except for a six-month period in 2008–09 (Figure 2). The NFU argued that this mismatch arises from the weak bargaining power of dairy farmers, particularly with relation to milk contracts, which they perceive to be exploitative. However, DairyCo note that AMPE and MCVE should not be viewed as equivalent to the price that processors should pay for raw milk as the price for raw milk is affected by other factors including milk supply, processor efficiency and profitability, and competitor prices.

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45 Including NFUS (Ev w2), NFU (Q30, the Minister (Q 296), Tesco plc (Q 223). [Note: references to 'Ev wXX' are references to written evidence published in the volume of additional written evidence published on the Committee’s website]

46 Ev w2

47 Ev 90

48 Q 296

49 Ev w2

50 Analyses were presented by Dairy UK (Ev 77–85) and the NFU (Ev 68)

51 Q 7

52 The indicators used by the NFU are the AMPE, Actual Milk Price Equivalent, and MCVE, Milk for Cheese Value Equivalent. AMPE is derived from the commodity market prices for butter and skimmed milk powder and MCVE from the commodity market prices for mild cheddar and its byproducts (whey and butter). AMPE and MCVE are an estimate of the value of the raw milk used to make commodity products after accounting for the processors’ costs and profits using the following formula: Income from selling processed milk products – Costs – Profits = Potential value of milk. (DairyCo, MCVE Help Sheet, http://www.dairyco.net/datum). A single ‘commodity price’ was created by combining the combining monthly average values of the MCVE price (80%) and the AMPE price (20%), reflecting the usual uses for milk in the UK.

53 Q 5, NFU Briefing, Is the dairy supply chain working properly?, 1 March 2011

54 DairyCo MCVE Help Sheet, http://www.dairyco.net/datum
16. Dairy UK’s analysis showed a statistically significant correlation between the rolling averages of processed milk product commodity prices and farmgate prices from 2003 to 2010 (Figure 3). The statistical correlation between UK farmgate and commodity prices was higher than that found for other markets, such as the US or Ireland. Dairy UK concluded that “UK farmgate prices follow trends in [wholesale] butter/SMP [skimmed milk powder] and mild cheddar” and that “the UK market is not dysfunctional compared to its global counterparts”.

55  Ev 77–85. The data presented are indices of the prices of processed products (skimmed milk powder and mild cheddar) on commodity markets and the average UK farmgate milk price relative to their average values in 2003. The milk pricing model assumed that UK farmgate prices follow butter/powder and mild cheddar markets. A single ‘commodity price’ was created for each country by combining the combining monthly average wholesale prices. A weighted average of 80% mild cheddar and 20% butter/powder was chosen as the best fit, similar to the NFU’s analysis. Rolling averages were used to reduce the effect of seasonality payments, particularly on the farmgate price.

56  Ev 85
17. As Figure 2 demonstrates, farmgate prices, historically and at the present, appear lower than expected based on the value of processed milk products on commodity markets. The NFU argued this was “due to the failure of milk buyers to pass back a fair share of the profits”, however, the perceived discrepancy could arise from several factors, including low cost efficiency of the processing sector. While farmgate prices do track commodity market prices over the long-term, as shown in Figure 3, short-term lags and divergences appear, which is exacerbated by seasonality. Farmgate prices appear to have been slow to respond to increases in commodity market prices since January 2011.

18. The NFU also questioned why farmgate prices for the liquid milk stream should be determined by commodity market price, given that they are feeding into fundamentally different markets. We have sympathy for their case, however, in our view, it is inevitable that commodity prices will determine farmgate prices throughout the industry. This is because commodity markets are the market of ‘last resort’ for the substantial number of producers that are not able to sell into liquid or other value-added markets.

**Adding value through the supply chain**

19. UK farmgate prices are inherently dependent on UK processors’ ability to competitively add value to raw milk. Dairy UK argued that the main problem was the lack of profitability of the industry overall, stating that “the big issue for the dairy industry is getting more wealth. The key driver is increasing the pie”. Several witnesses felt that the industry’s focus on liquid milk was to its detriment, meaning that processors focussed on winning supermarket liquid milk contracts rather than looking for more value-added outlets. The Minister intimated that there had been a failure to innovate and invest in large-scale, modern processing plants sufficiently. The legacy of the Milk Marketing Board is often blamed for this lack of investment in UK processing facilities. The historic dimension has had two additional consequence for the UK. First, it has reduced the time available for farmer-owned co-operatives to build up capital, and second, it has enabled the penetration of foreign brands, such as Anchor and Lurpak, in the UK market.

**Retail margins**

20. Low farmgate prices have also been blamed on downwards price pressure by the major supermarkets and intense retail competition. NFU Scotland said “processors big and small are offering unrealistically low prices just to retain their market share, but at unrealistic margins”. Over the past ten years, the retail price of liquid milk has increased

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57 NFU Briefing, *Is the dairy supply chain working properly*, 1 March 2011
58 Ev 69
59 Q 58
60 NFU (Q 10), Minister of State for Agriculture and Food (Q 296), NFUS (Ev w3)
61 Q 296
62 Dairy UK (Q 63, Q 64); NFU (Q 4, Q 15)
63 Q 15, Q 29
64 “Spread the news: buy British butter”, *The Times*, 12 May 2011; Q 15
65 NFU Briefing, *The Great Milk Robbery*, June 2010, p 6; Dairy UK (Q 67); NFUS (Ev w3), Ulster Farmers’ Union (Ev w8)
66 Ev w3
by 60% while the farmgate price has increased by only 34% and the wholesale selling price by 31%.\textsuperscript{67} (Figure 4) As a result, the gross margin enjoyed by the retailer has increased by 170% while that of the processor has remained static. In cheddar, processor margins have declined in the past decade while retailer margins have increased.\textsuperscript{68}

**Figure 4: Liquid Milk Margins.**

![Graph showing liquid milk margins over time.](image)

*The gross margin equals the difference between the selling price and buying price for milk

Source: DairyCo, Dairy Supply Chain Margins, October 2010

21. The Minister told us that these increases in retailer margins were neither fair nor sustainable.\textsuperscript{69} He said that "when the product is still pretty close to the material that left the farm, as opposed to a quiche or something, it is difficult to justify such a substantial increase in the retail price without increasing the price to the producer".\textsuperscript{70} Dairy UK were divided over the issue of retail margins. The farmer representative of Dairy UK agreed with the Minister;\textsuperscript{71} however, Jim Begg, the Director General of Dairy UK, denied that the price paid in shops had much bearing on the farmgate price, stating that:

...the main misunderstanding comes with the belief that when you determine the farm price you start with the retail price and work down. In fact it works the other way completely. You start at the bottom and you work up, and the farmer’s milk price is driven by completely different circumstances from the retail price, or even the price that the processor gets for his product. The farmer’s price is driven by world commodity prices, which is driven by the supply and demand.\textsuperscript{72}

\textsuperscript{67} DairyCo, Dairy Supply Chain Margins, October 2010, p 8

\textsuperscript{68} Ibid, p 10

\textsuperscript{69} Q 354

\textsuperscript{70} Q 355

\textsuperscript{71} Q 86

\textsuperscript{72} Q 69
The NFU adopted a sanguine attitude to margins, stating that “what matters to us is not how margins are distributed, it is ensuring that farmers get a fair price and ensuring that farmers are able to trade in a market that is fair”.73

22. The Minister claimed that there was little scope for Government to interfere in retail margins “...if we exclude Government intervention in the market by dictating margins, formulae or something like that”.74 In addition to the implications for compliance with EU common market regulations, setting a minimum price could distort UK farmers’ ability to compete globally and is likely to increase the retail cost of dairy products, for which consumer demand is relatively inflexible.

23. The Minister stated that market forces would generate a price increase if dairy production fell sufficiently to create an imbalance between supply and demand for liquid milk.75 Domestic supply and demand imbalances are only a serious concern for the liquid milk sector as processed products can be sourced internationally. Given that processors can vary production between liquid and processed streams, a severe shortage would only arise if liquid milk suppliers could not source sufficient raw milk from either stream, that is, a 50% drop in production.76 We do not think this is an acceptable solution as it would entail a very substantial drop in the number of dairy producers, with undesirable consequences for rural communities, landscapes and tourism, and consumer choice.

Dedicated supply chains

24. A recent positive development has been the establishment of dedicated supply chains producing liquid milk for the major supermarkets. These benefit the farmers involved through guaranteeing higher prices to them than those paid to farmers outside the supply groups.77 Dedicated supply chains provide additional benefits, such as security and predictability for suppliers and retailers, increased focus throughout the supply chain on the needs of the customer, and in some cases, provision of extension services or investment to help producers become more cost-efficient or sustainable.78

25. Currently only a minority of dairy producers, some 10% of the total,79 benefit from being in a dedicated supply chain. This creates a divided market between the ‘haves’ supplying liquid milk to the supermarkets and the ‘have-nots’ that supply processed products into commodity markets.80 In June 2011, the highest farmgate price, over 29 ppl, was paid to farmers in the Tesco’s dedicated supply chain, followed by farmers supplying Marks and Spencers and Sainsburys.81 The lowest milk prices, around 25 ppl, were paid to

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73 Q 34
74 Q 356
75 Q 356
76 Q 162
77 NFU (Q 38), Dairy UK (Ev 76), Tesco (Ev 88), The Co-operative Group (Ev 86), Robert Wiseman Dairies (Q 382)
78 Dairy UK (Ev 76), British Retail Consortium (Ev w9), Defra (Ev 91), Tesco (Ev 88), The Co-operative Group (Ev 86)
79 Ev 91
80 Q 295
81 DairyCo Datum, UK Milk Producer League Table, 6 June 2011, www.dairyco.net/datum. Farmgate prices paid to members of farmer-owned co-operatives do not include income from any dividend to co-operative members.
farmers in the dairy co-operatives First Milk and Milk Link, which are supplying commodity cheese production or supermarkets’ balancing pools.

26. We questioned why the dedicated supply chain model could not be extended to other sectors, such as own-brand cheese, allowing more farmers to benefit.\(^{82}\) Tesco told us that all their non specialist cheddar cheese and the majority of their butter was British.\(^{83}\) However, they argued that “trying to set up a dedicated supply chain in respect of the milk producers for production of cheese in practical terms would be much more difficult”.\(^{84}\) We found the arguments that it would be too difficult to set up a dedicated supply chain for processed dairy products unconvincing. A more likely barrier is the cost incurred by paying above the market price. Tesco estimated the additional cost of operating their Sustainable Dairy Group as £35 million per year,\(^{85}\) which would amount to £50,000 for every dairy producer in the group.\(^{86}\) Moreover, the incentive for retailers to set up dedicated supply chains to ensure security of supply is less for processed products, which can be sourced globally, than for liquid milk, which of necessity is sourced domestically.

27. While retail prices do not directly determine farmgate prices, it is in retailers’ long-term interests for producers to be paid a price that covers their production costs. We welcome the efforts made by retailers to raise farmgate prices and provide greater certainty and transparency of pricing through establishing dedicated supply chains. However, only a minority of producers benefit from these arrangements—the real challenge for Defra is to extend the principles of dedicated supply chains into processed products such as cheese and butter.

28. \textbf{We are confident that the future prospects of the UK dairy sector are positive, but this depends on Government and the dairy industry resolving certain issues.} Despite having one of the most efficient production systems in the world, UK dairy farmers are unable to cover their costs and dairy processors are outcompeted by imported products. Farmgate prices have recently become decoupled from both commodity market indicators and farmers’ production costs, indicating that farmers are not consistently able to recoup sufficient value from the supply chain. We conclude that Government action is justified as the substantial drop in the number of dairy producers that would be required to increase farmgate prices through market forces alone would have undesirable consequences for rural communities, landscapes and tourism, and consumer choice. Consolidation in the industry must be driven by confidence, innovation and investment.

29. \textbf{We call on Government to take action to resolve this situation through addressing the structural imbalances that result in low farmgate prices; encouraging increased investment in processing, particularly in value-added products; and exerting influence on retailers to establish dedicated supply chains for processed dairy products, such as}
butter and cheese. We draw attention to our views on the draft Groceries Code Adjudicator Bill.\(^{87}\)

\(^{87}\) Letter from Miss Anne McIntosh MP, Chair of the EFRA Select Committee to Mr Adrian Bailey MP, Chair of the BIS Select Committee on 22 June 2011.
3 The Milk Package proposals

Background to the Milk Package proposals

30. On 9 December 2010, the European Commission published a ‘Proposal for amending Council Regulation (EC) No 1234/2007 as regards contractual relations in the milk and milk products sector’. This is known as the ‘Milk Package’. The suggested measures aim to improve stability in the dairy sector. The impetus for the Milk Package was the sustained period of low dairy prices in 2008–09 resulting from decreased demand for dairy on the global markets and increased dairy production in third countries following exceptionally high prices in 2007. Average EU dairy farmgate prices fell by 30% between 2007 and 2009. The European Commission concluded that:

...the sharp decline in dairy commodity prices failed to fully translate into lower dairy prices at consumer levels, generating a widening in the gross margin of the downstream sectors for most milk and milk sector products and countries, and preventing demand for them to adjust to low commodity prices, slowing down price recovery and exacerbating the impact of low prices on milk producers.

31. In October 2009, the Commissioner created a High Level Experts’ Group (HLG) on Milk to ‘work on a regulatory framework to be put in place for the medium and long term, which can contribute to stabilising the market and producers’ income and enhance transparency, while respecting the outcome of the Health Check [of the Common Agricultural Policy]’. The HLG, having taken evidence from organisations across the dairy supply chain, identified several problems in the dairy industry. These have been carried forward in the Commission’s proposed regulation (Box 1).

<table>
<thead>
<tr>
<th>Box 1: The European Commission’s analysis of the problems in the dairy sector</th>
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<tr>
<td>• There is a problem of price transmission along the chain, in particular as regards farmgate prices.</td>
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<tr>
<td>• Value-added in the chain has become increasingly concentrated in the downstream sectors, notably with dairies.</td>
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<tr>
<td>• The volume which will be delivered during the season is not always well planned and there is a potential lack of adaptation of supply to demand as farmers are obliged to deliver all their milk to their co-operative and the co-operative is obliged to accept all the milk.</td>
</tr>
<tr>
<td>• The use of formalised, written contracts containing even basic elements made in advance of delivery is not widespread.</td>
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89 Milk Package, para 2
90 Report of the High Level Group on Milk, June 2010, p 47
91 Milk Package para 2
92 Milk Package Explanatory Memorandum, p 2
93 Milk Package paras 6–8
32. The HLG on Milk produced a report on 15 June 2010 accompanied by seven recommendations. Of these, the first four are intended to be addressed by the Milk Package (Box 2). An additional recommendation on origin labelling will be covered by the Commission’s ‘Quality Package,’ and those on market instruments and research will be considered as part of a wider debate on the future of the CAP.

### Box 2: Summary of the Milk Package Proposals—Amendments to Regulation (EC) No 1234/2007

- Member States may opt to make it compulsory for dairy producers and processors to have written contracts that specify a price or price formula, the delivery volume, the duration of the contract and the timing of collections (Article 185f).
- Dairy producer organisations shall be allowed to establish that can jointly negotiate contract terms, including price, as long as they do not exceed more than 3.5% of EU production or 33% of national production by volume (Article 126a).
- Interbranch organisations can be set up across the supply chain to improve transparency and promote best practice, without distorting competition (Article 123).
- An explicit legal basis for Member States to collect information from processors on raw milk deliveries on a monthly basis (Article 192).
- The new rules will apply only until 30 June 2020 (Article 196b).

33. The European Parliament Agriculture and Rural Development Committee reached its position on the Milk Package on 27 June 2011. It made several amendments to strengthen the Milk Package in favour of dairy producers including increasing the size of Producer Organisations to 40% of national production and requiring that written contracts, specifying a milk price for no less than one year, are compulsory across the EU.

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94 The HLG made the following recommendation on marketing standards and origin labelling:

The HLG has taken note of the ongoing activities regarding labelling and invites the Commission to follow closely the developments to ensure that imitation dairy products are distinguished properly, thereby avoiding the use of names and terms reserved to dairy products. On place of farming the HLG invites the Commission to consider the feasibility of different options for obligatory/voluntary place of farming labelling of basic primary dairy products. Both for rules on labelling of imitation product and on place of farming, coherence of dairy sector proposals should be ensured with the Food Information for Consumers legislation currently under consideration by the legislator. (Report of the High Level Group on Milk, June 2010, p 23)

The Quality Package was published on December 2010 and is being considered by the European Parliament and Council. The Quality Package proposes a comprehensive policy on certification schemes, value-adding terms for agricultural product qualities, and product standards.

95 The HLG made the following recommendation on innovation and research:

The HLG underlines the importance of innovation and research for the competitiveness of the dairy sector. The HLG invites the Commission to propose a reinforcement of innovation in the Common Agricultural Policy after 2013, in particular in Rural Development Policy. The HLG further invites the Commission to improve the communication of the current possibilities for innovation and research within the existing framework of Rural development and research framework programmes. The HLG invites Member States to fully take advantage of the existing possibilities. As regards research the HLG calls upon stakeholders to define clear research priorities for the dairy sector in order to allow the sector to better benefit from national research programmes as well as the Community research framework programme. The dairy sector is also invited to intensify its participation in the ongoing developments that take place in the HLG on competitiveness of the food chain, which also addresses the issue of innovation and research. (Report of the High Level Group on Milk, June 2010, p 26)

96 A ‘producer organisation’ (PO) is defined in Article 122 of Council Regulation (EC) No 1234/2007, which describes POs as being “constituted by” and “formed on the initiative of” producers. A PO pursues specific aims which may include: ensuring that production is planned and adjusted to demand, particularly in terms of quality and quantity; concentration of supply and the placing on the market of the products produced by its members; and optimising production costs and stabilising producer prices. (Ev w23)

97 Agriculture and Rural Development press release, 27 June 2011
Agriculture and Rural Development Committee’s report, drafted by UK MEP James Nicholson (European Conservatives and Reformists group), is expected to be put to a vote by the European Parliament by the end of 2012.

**Raw milk contracts**

34. Nearly all milk producers in the UK already have a written contract with their buyer, but these generally do not meet the standards stipulated in the Milk Package. The AHDB told us that the vast majority of contracts do not have clear pricing; buyers are able to change price at short notice, or even retrospectively while farmers are locked in by long notice periods; and contracts often do not specify volumes, which reduces the predictability of supply for processors. Farming groups felt that the existing contracts allowed processors to transfer the risks of market competition and price volatility onto farmers. The NFU added that “you would not sign those sorts of contracts in any other walk of life”. However, Dairy UK argued that “whilst these type of arrangements may not accord with notions of ‘fairness’, they are unquestionably appropriate to the dairy industry”. We heard during an evidence session into the draft Groceries Code Adjudicator Bill that it is also standard practice in the horticultural sector not to have written contracts specifying price or volume.

35. There are two key issues surrounding the proposals on raw milk contracts: first, whether the proposed elements to be included in standard contracts are necessary and sufficient; and second, whether Defra should make standard contracts compulsory. The NFU, NFU Scotland (NFUS) and AHDB supported the inclusion of either a static price or price formula, as well as volume, timing and duration in standard contracts. The NFU and AHDB proposed that termination clauses should be included to enable farmers to exit the contract if price variation exceeded the agreed limits. NFUS suggested a particular pricing formula, based on commodity market indicators, that could be used as the foundation of producer contracts. Dairy UK said they had no difficulty with the idea of contracts covering the four elements proposed by the Commission.

36. The NFU additionally requested that contracts not include exclusivity clauses, as these reduce opportunities for competition. Dairy UK agreed that “non-exclusive contracts...
may become more practical as producers grow larger and contractual arrangements are developed that give purchasers predictability in the volumes of milk collected. Moving away from the current system where processors are required to take all the milk from a farm could help farmers make the transition away from a quota-based system and help processors manage their capacity.

37. Representatives of processors and retailers raised some concerns about stipulating particular elements in contracts. Christine Tacon, the Managing Director of the Co-operative Farms, argued that flexibility on volumes protected both sides, for example if adverse weather conditions prevented a farmer from delivering on his commitments. Dairy UK did not accept that the contract should have to be renegotiated if the price was changed. They argued that this would increase the commercial risk faced by processors of potentially uncompetitive raw material costs, and Mark Taylor of Dairy Crest said processors would drop the farmgate price as a result.

38. The Tesco Sustainable Dairy Group (TSDG) provides one example of how a contract specifying a price formula might work in practice. The TSDG contract commits Tesco to paying a milk price that is above the average cost of production of TSDG Members and also includes a market tracker that takes effect if commodity market prices exceed the cost of production. Andy Bloor, the Chairman of the Wiseman TSDG noted that production costs had exceeded market prices since 2009. Andy Bloor extolled the benefits of their production cost based system, stating:

What we found within the first year, or probably three years, of this group was that farmers were in the position to start reinvesting, which was something they had not done for a number of years. So it was a dream initially that you would be able to ride around the countryside and be able to pick out a Tesco farm, and that is already happening within four years.

39. With the exception of the Ulster Farmers’ Union, farming organisations called on Defra to make written contracts compulsory. The NFU told us that compulsory contracts specifying a price or price formula would “give much greater certainty, clarity and transparency for dairy farmers and thereby build more confidence in the future”. Dairy UK were strongly opposed to the regulation of contracts, stating that they would undermine trust between farmers and processors and increase instability. We were not

109 Ev 73
110 Q 116
111 Ev 73
112 Ibid
113 Q 61
114 Ev 88
115 Q 233
116 Q 222
117 AHDB (Ev w1), NFUS (Ev w2), NFU (Ev 67)
118 Q 8. Similar points were made by Tesco (Q 256), European Commission (Q 180), Rex Ward, Dairy UK Farmers Forum (Q 61)
119 Ev 70, 72, 73. Robert Wiseman Dairies also argued against greater regulation of contracts (Q 377, Q 387).
persuaded by this argument. The Co-operative Group said a prescriptive, EU-wide approach to contract negotiation risked “stifling innovation and efficiency”. The Minister did not like the idea of compulsory contracts, but undertook to consult the industry if the Milk Package was agreed. He added that “I do not share the industry’s optimism that it is the panacea to some of their problems”, claiming the industry did not appreciate “how little information could be forcibly put into the contract”.

40. We conclude that contracts should provide certainty and clarity to give both parties the confidence to invest—the current system fails to achieve this. Our view is that the Commission’s proposals offer considerable scope for Defra and the industry to jointly establish a more effective system of raw milk contracts. We support the recommendations of the Farming Regulation Task Force that regulation should be the last option, not the default. The majority of producers already have written contracts, however, processors have thus far resisted providing clarity on pricing in contracts (except where required by retailers). Dairy UK’s evidence does not suggest they are likely to rethink their approach. We therefore consider that a regulatory approach is justified in the absence of voluntary action. The Groceries Supply Code of Practice already sets a precedent for regulation of terms and conditions between food suppliers and buyers in cases where there is deemed to be an imbalance of bargaining power.

41. We recommend that raw milk contracts should include the four elements specified by the Commission—price, volume, timing of deliveries, and duration. In addition, the contract should make it clear under what conditions the contract can be terminated by either party. Exclusivity clauses should be discouraged to allow farmers to respond to market signals following the abolition of quotas. We realise that in an era of increasing price volatility, imposing prescriptive approaches to price or volume is unlikely to be in the long-term interests of producers or processors. However, if farmers are to be tied into long contracts, which benefits processors, they should know the basis on which their milk price will be calculated and be able to adjust their business model to respond to market signals. If a processor is unwilling to commit to this degree of certainty, the farmer could opt for a shorter notice period instead. We do not suggest that all contracts must contain an explicit price or price formula as these could be overly restrictive, but contracts should set out the principles underpinning price and mutually agreed tolerances. Given that the majority of dairy contracts do not contain these elements, in order to effect the change that we think is needed, Defra should make it compulsory for producers to be offered a written contract containing the elements specified above.

120  Ev 87
121  Q 323
122  Q 310
123  Farming Regulation Task Force, Striking a balance: reducing burdens; increasing responsibility; earning recognition. A report on better regulation in farming and food businesses, May 2011, p 23
124  Ev 67
125  Ev 72–73
126  The Groceries Supply Code of Practice is part of the Groceries (Supply Chain Practices) Market Investigation Order 2009 (Groceries Supply Order). The Competition Commission made the Order after its investigation into the supply of groceries in the UK found that, while the exercise of buyer power by grocery retailers is likely to have positive implications for consumers, it could raise concerns in certain, limited circumstances (Competition Commission, The supply of groceries in the UK market investigation, April 2008). The Government has committed to introducing an adjudicator to enforce the Code (HC Deb, 24 May 2011, c47WS).
42. The European Parliament Agriculture and Rural Development Committee’s proposal that milk contracts should stipulate a milk price fixed for no less than one year is, in our view, overly restrictive and could hinder processors and producers from responding to market signals. We recommend that the UK Ministers and MEPs do not support this proposal.

**Producer Organisations**

43. The High Level Group on Milk found that the concentration of raw milk supply is low with a resulting imbalance in bargaining power in the supply chain between farmers and dairies.\(^\text{127}\) The processing sector in the UK is highly consolidated—87% of milk output comes from just five companies and 78% of cheese output from eight companies.\(^\text{128}\) This results in an effective processor monopsony in some regions: one third of dairy farmers in LFA regions in England have only one buyer to supply.\(^\text{129}\) The NFU argued that:

Milk is a perishable product, that has to be collected every day, and dairy farmers have no choice but to agree to these contracts, thus there is no ‘freedom’ to contract from a farmer perspective.\(^\text{130}\)

44. Producer Organisations (POs) are associations of farmers that must be formally recognised by the Member State and can carry out a restricted range of activities.\(^\text{131}\) No formally recognised dairy POs currently exist in the UK.\(^\text{132}\) Agricultural co-operatives differ from POs in that farmer members of the co-operative transfer ownership of all their milk to the co-operative and become joint owners of the co-operative (although agricultural co-operatives could also register as formal Producer Organisations).\(^\text{133}\) The Commission proposes to grant a derogation of current competition law to enable dairy POs to negotiate contract terms including price (i.e. allowing price-fixing agreements), jointly for some or all of their members’ production subject to limits expressed as percentages of EU and national milk production.\(^\text{134}\)

45. EU and national law already enables co-operation among dairy farmers, particularly in the form of agricultural co-operatives. The Office of Fair Trading (OFT) noted that “[co-operatives] have generally been recognised as pro-competitive structures which allow farmers to better compete with other milk suppliers, thus contributing to the modernisation of and rationalisation in the agricultural sector and improving efficiency, to
the ultimate benefit of consumers”.135 If farmer associations do not involve an obligation to charge identical prices, they would not normally be in breach of EU competition law.136 On the other hand, the High Level Group found that:

If the farmers wish to market and sell their milk jointly and also agree on a common price for their milk, when an agreement between competitors involves price fixing and affects trade between Member States,137 this would normally be considered as a form of cartel prohibited by EU competition rules.138

The exception to this provision is that farmer associations may be allowed to jointly agree a price if this is deemed absolutely necessary for the agreement to work; generates substantial efficiencies; and the association does not command more than 15% or 20% of the relevant market share for a joint commercialisation and a joint production agreement respectively.139 Above this threshold, there is no presumption of illegality, but this will have to be assessed on a case-by-case basis.140 Dairy co-operatives are more likely to meet these criteria while POs might have more difficulty proving that joint price-setting was required, or else risk breaching the law.

46. Defra did not support the Commission’s proposal, arguing that “clarifying that it is already possible for producers to collaborate within existing competition law would be a quicker and less risky way of achieving balance”.141 The Minister told us “there is absolutely nothing in competition law today to stop up to 20% or 25% of dairy farmers from working together as a cohesive group and demanding the price they want”.142 This is not entirely correct as dairy Producer Organisations are currently only permitted to jointly agree a price if they can prove that this is essential for their operations. The Commission proposed that the threshold size of a PO be specified as a percentage of national or EU milk production, rather than as a percentage of the relevant market. Their rationale was that the relevant market was not always easy to define, and that therefore setting a national limit would be clearer.143 The NFU concurred that “whilst there might be some indications out there that suggest that up to a certain level you can have a degree of collective bargaining, nowhere are they set out in absolute, clear terms”.144

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135 Ev w21
136 Ev w21–22. 26. This exclusion does not apply if the European Commission finds that that competition is thereby excluded or that the objectives of Article 39 of the Treaty of the Functioning of the European Union are jeopardised.
137 Trade between Member States is deemed to be affected if the parties have a combined market share of more than 5% on any relevant market (Ev w22).
138 There are exceptions to this, namely, if a large buyer does not want to deal with a multitude of prices and requests a single supply price or if farmers agree on jointly launching a new product, such as a common brand of milk, and such an initiative can only be credibly achieved if all aspects of marketing, including price, are standardised (Report of the High Level Group on Milk, p 37).
140 Ev w21
141 Ev 92
142 Q 330
143 Ev w25
144 Q 23
47. Dairy farmers are particularly disadvantaged in that they are selling a perishable product in a highly consolidated market with often little choice, at regional level, to whom they sell. We welcome the Commission’s proposals, which will make it considerably easier for dairy farmers to collaborate over prices and so increase their bargaining power, without fear of investigation from competition authorities.

48. The industry was divided over the proposed size limit of Producer Organisations at 33% of national production. NFUS emphasised that POs needed to be sufficiently large to enable dairy farmers to negotiate effectively with buyers, while Dairy UK argued that “to permit one segment of the supply chain to create a dominant monopoly is flatly at odds with the concept of a market led industry striving for competitiveness.” The European Commission did not agree “because with 33% you have an option, for any processor, to negotiate a price with three different producer organisations”.

49. Competition authorities also expressed concerns that the proposals could lead to distortion of competition. A Resolution of the Meeting of Heads of the European competition authorities “strongly warned against any legislative proposal that would enable dairy farms to jointly fix milk prices” without appropriate limits based on the relevant market and without requiring POs to carry out additional efficiency-enhancing activities. The OFT were concerned by the proposed size limit, stating that “a measure based on quantities of production risks permitting strong distortions to arise in the UK (and EU) dairy markets”. As British processors are generally restricted to sourcing raw milk domestically, the risk that POs distort competition is arguably greater here than in the rest of Europe where a processor might conceivably source from several countries. The OFT recommended that competition authorities should be able to define the relevant market on a case-by-case basis, rather than the presumption that the relevant market was national. However, in the case of the First Milk-Milk Link merger it was accepted that Great Britain was the relevant geographic market. The OFT also warned about the stringency of the conditions under which national competition authorities would be able to intervene, namely, only if they believed competition was being excluded.

50. The impact of the Milk Package proposal on existing co-operatives is not clear. First Milk warned that co-operatives might be required to negotiate contracts with Producer Organisations (POs) that form amongst their membership, arguing that:

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145 Ev w3
146 Ev 72
147 Q 189
149 Ev w25
150 The perishability of raw milk precludes long-distance transport (over about 100 miles). Therefore, for UK processors sourcing raw milk, in practice, the relevant market is domestic producers (Office of Fair Trading, Anticipated merger between First Milk Limited and Milk Link Limited, ME/3352/07, 20 December 2007). The EU proposals allow substantial consolidation of producers at a national level (that is, down to as few as three POs). In Member States with land borders with other Member States, the available market for a processor might span several Member States, and therefore encompass more POs.
151 Office of Fair Trading, Anticipated merger between First Milk Limited and Milk Link Limited, ME/3352/07, 20 December 2007
152 Ev w25. Dairy UK also expressed concern about this aspect of the Commission’s proposals (Q 77)
This proposal would put members and their co-op in an impossible position if a co-op member was also a PO member, and the PO was undertaking a contract negotiation that may directly undermine the value and security of the same farmer's investments in the co-op. The last thing we need is anything that undermines farmer confidence in investing in their company's own value-added activities.\footnote{Ev w12}

However, the OFT said that a co-operative could defend against internal POs by becoming recognised as a PO itself for its milk brokering operations and for negotiating the sale of any of its members' milk to a third party processor.\footnote{Ev w25}

\textbf{51. We note concerns that the proposed size limit of 33\% of national milk production risks creating regional producer monopolies. On the other hand, lack of a clear threshold size risks creating uncertainty and deterring participation among farmers. To clarify the situation and bring it in line with existing competition law, we recommend that Producer Organisations be able to cover up to 20\% of national milk production and above that limit, be subject to a case-by-case analysis by the National Competition Authority until the 33\% limit is reached.}

\textbf{52. The Co-operative Group were supportive of greater collaboration in the industry, but warned that Defra’s attempts to implement the Fruit and Vegetable Producer Organisation scheme in England had been “absolute chaos”.\footnote{Ev w25} In April 2011 the European Commission announced that the UK was being fined £23.8 million due to weaknesses in the administration of the Fruit and Vegetable PO scheme.\footnote{European Commission press release, 15 April 2011} The NFU warned that the criteria for recognising POs had not been set out clearly in the Commission’s proposal.\footnote{Ev 70} In light of the substantial disallowance incurred through Defra’s misadministration of the Fruit and Vegetable Producer Organisation regime, Defra must ensure that the criteria for recognising Dairy Producer Organisations are clearly and unambiguously agreed between itself, its agencies and the European Commission, before implementation.}

\textbf{Transparency}

\textbf{53. The Food and Drink Federation (FDF) and Defra called for greater transparency on dairy stocks and production; the FDF said this was needed to “mitigate speculation which results in market volatility”.\footnote{Ev w10} Farming organisations argued for greater transparency on supply chain margins, the NFU said “clearly we have to be careful about infringing commercial confidentiality, but equally it is important that farmers understand the market environment they operate in”.\footnote{Q 312–314} The European Parliament Agriculture and Rural Development Committee’s report also calls for greater transparency, including on average prices paid for raw milk and the establishment of a Market Monitoring Agency.\footnote{European Parliament press release 27 June 2011}}
54. The Commission’s recommendation for improving transparency is limited to collating the volume of raw milk delivered to dairies. The UK is far advanced in terms of market information through the wealth of data published by the DairyCo Datum, including weekly raw milk deliveries to processors.\footnote{DairyCo Datum, UK Monthly and Annual Milk Deliveries, http://www.dairyco.net/datum/} Therefore the Commission’s proposals do not offer any benefit to the UK, but equally are unlikely to pose additional costs. The Commission’s proposals on transparency offer little benefit to the UK as the relevant data is already published. We encourage the Government to pursue greater transparency across the dairy supply chain to improve market awareness and reduce volatility.

**Quotas**

55. The evidence that we received demonstrated no desire to alter the plans to phase out quotas by 2015. The impact of ending quotas on the UK dairy sector is still unclear—on the one hand, it could provide opportunities for expansion, on the other hand, it could expose the domestic industry to greater competition. Tom Hind of the NFU believed “we need to watch what happens in Ireland very closely, because the Irish Government and the Irish food industry has a very ambitious export strategy, which includes increasing its scale of dairy export by [...] between 50% and 100%”.\footnote{Q 31} The Minister also felt strongly “that we have to fight back against this import penetration by developing our own products and investing in processing so that we can compete at price”.\footnote{Q 362} The forthcoming lifting of quotas adds weight to the argument for proactive action to bolster the industry before the window of opportunity to expand production has passed.
4 The Government’s role in ensuring the future of the dairy sector

56. Defra’s Business Plan includes a priority to support and develop British farming, including promoting increased domestic food production.164 The Department’s memorandum sets out the action it is taking in support of the domestic dairy sector (Box 3). While these initiatives are laudable, they do not present a comprehensive action plan to improve the situation in the dairy sector, particularly for producers. For example, the voluntary code of practice on labelling does not protect British dairy farmers as it enables dairy products to be labelled as ‘British’ even if they have only been packaged here.165 While we support the need for a Groceries Code Adjudicator, it will not be of substantial benefit to dairy farmers as they are not direct suppliers of supermarkets.166 We are awaiting the Department’s report on its commitment to procure food that meets British or equivalent standards of production, due to be published in June.167 When we questioned the Minister on what he could do to improve farmgate dairy prices, he answered “not a lot”.168

57. Defra’s domestic action programme for the dairy sector offers little of real benefit for dairy farmers. We are surprised and disappointed that the Minister was not able to offer more concrete and proactive suggestions to improve the situation in the dairy sector. We therefore took evidence on other means of improving the health of the dairy industry. We trust that Defra’s response to this report will set out how their commitment to support and develop British farming will be realised for the dairy sector in time for the abolition of quotas in 2015.

Box 3: Defra’s domestic programme to support the dairy sector169

- Monitoring adherence to the voluntary code of practice on country-of-origin labelling of some dairy products.
- Committing through the Government Buying Standards, to procure food to British or equivalent standards of production where this does not lead to an overall increase in costs.
- Reinvigorating the Dairy Supply Chain Forum—a cross-industry group that meets bi-annually to consider the health and future of the dairy sector.
- Establishing the Groceries Code Adjudicator, which will monitor and enforce adherence to the Groceries Supply Code of Practice.170
- Dispensing monies available under the EU CAP budget to help improve the competitiveness and sustainability of the dairy sector.

165 NFU (Q 41). The NFU (Q 41) and Dairy UK (Ev 74) called for country-of-origin labelling to be made compulsory.
166 Ev w9. The Groceries Code Adjudicator will enforce the Groceries Supply Code of Practice, which is part of the Groceries (Supply Chain Practices) Market Investigation Order 2009 (Groceries Supply Order). The code covers the relations between the major retailers and their direct suppliers.
168 Q 340
169 Ev 91
170 A draft Bill establishing the Groceries Code Adjudicator was published in May 2011 by the Department for Business, Innovation and Skills
Developing diversified and value-added markets

58. The Minister described what he saw as “systemic problems” in the dairy sector:

There are only three major processors that bottle for those supermarkets, and obviously they have to compete with each other for those very substantial contracts. Arguably, there is some imbalance there. [...] In my view, we have a bigger systemic problem behind that with the rest of the milk [...] We can all dispute or debate the reasons for it, but the fact is that 43% of our milk is going into processing and we should be doing far more than that. We are importing very large quantities of added-value dairy products—cheeses, yoghurts and that sort of thing—on which we ought to be competitive.\(^\text{171}\)

The tendency for the UK processing industry to focus on liquid milk does not just stem from issues of competitiveness of UK processors, it is also driven by consumer demand. The UK consumes about 20% more liquid milk per capita than the EU average but 33% less cheese per capita.\(^\text{172}\) Part of the UK’s trade deficit in processed dairy arises from consumer preference for foreign cheese varieties—70% of cheese imports in 2010 were in the speciality cheese category.\(^\text{173}\) Low consumer awareness of country-of-origin may influence butter imports—about 40% of consumers in 2008 thought Anchor, which is produced by the New Zealand co-operative Fonterra, was a British brand.\(^\text{174}\)

59. Several witnesses agreed that diversification and expansion in value-added products was needed to drive up prices which would benefit the whole supply chain.\(^\text{175}\) However, the Co-operative Group sounded a note of caution that:

One of the things we need to understand is how much of liquid milk production the UK could conceivably put into added value; 50% of what is produced is liquid milk. I do not think the consumer wants added value, they are quite happy with what they have.\(^\text{176}\)

Increased investment in processing facilities was seen as central to enabling the industry to diversify or to increase exports.\(^\text{177}\) For example export of liquid milk to the EU is hampered by the lack of domestic UHT processing facilities.\(^\text{178}\) However, the Minister told us that the powers of Government to increase investment in dairy processing were limited as “the reality is that today the Government are not in that flush position where we can necessarily be generous, either in allowances or more Government grants”.\(^\text{179}\)
60. The Plan for Growth paper, published by HMT and BIS in March 2011, sets out the broader need for businesses to access a wide range of sources of finance if they are to reach their full growth potential, particularly small to medium sized enterprises (SMEs). Although the dairy sector is highly consolidated at one end, there are some 400 processors that handle less than 5 million litres yearly. The plan announces actions to increase access to finance, particularly for SMEs. These include an extension of the Enterprise Capital Funds programme, which will provide up to £300 million in equity finance to SMEs over the next four years; a £2.5 billion Business Growth Fund targeting established businesses with high growth potential and a turnover of £10–100 million; and increased availability of credit from UK banks to SMEs. In addition, the plan makes the commitment that the major UK banks will make £190 billion of new credit available to businesses in 2011, of which £76 billion will be available specifically for SMEs.

61. The Government should facilitate investment in dairy processing as part of its wider strategy to promote growth in the manufacturing sector and increase exports and Defra’s business plan commitment to promote increased domestic agricultural production. We recommend that Defra review the accessibility to the dairy industry, particularly SMEs, of existing private and public funds for increasing growth and competitiveness and take steps where necessary to improve access. The review should include finances available through the Common Agricultural Policy, but also funds that are not specific to agriculture, such as the Business Growth Fund and Enterprise Capital Funds.

62. Defra claimed that the UK was well-placed to exploit export markets. However, the Co-operative Group noted that the global dairy industry presented challenges for the UK as a number of countries could produce dairy commodities for export at costs well below those that were sustainable in the UK. Dairy UK were more sceptical about the potential for increasing dairy exports, arguing that “if it made economic sense for the dairy industry now, we would be doing it”. Defra’s Business Plan includes a commitment to support British food exports. UK Trade and Investment has set out its strategy for increasing trade, however there appears to be no intention to focus on agriculture at all. The NFU suggested that UK Trade and Investment could be doing more to facilitate food markets overseas. The 2012 London Olympics present a particular opportunity to promote British products through their commitment that all dairy products will have to meet Red Tractor assurance standards. Defra should develop a strategy with UK Trade and Investment and the Foreign and Commonwealth Office to promote UK dairy products and increase exports.

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180 DairyCo Datum, Structure of UK Milk Processors, 10 November 2010, www.dairyco.net/datum
181 The Plan for Growth, p 65
182 Ev 91
183 Ev 86
184 Q 50
186 UK Trade and Investment, Britain open for business, May 2011
187 Q 42
188 Assured Food Standards press release, 16 December 2010
63. We heard that promoting research, development and innovation throughout the dairy supply chain could have beneficial impacts, for example through increased production efficiency or through developing new uses or end-markets for dairy products.\textsuperscript{189} The Managing Director of the Co-operative Farms described the approach used by Fonterra, the farmer-owned co-operative that processes over 90% of New Zealand’s raw milk:

Fonterra, for example, has a dairy research institute dedicated to finding other uses for milk products. They are making plastics out of milk; they are making ingredients that will thicken yoghurts that are being bought by the likes of Danone to thicken yoghurts. All of this is being created in New Zealand. They are also naturally extracting the calcium from milk to create ingredients to enrich products with naturally produced calcium.\textsuperscript{190}

In the UK, there have been some promising experiments as well. Tesco described their partnership with the Dairy Centre of Excellence at Liverpool University to work on production efficiency and environmental sustainability.\textsuperscript{191}

64. In addition to specific supply group initiatives, dairy research and development is provided through, \textit{inter alia}, the Dairy Council, DairyCo, Defra and the Biotechnology and Biological Sciences Research Council (BBRSC). The Dairy Science Forum noted that there was very limited funding support from the processing and retail sectors, outside of the dedicated supply chains.\textsuperscript{192} The Dairy Council is a non-profit making organisation funded by dairy processors and producers through Dairy UK that aims to provide an evidence basis for nutritional claims around dairy products.\textsuperscript{193} DairyCo is funded through the levy paid by dairy producers and “invests in Research and Development (R&D) activities with the sole purpose of improving the efficiency of milk production in an environmentally, economically and socially acceptable way”.\textsuperscript{194} DairyCo recently announced two new research partnerships, worth £5m over five years, to consider ‘Soil, Forage and Grassland’ and ‘Health, Welfare and Nutrition’.\textsuperscript{195} Defra spent £71.3 m between 2005 and 2010 on dairy research focussing on research to quantify and improve the environmental performance of dairy farming and research to improve the health and welfare of dairy cows.\textsuperscript{196} Andy Bloor, Chairman of the Wiseman Tesco Sustainable Dairy Group suggested that the industry-funded research could be better targeted:

The research that seems to be going on within the industry—I am probably being a little bit cynical—seems to be going round telling us how we can produce more milk and grow the crops better, whereas we feel that it should be going to the area of developing more products: niche markets, higher value. I think if you talked to the

\begin{footnotes}
\item[189] Including Dairy UK (Ev 73), the Co-operative Group (Q 109), Tesco (Q 292)
\item[190] Q 109. The witness had previously worked as Marketing Director at Fonterra.
\item[191] Q 220, Q 282
\item[193] The Dairy Council, http://www.milk.co.uk/default.aspx
\item[195] DairyCo press release, 27 June 2011
\item[196] HC Deb, 26 April 2011, c4W
\end{footnotes}
average producer they would say that the money that they give to DairyCo, which continually regurgitates past information, would be better centred on developing more markets and a better high-end product.  

65. Other than that conducted within commercial concerns, dairy-related research in the UK is focussed on animal welfare and environmental sustainability. This has resulted in a lack of research into innovative ways of adding value in the dairy sector through novel processes, markets or uses. Defra should use the Dairy Supply Chain Forum to identify who is best placed to deliver this research and how it should be funded, which should include the retail and processing sectors, with the ambition of establishing a new research arm within one of the existing industry or government-sponsored programmes.

**Reducing production costs**

66. The most direct means of Government action to increase the profitability of dairy farmers is through reducing production costs. Reducing production costs by making more efficient use of inputs also reduces the environmental impact of dairy farming. The NFU’s recent Cost of Production report estimated that average production costs were 29 ppl between April 2010 and March 2011 compared to average farmgate prices of 25 ppl. DairyCo’s MilkBench+ project confirmed that “farmgate milk prices were typically at least one pence per litre below our detailed full economic cost of production estimates in 2010/11”. Feed and fuel, the key input costs for dairy farmers, have exhibited significant volatility in recent months—the crude oil price has almost doubled in the last two years while farmgate milk prices have risen by less than 20% (Figure 5). It is likely that this upwards trend in feed and fuel prices will continue in future. However, production costs vary significantly between farms suggesting that there is scope for improved efficiencies.

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197 Q 292

198 NFU, Cost of Milk Production Report April 2010–March 2011 Estimates, February 2011. The report was based on actual costs for April 2009 to March 2010 and projected costs for April 2010 to March 2011 for 809 dairy units provided by independent consultants. The NFU’s report compared the estimated cost of production to the farmgate price of in November 2010 (25.94 ppl). The updated average farmgate price for the relevant period (April 2010 to March 2011, obtained from DairyCo) is 25.1 ppl.

199 Ev w14. DairyCo added that “it is important to note that the participants on Milkbench+ are self-selecting, and would not necessarily considered to be a representative sample of all dairy farms”. This may explain the discrepancy between the DairyCo figures and the NFU figures.

200 DairyCo (Ev w14) and Defra (Q 295). The Dairy Science Forum found that the variation in technical performance between farms with similar production systems can be as much as a third (Dairy Science Forum, Strategic Review of UK Dairy Farming’s priorities for R &D and Knowledge Exchange for 2011–2021, June 2011)
EU proposals for the dairy sector and the future of the dairy industry

Figure 5: Input costs and output prices in the UK dairy sector. May 2009 = 1.

Source: Compiled from data supplied by DairyCo.

67. There are some industry-led initiatives in existence to help farmers better understand their business and reduce their cost base. DairyCo recently established MilkBench+, a free, confidential web-based dairy benchmarking scheme. It aims to get 500 farms to participate in MilkBench+ per year (that is, 5%). DairyCo are also trialling “Planning for Profit” workshops where farmers investigate different business management options and generate a costed business management plan for their enterprise with trained consultants. However, these workshops are not free, which is likely to bias take-up. Retailers may also provide extension services, for example farmers in the Tesco Sustainable Dairy Group are given assistance to produce their accounts. Sainsbury’s has been supplying farmers with free veterinary advice, and Asda DairyLink farmers have access to expert advice sessions about practical issues such as lameness.

68. The Technology Strategy Board (TSB), a non-departmental public body sponsored by the Department for Business, Innovation and Skills, established a “Sustainable Agriculture and Food Innovation Platform” in 2009. The Platform intends to invest up to £90 million over five years. Funding competitions have been held already for sustainable protein...
production and new approaches to crop protection. A key advantage of the TSB’s approach is its focus on business-led innovation. This focus is likely to facilitate knowledge exchange and uptake by the industry, an area where improvement is urgently needed.\textsuperscript{207}

69. While the Government’s scope to alter the distribution of supply chain margins may be limited, it does possess the levers to help farmers reduce their production costs. This can increase profitability, but only if accompanied by measures to improve farmers’ bargaining power to ensure that margin gains are not redistributed up the chain. We welcome the assistance with business management provided by DairyCo’s Planning for Profit workshops, but note that the cost may deter the businesses that are most in need from attending. Defra should proactively encourage this project and investigate whether workshops can be provided at a lower or no cost through funding from retailers and the Rural Development Programme. We recommend that Defra set an ambitious target of 30% dairy farmer participation in the programme and report back within one year.

70. Stimulating technological development in the dairy production and processing sectors through business-led innovation would be a useful focus for the Technology Strategy Board’s Sustainable Agriculture and Innovation Platform. Defra must make the case for directing funds to this area to the Platform’s steering group.

71. Anaerobic Digestion (AD) is a process where plant and animal material is converted into useful products, such as biogas or organic fertiliser, by micro-organisms in the absence of air. Increased use of AD facilities by dairy enterprises has the potential to reduce energy use, fertiliser and waste management costs, mitigate greenhouse gas emissions from dairying and reduce diffuse pollution.\textsuperscript{208} However, the Dairy Roadmap reveals that only nine AD plants have been established on UK dairy farms, far short of the Government’s target of 30 installations by 2010.\textsuperscript{209} A survey of 2000 dairy farmers found the main barriers to adoption were the high establishment costs and the perceived difficulty of obtaining planning permission.\textsuperscript{210}

72. Defra and DECC published an Anaerobic Digestion strategy alongside Defra’s Waste Review in June 2011. This sets out the Government’s actions to promote the uptake of AD by industry, one of Defra’s business plan commitments. Actions include improved information dissemination, a Defra task force to support good practice on on-farm AD, and a new £10m loan fund to help stimulate investment in additional AD infrastructure.\textsuperscript{211} DECC has also increased the Feed-In Tariff (FIT) for AD plants by 1–2 p/kWh depending

\textsuperscript{207} Dairy Science Forum, Strategic Review of UK Dairy Farming’s priorities for R &D and Knowledge Exchange for 2011–2021, June 2011, p 1
\textsuperscript{209} Defra, Dairy Roadmap, May 2011
\textsuperscript{210} RELU, Farm diversification into energy production by anaerobic digestion . The Agri-Food and Biosciences Institute estimated the capital costs of an AD unit to be in the order of £1,250 per cow for a 100 cow dairy farm with an estimated pay back time of 10–20 years (www.afbini.gov.uk).
\textsuperscript{211} DECC and Defra, Anaerobic Digestion Strategy and Action Plan, June 2011, p 30–33
on capacity.\textsuperscript{212} The NFU described the Government’s AD strategy as unambitious and lacking in real action,\textsuperscript{213} and the Country Land and Business Association described it as rehashing existing commitments with no real vision.\textsuperscript{214} The Chairman of the Anaerobic Digestion and Biogas Association said the increase in FITs was too small to make an significant change to the status quo on installations.\textsuperscript{215}

73. Anaerobic digestion (AD) on dairy farms has considerable potential to reduce costs and greenhouse gas emissions, yet uptake so far has been negligible. The Government’s Anaerobic Digestion Strategy and Action Plan were published after our evidence sessions had been completed, preventing us from giving it full consideration. We recommend that Defra review its plan and explain how it will achieve the targets on AD uptake set out in Dairy Roadmap.

Encouraging greater collaboration in the industry

74. Some witnesses advocated the benefits of greater collaboration and co-operation both between farmers and between farmers and processors.\textsuperscript{216} The Managing Director of the Co-operative Farms described her experience of Fonterra, a large milk co-operative in New Zealand:

\begin{quote}
When you look at Fonterra and the very big co-operatives, they have been hugely influential in adding value and passing know-how back down to farmers. The farmers themselves are not necessarily particularly efficient [...] but the co-operative structure has helped the farmers enormously.\textsuperscript{217}
\end{quote}

However, we received few practical suggestions for how co-operation could be encouraged. The Minister suggested there was little he could do, noting that “there have been so many attempts [...] by Governments of different complexions to encourage co-operation in this country. There have been some superb successes, but I am afraid the history is littered with a lot of co-ops that have failed”.\textsuperscript{218} The Co-operative Group felt that there was very “limited understanding” of the co-operative model among UK farmers.\textsuperscript{219} Dairy UK noted that “the operation of competition law in respect of co-operation between producers is not clear”, and said that opportunities for co-operation between dairy producers in the marketing of their product that were not widely known or understood by the industry.\textsuperscript{220} The NFU noted that the “history of farmer investment in processing in the UK is not always a happy

\textsuperscript{212} DECC press release, 9 June 2011. Feed-In Tariffs (FITs) provide an incentive for home- or land-owners to install renewable energy generation schemes. The FITs guarantee a minimum payment for all electricity generated by the system, as well as a separate payment for the electricity exported to grid. These payments are in addition to the bill savings made by using the electricity generated on-site. The Renewable Heat Incentive, due to be launched shortly after summer 2011, will mean that AD plants are eligible for a feed-in tariff of 6.5 p/kWh over a 20 year period for biogas or biomethane (Anaerobic Digestion Strategy and Action Plan, p 22).

\textsuperscript{213} NFU press release 17 June 2011

\textsuperscript{214} CLA press release, 15 June 2011

\textsuperscript{215} “Government has got it wrong with new FIT rates”, Farmers Guardian, 24 June 2011

\textsuperscript{216} For example, Tesco (Q 216), Dairy UK (Q 61), the Co-operative Group (Q 107), the Minister (Q 298)

\textsuperscript{217} Q 107

\textsuperscript{218} Q 297

\textsuperscript{219} Q 142

\textsuperscript{220} Ev 74
one, with a number of ventures having failed or not entirely meeting their initial aspirations.\textsuperscript{221}

75. The European Commission and the Office of Fair Trading have both produced guidance on the types of co-operation which are already allowed under existing EU and UK competition rules.\textsuperscript{222} The OFT added that it was likely to be updating its currently available guidance in the near future.\textsuperscript{223} On guidance, the independent Farming Regulation Task Force’s report found that:

Feedback from industry suggests that Government guidance often remains on shelves, unread and unused. Too often guidance seems to us to ‘watch Government’s back’ rather than help those who need to comply with the law.\textsuperscript{224}

To resolve these issues, the Task Force recommended that:\textsuperscript{225}

- Defra and its regulators invite appropriate trade associations and farmers to play a leading role in drafting guidance;
- Those involved in drafting jointly own that guidance with Government and should help promote it with those needing to use it,
- Defra, its regulators and trade associations trial guidance with ordinary farmers in advance to sort out problems.

76. The OFT has reviewed its approach to providing opinions on the application of competition law in response to concerns raised by business and other stakeholders that some forms of beneficial collaboration are currently not going ahead for fear of infringing competition law.\textsuperscript{226} They are trialling a ‘short form opinions’ tool to provide guidance to businesses contemplating a collaborative agreement.\textsuperscript{227} The OFT notes that the process is designed to be simple, short and flexible.\textsuperscript{228} However, the parties to the proposed agreement must be prepared to allow the statement of facts and short-form opinion to be published, which may deter participation.

77. We heard that increased co-operation among farmers was hindered by a lack of awareness of the available opportunities. Defra and the Office of Fair Trading should update the guidance on co-operation among farming businesses following the principles set out by the Farming Regulation Task Force. Defra should review the utility of the Office of Fair Trading’s ‘short form opinions’ tool to agricultural businesses.

\textsuperscript{221} Ev 69
\textsuperscript{223} Ev w23
\textsuperscript{224} Striking a balance: reducing burdens; increasing responsibility; earning recognition. A report on better regulation in farming and food businesses, p 26
\textsuperscript{225} Ibid
\textsuperscript{226} Office of Fair Trading, Short-form Opinions—The OFT’s Approach
\textsuperscript{227} Ev w23
\textsuperscript{228} Office of Fair Trading, Short-form Opinions—The OFT’s Approach
78. In 2009–10 the previous EFRA Committee held an inquiry into the collapse of Dairy Farmers of Britain (DFB), one of the UK’s large milk processing co-operatives.229 Notwithstanding the unfortunate demise of DFB, the previous Committee was supportive of greater co-operation in the industry and recommended several actions that could be taken by Government to strengthen UK dairy co-operatives. 230 The Government’s Response to the EFRA Committee’s Report highlighted several areas where work was ongoing to achieve this. 231 We request an update on the following commitments set out in the Government’s Response to the Environment, Food and Rural Affairs Committee’s 2010 report on Dairy Farmers of Britain: a Financial Services Authority-led code of best practice for co-operatives; an examination of ways to overcome constraints on capitalising UK co-operatives; the implementation of the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2010, and its implications for agricultural co-operatives.

**Large-scale dairying**

79. In February 2010 a planning application was submitted by a group of farmers to develop a large-scale dairy holding, housing some 8,100 cows, in Nocton, Lincolnshire— the first establishment of its kind in the UK. Following expression of concerns from residents and the local council, the proposal was re-submitted for a lower number of cows (3,700) and finally dropped in February 2011 after the Environment Agency expressed concerns about the potential for pollution seeping through limestone into groundwater. 232

80. The Nocton project, described as a ‘super-dairy’ sparked considerable debate and opposition arising from its perceived impact on the local environment, the welfare of the cows, the potential impact on small-scale dairy farms, and a general dislike of ‘factory farming’. For example, Compassion in World Farming said “the proposed construction of the UK’s largest dairy farm poses a giant threat to animal welfare and all those who believe that humane and sustainable farming is the only viable way to feed our planet”. 233 On the other hand, the Farm Animal Welfare Council advised that:

> A dairy cow that is kept in a very large herd can have a satisfactory standard of welfare, provided that the herd is divided into appropriate groups, each managed according to nutritional and other needs, and stockmanship is of the highest standard. 234

The RSPCA concurred that “large units can supply good welfare”. 235

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229 Environment, Food and Rural Affairs Committee, Dairy Farmers of Britain, Fifth Report of Session 2009–10, HC 227
230 Dairy Farmers of Britain, para 32
234 “Nocton Dairies: Mixed reaction to ‘super dairy’ plans”, Farmers Guardian, 18 November
235 Ibid
81. Our witnesses were generally supportive of the opportunities offered by large-scale dairying.236 Robert Wiseman Dairies said:

We cannot do anything other than encourage farmers to make progress with their businesses to help them achieve the efficiencies required to compete on a UK and European level. As a business, we have been allowed to make progress by investing. We have been allowed to upscale processing to the extent that our dairy at Droitwich is now producing 10% of the nation’s milk. That would not have happened anywhere 20 years ago. No one can criticise farmers for trying to achieve similar efficiencies.237

The Co-operative Group suggested that, for the UK to expand its dairy exports, large-scale dairy holdings might be necessary as “the Americans are hugely efficient because they have very large units, typically of 3,800 cows. They are very competitive and we actually have to be as competitive as that if we want to trade in the commodities [markets]”.238 The organisations that we heard from did not express the view that large-scale holdings inevitably compromise welfare; however research is going on currently into the environmental and welfare impacts of large-scale dairying.239 The NFU discounted the argument that large-scale dairy farms would put smaller ones out of business, claiming there was scope for both types of operation.240

82. Defra have yet to form an assessment on the appropriateness of large-scale dairy holdings in the UK and declined to give an opinion on the Nocton super-dairy project, stating that “it is not the Government’s policy to comment on individual planning applications”.241 Press reports suggest that the Minister is minded to support super dairies. He told Farmers Weekly that: “I certainly don’t think we should be philosophically opposed to larger-scale farming—whether it be dairy units or anything else. We have to face up to the market reality. If you can drive down the cost of production through being larger scale then you should do so”.242 However, when we asked the Minister if he intended to address this gap between public perception of large-scale dairy farming and the market reality, he said only that:

If the research shows that, given the present picture, there are very good welfare reasons why large-scale dairying is wrong, or that cows should be able to go out to graze, we would have to communicate that and probably bring it into our policy.245

83. The British public’s attitude to technological innovation in farming and food production tends to be conservative, as evinced by the long-running opposition to cultivation of GM food crops and to the use of cloned livestock.244 However, the Women’s

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236 Including Dairy UK (Q 95), the NFU (Q 46), the Co-operative Group (Q 164)
237 Q 106
238 Q 360
239 Q 47
240 Q 106
241 For example, HC Deb, 10 January 2011, c25W
242 “Tory farm minister’s first year in office”, Farmers Weekly, 8 May 2011
243 Q 361
244 Food Standards Agency, An evidence review of public attitudes to emerging food technologies, March 2009
Institute, popularly regarded as a bellwether for Middle England, recently rejected a vote on its resolution to campaign against large-scale farming. The NFU suggested that Government could “play an important role in ensuring that the facts are presented, and ensuring that at least agencies of Government do not use media perception as a means of influencing decisions they take on future dairying businesses”.

84. It is absolutely essential that the environmental, animal health and welfare, and social impacts of large-scale dairy farms are quantified and we welcome the fact that research is currently under way. We conclude that large-scale dairy farming presents an opportunity whose potential merits further exploration. The Government has significant power to disseminate the evidence-base on the impact of particular technologies, and if appropriate, to promote them. We do not accept that approvals for large-scale agricultural holdings are purely an issue for planners. As soon as evidence on the impacts of large-scale dairying is available, Defra must establish its policy position on this issue and then take a proactive stance in explaining the rationale behind its decision.

245 Women’s Institute press release, 8 June 2011
246 Q 93
247 Q 48
5 The implications of the Milk Package for the dairy sector

85. The farming industry were generally supportive of the key elements of the Milk Package, but recognised that it would not be sufficient to redress the structural issues in the sector. The NFU argued that “the measures proposed by the Commission are certainly promising, and have the potential to be beneficial for UK dairy farmers, providing Defra gives them its full backing”. 248 Dairy UK and Tesco were sceptical about the value of introducing more regulation if it would not offer a clear benefit. 249

86. The Minister told us that “we are broadly in support of it. I do not believe that it will make a dramatic difference, but clearly there are bits that might well help”. 250 However, we note that the Department has not committed to fully implementing Milk Package proposals on written contracts and is actively negotiating against the proposals on Producer Organisations. We question why the Department has given such lukewarm support to the Commission’s proposals, given that the Minister himself recognised the severity of the problems facing small dairy farmers and the Government’s own inability to redress the situation.

87. We welcome the analysis presented by the European Commission and the High Level Group on Milk, which has successfully highlighted the problems facing the European dairy sector. We support the key elements of their proposals but conclude that more will need to be done to address the structural problems in the UK dairy industry and have set out what additional action is needed. We were disappointed by the weakness of the Department’s proposals to improve the state of the dairy sector and call on Defra to take more a more proactive stance, commencing by implementing the recommendations set out in this report.

248 Ev 67
249 Dairy UK (Ev 70–71), Tesco (Q 266)
250 Q 310
Conclusions and recommendations

The state of the UK dairy industry

1. We are confident that the future prospects of the UK dairy sector are positive, but this depends on Government and the dairy industry resolving certain issues. Despite having one of the most efficient production systems in the world, UK dairy farmers are unable to cover their costs and dairy processors are outcompeted by imported products. Farmgate prices have recently become decoupled from both commodity market indicators and farmers’ production costs, indicating that farmers are not consistently able to recoup sufficient value from the supply chain. We conclude that Government action is justified as the substantial drop in the number of dairy producers that would be required to increase farmgate prices through market forces alone would have undesirable consequences for rural communities, landscapes and tourism, and consumer choice. Consolidation in the industry must be driven by confidence, innovation and investment. (Paragraph 28)

2. We call on Government to take action to resolve this situation through addressing the structural imbalances that result in low farmgate prices; encouraging increased investment in processing, particularly in value-added products; and exerting influence on retailers to establish dedicated supply chains for processed dairy products, such as butter and cheese. (Paragraph 29)

European Commission proposals for the dairy sector

Raw milk contracts

3. We conclude that contracts should provide certainty and clarity to give both parties the confidence to invest—the current system fails to achieve this. Our view is that the Commission’s proposals offer considerable scope for Defra and the industry to jointly establish a more effective system of raw milk contracts. (Paragraph 40)

4. We recommend that raw milk contracts should include the four elements specified by the Commission—price, volume, timing of deliveries, and duration. In addition, the contract should make it clear under what conditions the contract can be terminated by either party. Exclusivity clauses should be discouraged to allow farmers to respond to market signals following the abolition of quotas. We do not suggest that all contracts must contain an explicit price or price formula as these could be overly restrictive, but contracts should set out the principles underpinning price and mutually agreed tolerances. Given that the majority of dairy contracts do not contain these elements, in order to effect the change that we think is needed, Defra should make it compulsory for producers to be offered a written contract containing the elements specified above. (Paragraph 41)

5. The European Parliament Agriculture and Rural Development Committee’s proposal that milk contracts should stipulate a milk price fixed for no less than one year is, in our view, overly restrictive and could hinder processors and producers
from responding to market signals. We recommend that the UK Ministers and MEPs do not support this proposal. (Paragraph 42)

**Producer Organisations**

6. Dairy farmers are particularly disadvantaged in that they are selling a perishable product in a highly consolidated market with often little choice, at regional level, to whom they sell. We welcome the Commission’s proposals, which will make it considerably easier for dairy farmers to collaborate over prices and so increase their bargaining power, without fear of investigation from competition authorities. (Paragraph 47)

7. We note concerns that the proposed size limit of 33% of national milk production risks creating regional producer monopolies. On the other hand, lack of a clear threshold size risks creating uncertainty and deterring participation among farmers. To clarify the situation and bring it in line with existing competition law, we recommend that Producer Organisations be able to cover up to 20% of national milk production and above that limit, be subject to a case-by-case analysis by the National Competition Authority until the 33% limit is reached. (Paragraph 51)

8. In light of the substantial disallowance incurred through Defra’s misadministration of the Fruit and Vegetable Producer Organisation regime, Defra must ensure that the criteria for recognising Dairy Producer Organisations are clearly and unambiguously agreed between itself, its agencies and the European Commission, before implementation. (Paragraph 52)

**Other elements of the ‘Milk Package’**

9. The Commission’s proposals on transparency offer little benefit to the UK as the relevant data is already published. We encourage the Government to pursue greater transparency across the dairy supply chain to improve market awareness and reduce volatility. (Paragraph 54)

10. The forthcoming lifting of quotas adds weight to the argument for proactive action to bolster the industry before the window of opportunity to expand production has passed. (Paragraph 55)

**Actions for Government**

11. Defra’s domestic action programme for the dairy sector offers little of real benefit for dairy farmers. We are surprised and disappointed that the Minister was not able to offer more concrete and proactive suggestions to improve the situation in the dairy sector. We trust that Defra’s response to this report will set out how their commitment to support and develop British farming will be realised for the dairy sector in time for the abolition of quotas in 2015. (Paragraph 57)
Increasing the profitability of the dairy processing sector

12. The Government should facilitate investment in dairy processing as part of its wider strategy to promote growth in the manufacturing sector and increase exports and Defra’s business plan commitment to promote increased domestic agricultural production. We recommend that Defra review the accessibility to the dairy industry, particularly SMEs, of existing private and public funds for increasing growth and competitiveness and take steps where necessary to improve access. The review should include finances available through the Common Agricultural Policy, but also funds that are not specific to agriculture, such as the Business Growth Fund and Enterprise Capital Funds. (Paragraph 61)

13. Defra should develop a strategy with UK Trade and Investment and the Foreign and Commonwealth Office to promote UK dairy products and increase exports. (Paragraph 62)

14. Other than that conducted within commercial concerns, dairy-related research in the UK is focussed on animal welfare and environmental sustainability. This has resulted in a lack of research into innovative ways of adding value in the dairy sector through novel processes, markets or uses. Defra should use the Dairy Supply Chain Forum to identify who is best placed to deliver this research and how it should be funded, which should include the retail and processing sectors, with the ambition of establishing a new research arm within one of the existing industry or government-sponsored programmes. (Paragraph 65)

Reducing production costs on dairy farms

15. We welcome the assistance with business management provided by DairyCo’s Planning for Profit workshops, but note that the cost may deter the businesses that are most in need from attending. Defra should proactively encourage this project and investigate whether workshops can be provided at a lower or no cost through funding from retailers and the Rural Development Programme. We recommend that Defra set an ambitious target of 30% dairy farmer participation in the programme and report back within one year. (Paragraph 69)

16. Stimulating technological development in the dairy production and processing sectors through business-led innovation would be a useful focus for the Technology Strategy Board’s Sustainable Agriculture and Innovation Platform. Defra must make the case for directing funds to this area to the Platform’s steering group. (Paragraph 70)

17. Anaerobic digestion (AD) on dairy farms has considerable potential to reduce costs and greenhouse gas emissions, yet uptake so far has been negligible. The Government’s Anaerobic Digestion Strategy and Action Plan were published after our evidence sessions had been completed, preventing us from giving it full consideration. We recommend that Defra review its plan and explain how it will achieve the targets on AD uptake set out in Dairy Roadmap. (Paragraph 73)
**Stimulating co-operation and collaboration**

18. We heard that increased co-operation among farmers was hindered by a lack of awareness of the available opportunities. Defra and the Office of Fair Trading should update the guidance on co-operation among farming businesses following the principles set out by the Farming Regulation Task Force. Defra should review the utility of the Office of Fair Trading’s ‘short form opinions’ tool to agricultural businesses. (Paragraph 77)

19. We request an update on the following commitments set out in the Government’s Response to the Environment, Food and Rural Affairs Committee’s 2010 report on Dairy Farmers of Britain: a Financial Services Authority-led code of best practice for co-operatives; an examination of ways to overcome constraints on capitalising UK co-operatives; the implementation of the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2010, and its implications for agricultural co-operatives. (Paragraph 78)

**Large-scale Dairying**

20. It is absolutely essential that the environmental, animal health and welfare, and social impacts of large-scale dairy farms are quantified and we welcome the fact that research is currently under way. We conclude that large-scale dairy farming presents an opportunity whose potential merits further exploration. The Government has significant power to disseminate the evidence-base on the impact of particular technologies, and if appropriate, to promote them. We do not accept that approvals for large-scale agricultural holdings are purely an issue for planners. As soon as evidence on the impacts of large-scale dairying is available, Defra must establish its policy position on this issue and then take a proactive stance in explaining the rationale behind its decision. (Paragraph 84)

**Conclusions on the European Commission’s proposals**

21. We welcome the analysis presented by the European Commission and the High Level Group on Milk, which has successfully highlighted the problems facing the European dairy sector. We support the key elements of their proposals but conclude that more will need to be done to address the structural problems in the UK dairy industry and have set out what additional action is needed. We were disappointed by the weakness of the Department’s proposals to improve the state of the dairy sector and call on Defra to take more a more proactive stance, commencing by implementing the recommendations set out in this report. (Paragraph 87)
Formal Minutes

Wednesday 13 July 2011

Members present:

Miss Anne McIntosh, in the Chair

Thomas Docherty  Neil Parish
George Eustice  Dan Rogerson
Barry Gardiner  Amber Rudd
Mrs Mary Glindon

Draft Report (EU proposals for the dairy sector and the future of the dairy industry), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 87 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Eighth Report of the Committee to the House.

Ordered, That the Chair do make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

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[Adjourned till Tuesday 19 July at 10.00 am]
Witnesses

**Wednesday 27 April 2011**

Tom Hind, Director of Corporate Affairs, National Farmers Union  
Ev 1

Jim Begg, Director General, Dairy UK, Peter Dawson, Policy Director, Dairy UK, Mark Taylor, Group Milk Procurement Director, Dairy Crest, and Rex Ward, Chair, Dairy UK Farmers Forum  
Ev 10

**Tuesday 3 May 2011**

Christine Tacon CBE, Managing Director, The Co-operative Farms  
Ev 21

Hermanus Versteijlen, Director of Economics of agricultural markets and single CMO, European Commission Directorate General for Agriculture  
Ev 29

**Tuesday 10 May 2011**

David North, UK Corporate Affairs Director, Tesco Stores plc, and Andy Bloor, Chairman of the Wiseman Tesco Sustainable Dairy Group  
Ev 35

**Wednesday 18 May 2011**

Rt Hon James Paice MP, Minister of State for Agriculture and Food, and Andrew Robinson, Head of Livestock and Livestock Products, Department for Environment, Food and Rural Affairs  
Ev 45

**Wednesday 8 June 2011**

Peter Nicholson, Milk Procurement Director, Robert Wiseman Dairies, and Graeme Jack, Communications Director, Robert Wiseman Dairies  
Ev 57

List of printed written evidence

1. National Farmers’ Union (NFU)  
   Ev 65: Ev 67
2. Dairy UK  
   Ev 70: Ev 72: Ev 77
3. The Co-operative Group  
   Ev 85
4. European Commission  
   Ev 87
5. Tesco Stores PLC  
   Ev 88: Ev 89
6. Department for Environment, Food and Rural Affairs (Defra)  
   Ev 90: Ev 93
7. Robert Wiseman Dairies  
   Ev 97
List of additional written evidence

(published in Volume II on the Committee’s website www.parliament.uk/efracom)

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## List of Reports from the Committee during the current Parliament

The reference number of the Government’s response to each Report is printed in brackets after the HC printing number.

**Session 2010–12**

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HC 522 (HC 922) | HC 635 | HC 556 (HC 953) | HC 736 | HC 671 (HC 1356) | HC 858 | HC 1400 | HC 400 | HC 401 |
Oral evidence

Taken before the Environment, Food and Rural Affairs Committee
on Wednesday 27 April 2011

Members present:

Miss Anne McIntosh (Chair)
Tom Blenkinsop
Richard Drax
George Eustice
Barry Gardiner
Mrs Mary Glindon
Neil Parish
Amber Rudd

Examination of Witness

Witness: Tom Hind, Director of Corporate Affairs, National Farmers Union, gave evidence.

Q1 Chair: Good afternoon Tom. Thank you very much indeed for joining us and participating in an inquiry into the dairy industry. For the record, would you just like to give your name and position?

Tom Hind: Sure, my name is Tom Hind and I am Director of Corporate Affairs at the National Farmers Union.

Q2 Chair: Thank you. Would you just like to outline for us what you believe the main problems are for the UK dairy industry, as of today?

Tom Hind: I think it is a very big subject, particularly recognising that we are here essentially to look at the Commission’s dairy package and the UK Government’s response to it. But I guess I will start by giving a contrast between some of the good news and the bad news, and it is clear there is some good news in the industry. For a start, we are starting to see a modest recovery in milk production in the course of the last year after quite a considerable decline in the course of the last five. We are seeing milk prices rise in the industry, with some of the highest milk prices ever paid to dairy farmers being paid currently, and we have seen some positive development in the way that dairy supply chains work, particularly the development of dedicated supply chains and more direct relationships between farmers and grocery retailers, at least in the liquid milk sector.

However, on the downside, dairy farmers—wherever they are in the industry—are facing considerable pressures in terms of production costs. Those costs are borne as a result of quite significant rises in the price of straight and compound feeds, in terms of rises in energy prices, fuel prices, fertiliser, to the extent that costs of production are equally at record levels, and probably the highest cost of production that we have experienced for quite some considerable time. We estimate they are in excess of 29 pence per litre. On top of that, the industry continues to consolidate at the rate of 10 dairy farmers leaving the industry every week. That may bring about a more consolidated industry, but there are big questions as to whether we are losing critical mass, at least in terms of the long-term capability of British dairying to respond to some of the opportunities that might lie in the future.

The dairy market is continuing to fail producers: whilst we are seeing rising milk prices, the UK milk price continues to languish towards the bottom of EU milk prices league. We are currently round about 23rd out of 27 Member States, despite the fact that market indicators would indicate a milk price way in excess of current averages, and despite the fact that we are less than self-sufficient in milk and dairy products, and despite the fact that for a number of years—at least three years—we have had a significant exchange rate advantage, which gives a significant competitive advantage to UK milk processors.

Q3 Chair: Are you able to give an indication of how many dairy producers there were in the UK 10 to 15 years ago compared with today?

Tom Hind: I can, but it is probably better that I provide some supplementary written evidence that provides those details rather than give a rough answer here.

Q4 Chair: If you could, that would be most helpful. Would you say that the problems with the UK dairy industry are the same for the rest of Europe and the rest of the world?

Tom Hind: There are some challenges that dairy farmers across the world face in common, not least of which are the integrity of the product, the pressures and the challenges that are posed by climate change, the volatility of commodity markets, rising input costs and the consolidation of their customer base, by which I mean the major grocery retailers. Some of those problems are shared, but nevertheless there are some problems that are specific to the UK, and in particular the British dairy industry. Some of those problems relate to the structure of our market; some of those problems are a legacy, frankly, of the old milk marketing boards.

Q5 Chair: Is there an EU-wide answer, do you believe, to the current problems of the dairy industry?

Tom Hind: I do not think there is a single answer, either at a European level or at a national level, and I do not think those answers can be primarily provided by governments or by the European Union. But in relation to the Commission’s dairy package, we see some opportunities to overcome some of the problems that are associated with the weak bargaining power of...
dairy farmers and the exploitation that exists because of the nature of the way UK milk contracts operate.

Q6 Chair: I know we will come on to this in more depth in a moment, but how much of the current problems relate to farm-gate prices, and especially what the consumers are prepared to pay for the milk at the supermarket compared with bottled water?

Tom Hind: I think we should leave the question of retail pricing to one side and focus very much on the question of producer pricing. In relation to producer pricing, what is evident is that in relation to the broad commodity markets—like butter and skimmed milk powder, like cheddar cheese and so on—the price that dairy farmers are currently receiving and perceiving is significantly less than market indicators would dictate, and that suggests that there are some systemic problems in the way that the UK dairy supply chain operates.

Q7 Amber Rudd: Hello Mr Hind. Last year the president of the NFU said that the UK dairy industry risked becoming unsustainable. Do you think implementation of the European Commission’s milk package helps reduce that risk?

Tom Hind: I think it plays a contributory part in providing some answers to the problems faced by British dairy farmers, in particular by overcoming the significant problems that are experienced with milk contracts. Milk contracts are the single most significant document that dairy farmers sign: they determine the terms of trade, the conditions of trade that exist between farmers and first-hand buyers or manufacturers. The fact is that milk contracts within the UK are fairly uniform in the way that they work, and they all exploit the fundamental weakness of dairy farmers, which is the requirement to sell a perishable product on a daily or at least every-other-day basis. If you think about it as a dairy farmer, you are obliged to sign a contract of a similar type that locks you into supplying to one customer and one customer alone for a minimum 12-month period, with absolutely no certainty as to what price you are going to receive, with the exception of two contracts, broadly speaking: one is to supply Tesco and the other is to supply Marks & Spencer, which is for a privileged few dairy farmers. You would not sign those sorts of contracts in any other walk of life.

Q8 Neil Parish: Good afternoon, Tom. The European Commission want to see four elements in the contract, which is price, volume, seasonality of delivery and contract length. Quite a lot of contracts certainly have seasonality in there, but I imagine it is the contract length that you are particularly interested in. What is your view of a contract length, because in a falling market you are probably better off in a long-term contract if the price is reasonably high; if the market is going up then you are probably better off in a short-term contract because you can negotiate a better price. But how do you get the best of all worlds?

Tom Hind: Actually, the key element for us is the price determination. Contract duration is less of an issue. I think most dairy farmers are comfortable with the fact that we operate on rolling contracts in the UK with a notice period. There may well be some interest in the future from the point of view of some dairy farmers to looking at hedging a proportion of their volume on a fixed-term basis, and I know that certainly in France, for example, there is a desire to look at durational contacts rather than rolling contracts.

The issue in relation to price is to overcome this lack of certainty and transparency about the way that prices will be determined from month to month, from week to week. At the moment, as I say, milk producers sign contracts with some indication about how seasonality will operate, about how constituents will be remunerated for the milk that they are supplying, but with no certainty as to the base price, which can be adjusted according to generally quite vague variables, often at the insistence of the milk purchaser. That is not universally the case, but certainly is quite often the case. Under the Commission’s package, where Member States choose to put in place compulsory contracts, those contracts must either specify the price that a farmer will receive, or the means by which that price will be adjusted, and that will give much greater certainty, clarity and transparency for dairy farmers and thereby build more confidence in the future.

Q9 Neil Parish: And are there contracts at the moment with some of the companies that actually take that into consideration?

Tom Hind: There are some contracts that take that into consideration. It is difficult to set out a vision for a perfect paradigm of milk contracts. I think we believe that there has to be some degree of flexibility, but there are a couple of examples where companies have made some advances. I cited earlier the example of the Tesco contract or the supplementary contracts that farmers sign through Arla and Robert Wiseman Dairies to supply Tesco, which set out some clearer criteria as to how prices will be determined on a six-monthly basis. There have been some advances by Milk Link—one of our major co-operatives—and by Dairy Crest as well. I have to be careful about not necessarily excluding companies, given that I am not a first-hand adviser on dairy issues. Certainly there have been some issues that have been positive, but they have generally been on the margins.

Q10 Neil Parish: One of the internationally traded and recognised prices is milk powder price, and what seems to be interesting about the depressed price of milk at the moment is that milk powder prices are trading at a very high level worldwide. Why is this not being recognised in the price that farmers are being paid for their milk?

Tom Hind: I think it is a question of the structure of the market and the structure of our processing sector, which is heavily dependent on a relatively limited number of customers for its custom: essentially grocery market retailers who exploit the fact that individual processors are competing for volume to supply them with an essentially generic product, which is commodity cheddar. The ability to be able to extract higher margins and prices on the stock market from wider commodities like butter and skimmed milk powder depends very much on your ability to place
products onto those markets, which is limited given the processing capacity that we have—albeit we have the facility in Westbury Dairies—and is also limited by both a tactical and strategic view about where you want to place milk for the long term. Do you want to hedge your bets on the commodity market and potentially forgo long-term retail custom, or do you want to try and stick with the retailers because they are a long-term customer base? I can appreciate for a processing company that it is not easy to say all of a sudden, “I am going to try and find another customer for my milk on the commodity market and forgo the retailers,” but nevertheless we are not seeing that translation through because we are so fixated on that retail market in this country.

Q11 Neil Parish: One quarter of milk producers say they only have one option for a milk buyer. Another quarter of them—so 50% in total—say they only have the choice of two. Is this one of the problems with getting a better price for dairy producers and dairy farmers?

Tom Hind: The fact that in some parts of the country farmers do not necessarily have access to alternative milk buyers reduces the extent to which there can be competition for demand for raw milk. Nevertheless, that is a fact of life in terms of the consolidation of the industry that we have seen and probably will continue to see in the future. So I do not think we should overstate that as a particular issue for farmers, but certainly if you find yourself in, say, the south west of Cornwall there is effectively only one buyer; it helps because you can be a co-operative which brings some advantages for its members who supply that company, but it does mean that you are limited as to the choice of whom you can supply your milk to.

Q12 Neil Parish: You have argued that a failure to implement a compulsory contract would “undermine the desire to see a harmonised approach across the EU”. What would be the impact of Member States having a different approach to compulsory contracts? As you know, the Government is not keen on that idea.

Tom Hind: At this moment in time of course we are looking at Commission proposals rather than implementation, and Member States may well be relatively circumspect at this stage about what implementation choices they will make, obviously bearing in mind that the package that the Commission has proposed could be subject to further amendment as it goes through the decision-making process. Different Member States, because of the structure of their industries, different traditions and so on, will take different approaches. But there is a risk, for example, if a Member State like France were to put in place a requirement for compulsory contracts, that farmers could have much greater protection and certainty about the way that prices will adjust in future, yet dairy farmers here in the UK will be denied that opportunity.

Q13 Neil Parish: Is there a chance that big co-operatives—I won’t necessarily name one—that trade across Europe would also be putting different contracts in place in different countries?

Tom Hind: That is inevitable, given that contract law remains very much a national preserve, and indeed some Member States have to overcome the first hurdle, which is putting in place written contracts. Again, France is a very good example where dairy farmers do not possess written documents in terms of their supply agreements with dairy companies. That is the first stage to overcome. I think one of the important questions that we need to look at in terms of the future of the European Union in terms of milk is the fact that the ending of milk quotas will place much greater reliance on the milk contract to determine volume, and at the moment the milk quota is an individual producer right, so it is the producer’s right to decide if he holds quota, if he acquires more quota, and therefore it is his decision to decide whether to produce milk and how much milk to produce. When quotas go, the contract becomes the sole determinant of volume, and that lies in the hands of the first-hand buyer, not the dairy farmer, and it therefore means that the right to decide who produces what milk, where and when, lies in the hands of processors, and that to us represents a further transfer of power.

Q14 Neil Parish: Of course milk quota is implemented differently across Member States anyway: France has got it linked much more to the land, hasn’t it?

Tom Hind: I do not think that really makes much of a difference in this instance. The quota is still an individual producer right, and that is the fundamental thing to be mindful of.

Q15 Chair: You referred to co-operatives, and obviously in certain Member States, particularly Denmark, there is a much greater reliance on co-operatives. Does that give them an advantage?

Tom Hind: It gives them a significant advantage in terms of their ability to compete in the market, and by virtue of the fact that Denmark has to export because it is more than self-sufficient, the development of a major co-operative—over a number of years, I have to say—has given them an ability to exploit market opportunities, both within the European Union and in third-country markets. I do not think we should lament what has happened in other Member States: fair play to them, providing they compete within accordance with competition laws across the European Union within the single market. I think that is good on them. The issue here in the UK is that we do not have those businesses. Part of the reason we do not have those businesses is that we lived under the legacy of the milk marketing boards for several years, and therefore were starting from some considerable distance in terms of the organic development of these quite significant and important consolidated farmer-owned businesses at a European level.

Q16 George Eustice: Dairy UK obviously take a very different view on contracts and argue that the regulation of contracts is fundamentally at odds with the dynamism and innovation that has been shown in
the UK dairy industry. Do you think that having these compulsory contracts would provide enough flexibility—for example, on volumes—to encourage competition and innovation in the industry?

**Tom Hind**: I do not see why they should discourage flexibility, and I do not see why they should discourage innovation in contracts. All the Commission proposals do is provide for some rather basic terms and conditions that all contracts should meet. What those contracts then say is of course up to the individual supply chains in question. Of course, if I were a milk processor and I had full licence to decide how much I was going to pay dairy farmers and therefore could use that as a form of variable adjustment in terms of the commercial negotiations that I was having with my customers, then I would want to protect that flexibility to adjust milk prices on a whim.

**Q17 George Eustice**: They maintain that farmers gain from this by having a premium payment as the quid pro quo for that. Is that something you would recognise, or is that something you disagree with?

**Tom Hind**: I think that is something that you would perhaps need to elaborate with Dairy UK afterwards. It is fair to say that there have been some developments in contracts that have been positive, but I do not understand how the dairy package that the Commission has proposed would inhibit the development of those contracts in the UK.

**Q18 George Eustice**: Freedom of contract is quite a big deal in British law, so as soon as you start doing that and introducing it, it is a problem. What is it at the moment that stops farmers and producers demanding those contracts? Is it just that it is too fragmented and they take what they are given?

**Tom Hind**: I think it is two things. First, it is a combination of the fact that farming is very fragmented. We are dealing with about 10,000 individual businesses, who are organised in different groups but do not find it easy to collectively negotiate, and perhaps we will come on to issues around producer organisations and collective bargaining later—there are some issues there. I think it is also the fact that the contracts that they are offered are almost universally—leaving aside one or two exceptions—of a similar type. Therefore your ability to demand those terms is relatively limited by the fact there is not the competition in the marketplace to offer a diversity of contracts that might offer a little bit more certainty in terms of price determination.

Just to pick up this point about contract law and freedom to contract, the fact may be that, in terms of business-to-business relationships, we do see freedom to establish contractual terms between two parties, but in relation to consumer law we have at least seen developments to ensure that the position of consumers is protected from contractual abuse in business-to-consumer contracts, and I think there is some scope for looking at how some of the principles we have applied in terms of consumer contracts might be applied in terms of business-to-business relationships as well.

**Q19 George Eustice**: Just building on this point, I can understand why they are not offered the contract, but could the NFU publish what a standard contract should look like and get your members to say that, from 2012, this is a contract that you should use? Is that at all possible?

**Tom Hind**: I laugh not because of the question, which I think is a very good one, but at some of the challenges that we face. We did produce a standard template contract in 2007 as a means of driving forward the debate on contracts, and it has generated some debate, and we have relaunched that contract, and yesterday we launched a further campaign trying to push the debate on contracts and the Commission’s dairy package further forward. The challenge for us as a trade association is that we are bound by competition law not to bring individual undertakings—i.e. individual farming businesses—together to do something of that kind of nature. I think it would be a serious breach of UK and EU competition law for us to do that.

**Q20 George Eustice**: Just coming back, if you support the Commission’s proposals and they talk about having if not a set price determined in a contract then a means of determining what the price should be, what might that means be if it is not a fixed price for a fixed period?

**Tom Hind**: Again, as I said, I think there needs to be some flexibility. The important thing is that the terms and conditions by which prices should be varied are set out in advance in the contract; at the moment, there is a base price that can be varied by just one side. At least having clarity is important.

Last week our counterparts north of the border in NFU Scotland came out with some interesting proposals that suggested that there might be some kind of base formula that could be included in contracts. We are having some discussions with them about their ideas, and we are examining them closely. I think in reality because different supply chains are operating in different markets, the reality is that the terms and conditions on price variation are bound to vary from farmer to farmer, from market to market, and that should be encouraged, but at least having some clarity and certainty about what variables make up the price should be included in a contract.

**Q21 George Eustice**: What types of things might it be, though, just tangibly? Are you talking about the world market price?

**Tom Hind**: As NFU Scotland suggested, it could be tangibles, like you operate in a formula that includes known commodity market indicators, like the milk-for-cheese value equivalent, or the actual milk price equivalent. It could be based on other indicators, such as indicators of production costs: the retail prices index. It could be based on the agricultural price index that is published by Defra. There is a range of different indicators out there. It is not for us to recommend a one-size-fits-all approach. Again, the principle should be that the terms and conditions by which prices are varied are known and understood by the farmers before they sign the contracts.
Q22 George Eustice: And finally, what do you think a fair notice period would be? That is something else you say should be stipulated.

Tom Hind: Again, this is not for us to determine, but the level of notice should be commensurate with the level of risk that the farmer is bearing. So if the farmer is bearing a considerable amount of risk in terms of the ability of the price that he gets paid for the product that he supplies to be varied quite radically, then clearly notice periods should be relatively short; whereas, if there is certainty and predictability about the price that he should receive, there is a clear case for the notice period to be longer.

Q23 Tom Blenkinsop: Hello, Mr Hind. Under current UK competition law, producer organisations can take up to 25% of national production, and yet the largest UK co-operative accounts for just 11% of production. What factors are discouraging greater consolidation in the industry?

Tom Hind: First of all, just to establish one point in terms of UK competition law, as far as I am aware the definition of relevant markets remains one for the UK competition authorities, i.e. the Office of Fair Trading, to decide. So whilst there might be some indications out there that suggest that up to a certain level you can have a degree of collective bargaining, nowhere are they set out in absolute, clear terms. The Commission is proposing, within its package, an ability for farmers, through producer organisations, to collectively negotiate contracts up to 33% of either the national market or combined national markets across a number of different Member States, which is one approach that you could take. We have to bear in mind that the Office of Fair Trading operates some fairly arbitrary distinctions about what is and what is not a relevant market.

What prevents farmers from consolidating? First of all I think we should recognise that there has been some consolidation. Over the course of the last 10 years we have seen farmers come together into groups, either the co-operatives that fell out of the enforced collapse of Milk Mark in 1999/2000, which has now lead to the two vertically integrated co-operatives operating in England, Wales and Scotland, or the development of direct selling groups amongst the private dairies, where farmers have collaborated and co-operated in groups, where there is at least some discussion taking place about the relationships they have with retailers. However, those groups, by virtue of both the contracts that they sign—which are individual to the farmer and the company, not with the group—have a degree of relative bargaining power, in the sense that they do not collectively negotiate, because again, the contracts are individually held with the individual dairy farmer.

Q24 Tom Blenkinsop: Dairy UK argue that the exemption to competition law would reduce investment and create inefficiency. How would you respond to that?

Tom Hind: I would be interested to know what their arguments are, because I am not sure how that would inhibit investment and create inefficiency. The only inefficiency it might create from their point of view is, again, an inability to adjust milk prices downwards and protect margin.

Q25 Richard Drax: Would there be a material difference in bargaining power or competitiveness between a 25% and 33% producer organisation?

Tom Hind: I think it is very difficult to say. There is not a massive amount of clarity within the draft regulation in respect of how bargaining power or co-operation in terms of collective negotiations could operate, and whether it is 25% or 33% may to some extent seem a peripheral debate, especially when the draft regulation inserts a derogation that allows national competition authorities to set lower thresholds on an individual basis, or to intervene to prevent a collective negotiation from taking place below that 33% threshold. I think in general terms the regulation that has been drafted by the Commission prohibits against hard-line, red-line prohibitions of EU competition law, and therefore I see no reason why the 33% threshold should not be supported.

Q26 Richard Drax: Would the creation of producer organisations have an impact on small-scale dairy producers?

Tom Hind: I think the question really is whether the creation of producer organisations as a legally constructed entity would bring advantages to British dairy farmers, and given that we do not have a massive amount of certainty on the detail of the package, it is difficult to say. The concept of producer organisations exists in other industries: they are legally recognised in the fruit and veg sector, in the wine industry, in tobacco, which of course we do not grow here in the UK, and part of the reason that they are established is to draw down community funds to finance operational programmes, which are about improving the marketing position of collective groups of farmers, at least in the fruit and vegetable sector.

In relation to the dairy package, the hook, if you like, is different: it is not to draw down funds; it is to be able to collectively negotiate—to at least have a degree of legal certainty at a community level that, as a group of farmers, you can collectively negotiate contracts with a customer. This is particularly an issue for, say, farmers in Germany, where you have a number of very small producer groups, say in Bavaria, who are concerned that their ability to collectively negotiate with their customer is undermined by national competition law, which is not clear on this point. So it gives a degree of legal certainty and legal clarity. To that extent it could help and encourage our own producer groups who are working quite closely with their own private dairies to become much more cohesive, much more united, and perhaps more professional in the way that they conduct negotiations.

Now, that is a general statement based on the very limited amount of detail that we have at this stage, but it is certainly something that we are looking into, and something that we are discussing with producer groups actively as well.

Q27 Neil Parish: I just want to take you back to First Milk and Milk Link, who I think have about 10%, 11% each. Certainly when we talked to the Minister,
he was not against the idea of those two farmer-owned co-operatives combining or co-operating, because at the moment do they not create competition with each other, rather than necessarily help get the price up for producers?

Tom Hind: My personal view is that they do: they are competing in similar markets; they are both commodity-cheese manufacturers; they operate in slightly different geographical locations, but essentially within the same market, and that creates more competition within that market. We do need to see consolidation in dairy processing, particularly in the cheese sector, and I think it is really up to the individual companies to answer the questions as to why they did not merge. We certainly encouraged that merger at the time. There may well have been specific commercial reasons that inhibited that merger from taking place. The important thing is that we do need to see that consolidation to ensure that we have a much more efficient and competitive milk-manufacturing sector in future.

If you look at the decisions that were taken at the time, the important thing is that not only, as you say, has the MFU given an indication that is something he would encourage but at the time the merger was proposed the Office of Fair Trading also gave its assent at the first stage for that merger to take place. That serves to exemplify that, where we are involved as an industry in more European-wide commodity markets, like cheese, there is an opportunity for the industry to consolidate commercially where it chooses to do so, but it is the commercial decision that matters here, and not necessarily the position of competition authorities.

Q28 Chair: Can I just press you on what NFU members would prefer: would you rather have a price stipulated by market indicators than one that would be free to negotiate with one buyer?

Tom Hind: They are potentially one and the same thing, in the sense that if you had an exclusive contract you could still have a contract that specified the price determinants. I think all of our members want a degree of clarity, certainty and predictability about the factors that will influence their milk price for the duration of the contracts that they sign.

Q29 Barry Gardiner: I want to ask you about quotas in a minute, but before I do could I just ask you: in the rest of Europe, would it be fair to say that dairy farmers play a more active role in the value-added end of milk production, in terms of producing localised cheeses, in looking at that part of the market where they can actually get some of that value-added for themselves?

Tom Hind: I am not sure I would agree entirely. I think we have seen quite a considerable degree of diversification at farm level, to the extent that the British Cheese Board lends the fact that we have more varieties of cheese here in the UK, which in large part is due to innovation at farm level, and looking at the demand and desire from our customers for food of provenance. I think the farming industry has been able to exploit that to the extent that it can, but we have to recognise that we produce in excess of 13 billion litres of milk in this country. Not all of that can be supplied into niche markets; it has to go into some pretty big commodities, of which fresh liquid milk is one, and that is a largely commoditised market. The other part is generic cheese, which some of our dairy companies have tried to add value to, but frankly, essentially is a commodity product and is priced as a commodity product. I think the bigger challenge is at the company level, the manufacturing level. Yes, we have seen some fantastic innovation by dairy companies to develop new products and put those products onto market, but again, we do not have the historical legacy of investment at a commercial level by companies like Arla Foods, like Friesland Campina, like Lactalis and so on, and right the way across the European Union, into a wide spectrum of added-value products on a range of different markets. We are starting from some way behind, and I think the real problem is in our ability to diversify the product portfolio at the manufacturing level. This is not to criticise the companies, because I think they have done some really good work, but their ability to compete has been impeded to some extent by historical legacy.

Q30 Barry Gardiner: That is very interesting. How could the Committee help you—or how could Government help you—to get more investment into that industry to see that diversification?

Tom Hind: In relation to manufacturers, it is really a question that is best posed to the manufacturers themselves. I hope that you will ask the same question of Dairy UK. I think it would be unfair of me, as a representative of producers, to comment on the needs of manufacturers. All I can see, at this very aggregate industry level, is that we have a massive exchange rate advantage, we have relatively efficient, well-invested producers operating on quite low milk prices, and yet we are still importing in excess of 70,000 tonnes of cheddar cheese from Ireland every year. So there are some big questions about the structure of our industry. That suggests to me that we are not as competitive as we perhaps could be.

I think in terms of what Government could do from a farming point of view, we have always accepted that most of the solutions for the industry are commercial; they are not for Government. But Government can play a facilitative role in terms of setting the rules of the game; helping farmers to invest; ensuring that the fiscal incentives are there for farmers to invest in infrastructure in their businesses; and ensuring that we have a rural development package that encourages farmers to diversify, to acquire new skills, to collaborate and to consolidate. Here we have a package of measures that has been outlined by the European Commission that may not be perfect but at least offers some opportunities. Rather than dismiss those proposals, the approach of the UK Government should be to try to work with those proposals to refine them to help make sure that they deliver long-term advantages for British dairy farmers.

Q31 Barry Gardiner: Thanks very much. That has given us some good prep for our next engagement, but I will return to my homework for today on quotas.
The Commission has talked about the process of soft landing in getting us down from the whole business of quotas. If and when quotas end across Europe, what would the effect be on milk prices in the UK, in your view?

**Tom Hind:** I think the experience of the last few years and the volatility in the market shows that anybody who tries to predict a trajectory for milk prices in line with changes in milk quota and production volumes is either very clever or very silly. I think one thing we can be certain of is that milk quotas will end on 31 March 2015. There is no dispute about that; there is no longer any disagreement across the European Union—that will happen.

What will happen as a consequence of that is a matter of some conjecture. We have not seen the European Union fill the additional quota that has been allocated to the European Union over the course of the last three or four years. Nevertheless, some individual Member States have been able to increase production and would like to increase production further. Some of those Member States happen to be our competitors: the Netherlands, Denmark, and in particular the Republic of Ireland. I think we need to watch what happens in Ireland very closely, because the Irish Government and the Irish food industry has a very ambitious export strategy, which includes increasing its scale of dairy export by, I think, between 50% and 100% over the course of the next two years. Whilst the Irish Republic has important third-country markets right the way around the world, by far and away its biggest export market is the United Kingdom, and, if we do not follow and anticipate trends in Ireland at a commercial level, then there is every risk that we will continue not only to see the importation of significant quantities of Irish butter and cheddar cheese every year but increased quantities. It is important that we have a competitive manufacturing industry to deal with that.

**Q32 Barry Gardiner:** What is your take on the Commission’s suggestion that there might be a compensation package for reducing by 1% or 2% when required? How would you see the effect of that continued subsidy?

**Tom Hind:** I do not believe that the Commission’s proposal is the most intelligent one. I think farmers across the European Union would benefit from certainty, in particular the certainty that would come from ensuring that milk quotas are increased in a progressive fashion and abolished 2015.

**Q33 Barry Gardiner:** Defra is sceptical; you say it is less than intelligent?

**Tom Hind:** Let’s say we would be sceptical about the merits of that measure as well.

**Q34 Mrs Glindon:** Can I ask you, how should the value of milk be distributed through the supply chain? Should a particular proportion of the retail price of milk or cheese go to the dairy farmer?

**Tom Hind:** We make no statement about how margins should be distributed, only that farmers should receive what we consider to be a fair price, a price that reflects the investment that dairy farmers make in building up their herds and investing in their businesses, in trying to achieve economies of scale, and to meet the production costs that farmers face. What happens thereafter is a subject of commercial negotiations.

Clearly there has been some important illumination given on margin distribution in the supply chain, but what matters to us is not how margins are distributed, it is ensuring that farmers get a fair price and ensuring that farmers are able to trade in a market that is fair. There are obviously two components to that. One is the relationship between farmers and the companies that they have business relationships with—and that brings us back to the issue of raw milk contracts—and the second is the relationships that those companies have with their customers, which of course is a matter for the Groceries Supply Code of Practice, and hopefully the groceries market adjudicator when that is introduced.

**Q35 Mrs Glindon:** Can I just ask you, will the Commission’s milk package proposals or the groceries code help dairy farmers achieve a fairer proportion of retail price of milk?

**Tom Hind:** I believe that the Commission’s proposals could go some way to giving greater clarity, clarity and predictability. I do not necessarily believe that they would lead to a wholesale redistribution of margin, but they would certainly prevent the position of farmers from being eroded by off-the-cuff decisions that are taken by milk processors who have conducted a weak negotiation with a customer that has led to them cutting their prices for the product that they sell to their customers by quite a lot. That might sound like a longwinded description, but what I am saying is that they would inhibit some of the short-termism that takes place in terms of milk pricing. They would not necessarily redistribute margins.

Again, as far as the grocery market adjudicator is concerned, and the Groceries Supply Code of Practice (GSCOP) is concerned, what it is there to do is to eliminate the abuse of power, not to distribute margin. It is about ensuring that we eliminate some of the abuses that continue to take place that we do hear about that exist at the top of the supply chain. That might bring greater certainty and predictability for manufacturers in their dealings with retailers; it might reduce the extent to which they are forced—again on a whim—to provide large financial handouts to some of their customers that are not written into contracts, and thereby might provide a much more stable industry environment, but it would not of itself redistribute margin.

**Q36 Mrs Glindon:** You mentioned the customers at the end. Do you think consumers are sufficiently aware of the impact of retail prices on farmers?

**Tom Hind:** I think we have seen an increased awareness amongst consumers about some of the issues within the supply chain. The consequence of that has been that we have seen some development by grocery retailers to offer better terms and conditions to farmers through dedicated supply chains, and that has had a benefit for the minority—albeit a relatively large minority—of dairy farmers who have the ability to access those contracts.
But there is a much wider problem outside of those arrangements in the rest of the industry that I think to some extent does go unnoticed, and it is important for organisations like the NFU, Dairy UK and others to try to bring that to the public’s attention. At the end of the day we want a British public that values British products, that believes that British dairy farmers and manufacturers are producing high quality, innovative, exciting dairy products, in which all parts of the supply chain generate some added value and some benefit from. Ultimately, given that we are operating in a market economy, given that ultimately it is customers who make decisions about what we produce, how much, where and when, many of the solutions to the problems in the industry can only be found by the interaction we have with customers.

Q37 Mrs Glindon: It is getting people beyond just perhaps the cheapest prices.

Tom Hind: I think we have to be mindful of the fact that, in times of financial hardship, at least some consumers are very careful about expenditure, and that is why we do see at this moment in time much more discounting, more promotions being offered to try to maintain brand levels through supermarkets and elsewhere, and that does have, potentially, negative consequences in the short term.

But I think at least in the long term—provided we have a stable economic recovery and growth in the future—the prospects for the British dairy industry ought to be positive. We have a very good market here at home: over 60 million consumers who are relatively affluent. We have a well-structured, well-invested dairy farming industry, we have some cracking processing facilities, and we have a massive market that is growing on our doorstep that we could and should be exploiting much more than we are doing at the moment. So it is not all doom and gloom; there are some really positive spots out there, but it is important that we correct these systemic failures in the dairy market once and for all. Although again the Commission’s proposals do not provide anything near the solution to one of the biggest problems, which is the way that raw milk contracts operate, which is fundamentally exploitative.

Q38 Mrs Glindon: Can I ask you finally: do you think that the introduction of dedicated supply chains has benefited dairy farming as a whole?

Tom Hind: Yes I do. I think the benefit has of course come to those individuals who have been able to benefit from those direct supply contracts, and that is not anywhere near universal. But I think the one thing it has done is moved us from a situation where every single dairy farmer is a “have not” to a situation where we at least have some “haves”. Okay, there are some big challenges in the wider industry, and some may argue that the creation of dedicated supply chains has exacerbated and increased the pressure that retailers exert in terms of the wider market; it is difficult for me to demonstrate or prove that, but compared with the situation that I experienced when I entered the dairy industry about seven or eight years ago, we at least have a degree of certainty, where the producers who are supplying a 365-day-level supply, high-quality product into the liquid market can at least benefit from some greater degree of certainty and predictability about the relationship they have with their customer.

Q39 Amber Rudd: Putting the Commission’s proposals aside, what else do you think the UK Government should be doing to support the dairy industry?

Tom Hind: Again, as I said before, the bulk of the problems, and indeed the bulk of the solutions for the industry, lie within the industry itself. They are only for the supply chain either collectively or individually within different companies to resolve: there is no single solution, and there is certainly no magic bullet that Defra can fire. But there are a number of things that the UK Government can do. Clearly we have been encouraged by the fact that the Minister has sought to re-energise the Dairy Supply Chain Forum. That could be a useful vehicle for trying to resolve some of the rhetorical problems that the industry faces. We think that Defra could work more closely with the industry to draw up a code of contractual best practice that goes beyond the European Commission proposals that are at a very basic level to say, “What should a contract consist of? What should be the ideal terms and conditions?” That is something that Government could work on constructively with the industry.

We think that Government could look at how information on prices and margins in the supply chain is delivered. Clearly we have to be careful about infringing commercial confidentiality, but equally it is important that farmers understand the market environment they operate in. The fact that they receive a price that is here, yet commodity market indicators are here indicates that there is a lacuna in terms of the information that is provided on how markets are trading.

Finally, we think Government could look at the way that the Rural Development Programme works, and I think the opportunity to bring the delivery of the Rural Development Programme for England into Defra and away from the Regional Development Agencies, a much more centralised approach, provides some opportunities to look constructively in the next couple of years at how national measures can be packaged that might benefit dairy farmers in terms of helping with skills, knowledge transfer, and the professional capability of those people who negotiate on behalf of dairy farmers as well.

Q40 Amber Rudd: Thank you. Do you think that the introduction of Government buying standards might be helpful?

Tom Hind: I think it would be helpful in terms of addressing one of the persistent concerns that our members raise about the standards to which Government departments buy. We were expecting Government to come forward with a set of standards before the parliamentary recess. That has not happened. We are hoping that they are produced early within the next month or so, and we look forward
to receiving those proposals when they come forward from Government.

Q41 Amber Rudd: And what about labelling? Do you think that we could do better on that?

Tom Hind: I think we could do better on labelling. There is a gap, certainly in processed products, in terms of determining the origin of labelling. A good example again is Irish cheddar, which can be imported by a company operating in the UK, cut and packaged here in the UK and labelled with a UK health mark. It does not need to be labelled as Irish cheddar. I think it is important that we do have a much more universal approach to origin labelling. I know the UK Government favours a voluntary code in terms of origin labelling; that takes us so far, but we think it is really important to get behind the package of measures that was agreed at second reading in the European Parliament a couple of weeks ago that extends mandatory origin labelling away from red meat into dairy products as well.

Q42 Amber Rudd: Thank you. The British Retail Consortium described the UK dairy sector as “well placed to meet increasing global demand”. Do you think there is anything else that Defra could do to improve export potential in the dairy sector?

Tom Hind: Again, I think this is really a question that needs to be posed towards milk processors, since they are the ones who will primarily be interacting with export opportunities, rather than farmers. I think there is a discussion about the legacy of Food From Britain and whether we have an aggregate proposition to make into our key export markets as a food and farming industry. These decisions predate my involvement in these issues. But I think there is a discussion to be had about the extent to which—through UK Trade & Investment for example—we could be looking at facilitating food markets overseas, as well as wider services, industrial goods, pharmaceuticals markets, which are the core focus of UKTI.

Q43 Chair: You mentioned Irish cheddar, but is it not the case that British lamb benefits by being finished in France and sold as French lamb?

Tom Hind: We have nothing to hide. We operate within a single European market. We have no problems with the idea that products that are exported from the UK are labelled as UK products.

Q44 Chair: Can I just ask: what help is there to dairy farmers especially who have left the industry moving into other sectors, and particularly those who have left the uplands?

Tom Hind: There is no financial assistance that is available; there is some kind of restructuring package if that is the angle that is being examined here. Many of the decisions that are taken to exit dairy and go into some other sector are based on the perception that the prospects of those sectors—either in terms of market returns, lifestyle, ease of work, labour and so on—are easier than they are in dairy, which is a relatively resource-hungry activity from a farming point of view.

Q45 Chair: The concerns about slurry, the liquid slurry that comes out, has that been an issue with farmers leaving the dairy sector?

Tom Hind: It is an issue. The extent to which we can quantify how many dairy farmers have ceased or are maybe looking to cease production because of restrictions in Nitrate Vulnerable Zones (NVZ) is difficult to give with any clarity, but it certainly is an issue, because the cost of compliance, in particular to have the necessary storage capacity available to comply with the close periods under NVZ rules, is quite onerous and quite significant, and of course because of decisions taken by the previous Government to phase out agricultural buildings allowances, it is no longer tax efficient for farmers to make the investments in those kind of storage capacities. That is something again that Government could look at—making sure that we have the right kind of fiscal incentives to help farmers deal with the cost of compliance.

Q46 Neil Parish: That leads on quite neatly. One direction that UK dairy farming could take is to go forward with the super-dairy: thousands and thousands of cows on one farm. Should Defra take a more proactive role in engaging the public on issues of super-dairies, and what position does the NFU take on the matter?

Tom Hind: I think we all have a responsibility to communicate the facts and ensure that facts are not overridden by fiction in respect of larger scale dairy farming. I think we should be careful about generalising a single direction of travel for the industry. There are many smaller scale family dairy farming businesses up and down this country that are robust business units, and are likely to remain robust business units, and are likely to remain a key part of the dairy farming landscape. Equally, it will always be in the interests of a large proportion of the British dairy industry to take advantage of our natural and geographical benefits that come from rainfall—maybe not this month, but normally—in certain parts of the country to produce grass. So we are always going to have industries that capitalise on that, and larger dairy businesses do not lend themselves very well to that kind of full-scale grazing operation.

But the important thing for us is that we have an industry that invests, that is competitive, that is efficient and is fit for the long term. To be able to compete, we need to seek economies of scale, and that means that we do need to look at ensuring that we have the ability to consolidate and to grow much larger farming businesses. That, for us, is an important development, but it is not a universal development that we will see, and certainly, yes, we do play a role as an organisation in trying to communicate the facts about large-scale dairying activities and what we think the benefits might be, not just in increased economies of scale, in terms of increased competitiveness, but better animal welfare, better environmental management, ability to deal with carbon emissions and so on and so forth. It is important that we look more holistically at the benefits that could come from some of these units.
Q47 Neil Parish: Part of me agrees with you entirely on the competitive side, but the other side of it is aren’t they one way of putting more family farms out of business? When you are trying to promote cows grazing and happy cows like Kerrygold Butter and the like, when you are trying to market that, you are keeping the cows indoors all the time. I think there is a serious question here: if you are promoting a dairy industry to the public, is it the right image we necessarily want to push?

Tom Hind: I do not understand the arguments that are advanced by some that the development of larger dairy farming enterprises somehow puts smaller businesses out of operation. There is no evidence to substantiate that argument. Again, we have seen a significant contraction in the scale of milk production in this country, and the fact that we might have some, and a relatively small number, of businesses that are looking to increase scale ought to be seen as a means of helping us redress that systemic decline we have seen in UK dairy farming.

In terms of industry image, I think it is important that we portray the dairy-farming sector as a business that needs to operate in the marketplace. Yes, it needs to be environmentally sustainable; yes it needs to respond to consumer demands; yes it needs to ensure that it has the highest standards of animal welfare and husbandry, but they can come from larger dairy businesses as well. What matters to us is not what a farm looks like but how that farm operates, making sure that it is operating to the highest standards, and we can generalise right the way across the industry about what is good and what is bad in terms of standards, but it very much comes down to individual management within that unit, rather than scale of production.

Q48 Chair: Mr Hind, you have been very kind. We are about to be interrupted by a vote. Can I press you on two issues: should Defra take a more proactive role in engaging the public on issues such as super-dairies? You also referred to whether Defra should look at providing assistance to farmers preparing for the new criteria for NVZs. If I could press you on what you would like to see on those two points.

Tom Hind: Again, I think it is largely for the industry to ensure that it portrays itself to the outside world, but I think Government does play an important role in ensuring that the facts are presented, and ensuring that at least agencies of Government do not use media perception as a means of influencing decisions they take on future dairying businesses. I think it is certainly a question that you should ask Dairy UK, given the involvement that they have with the dairy councillors—the industry’s representative body in terms of its external image—later. But certainly we would think it important that the Government helps to establish facts and helps to ensure that prejudice is not used as a means of discriminating against businesses.

Q49 Chair: So your bottom line would be you would like certainty and greater transparency?

Tom Hind: And predictability.

Chair: Thank you very much indeed for being with us; you have been very generous with your time. If I could invite the next witnesses to take their place, I will adjourn now because there is going to be a vote at four o’clock, and we will meet again at quarter past four. Thank you very much indeed, Mr Hind.
But what we have seen, as a result of the closer connections in farm groups, is the development of contracts. We would agree with much of what the NFU has already told you, but we would challenge the concept that the contracts that exist in the UK industry are inadequate in some way. In fact, we think that the contract evolution in the UK has been much greater than in any other Member State. It is important to remember, as we consider the dairy package, that we have got farm contracts: every farmer has got a contract. We think that is a very important point of principle. That does not happen in other Member States. But we have been able to evolve these contracts. We have a range of contracts; we have contracts that suit the business in particular and allow the relationship between farmers and processors to develop in a way that—as we said in our submission—allows the payments of market premiums. My colleagues can elaborate on the way in which that has been done.

Q52 Chair: We will go through that. Just at the outset, I find it a little strange, and I wondered if you shared that feeling, that perhaps the key terms of what the contract are not known by the farmers at the beginning of the period of the contract. It would not happen in any other sector.

Jim Begg: That is very much in the nature of the market. It is not just a feature of the UK; it is a feature of effectively all dairy markets right around the world. We have looked at this very closely and we see a great degree of similarity in the pricing arrangements that prevail between processors and buyers.

Q53 Chair: It does not make it right, just because it happens everywhere else.

Jim Begg: As I say, we have advanced the cause, if you like, of trying to make contracts more understandable and more reasonable than pretty much anywhere else, and we would challenge the suggestion that the farmer may be in a vulnerable situation as a result of that, because the way milk prices are calculated, the way they are derived, is very important to understand that milk prices are driven by the trend in commodity markets: commodity markets are determined by the supply and demand for milk globally, so there is only so much that any particular national country can do, but that is the way it has developed. That means that dairy companies, if they are to receive a supply of milk, have to pay a commercial milk price. They are paying a price that is driven by the market, farmers have protection from that, and that is the way it effectively applies in the UK, and pretty much around the world.

Q54 Chair: And you do not agree that the level of risk is mostly on the farmer?

Jim Begg: The level of risk is spread fairly evenly across the supply chain. Of course one of the issues is that the whole question of cost recovery, and the ability of the industry to recover costs. Sometimes the view is put forward that the market is not working because, say, the milk price does not cover the cost of production. That is no more true for farmers than it is for any other part of the supply chain. No one in the supply chain in a commercial open market can rely on cost recovery. So because that does not happen does not necessarily mean that the market is not working or is in some way dysfunctional. There is a degree of protection that is within the system and the way that milk prices are generated. What the contracts can do is develop from that and try to steer the relationship between the farmer and the processor in a better way to get the maximum welfare of the market.

I should also just say that we have very much the same interests as NFU. We are looking at this whole dairy package from the point of view of getting more wealth out of the market, and in fact how it addresses the various issues that we see are important going forward, and very much part of that is the fact that we have profitable farms—farmers who get a good return for their labour, and also have investment funds to go into the future. If farmers do not have investment funds for the future, we have no farmers and we have no industry, so there is nothing to gain from a processor driving prices down below the price that the market throws up, or in any way doing anything that could not encourage development of the profitability of farm enterprises. It is absolutely at the core of our assessment of the dairy package.

Chair: We will explore this.

Q55 George Eustice: Would you agree with the Commission’s assertion in their memorandum to their proposal that the milk sector went through a deep crisis, and this shows some of the shortcomings in market orientation in the milk sector?

Jim Begg: Again, as I say, the way we have looked at the Commission’s package is that what we are heading towards in all of this is an open market and a free market, and we have been led into that situation. We have been encouraged to head forward to a free market, all the signals from the Commission have been to that intent, and we are supportive of that because we are moving away from the whole concept of regulation and we see our future very much in an open marketplace and operating on commercial principles of competition. The Commission’s package coming back and introducing the possibility of regulation naturally was something that we looked at with some degree of scepticism because, if you like, it takes us a step back, in our view, rather than a step forward.

Q56 George Eustice: But leaving aside what their proposal said, which I think we will come to later, do you recognise that the dairy industry has been through a period of deep crisis? You are very bullish about the dairy strategy, but the NFU and the Commission are not.

Jim Begg: We are not in denial that there are some very real problems in the sector in the short term. We are of the view that you have to take a long-term perspective on these things; you have to look at the situation in the long term. It is very easy to look at the current system that you are in, for example, look at the milk price and the return from the marketplace at one point of time, and deduce a forward policy—a wrong policy, in fact, because the position that you
are in at any particular point in time is not the one prevailing in the long term.
What we have seen in the last three years, and what the dairy industry and the European Community have seen, is a huge, massive increase in the volatility of markets. Many people consider that the volatility of revenue and returns in the marketplace is the key thing. I think from a farmer’s point of view, the real big issue is the reason for the volatility in input costs. We have seen a huge variation in input cost, and that has undoubtedly created pressures on some farms—not all farms, but many farms. The crisis that we talk about in that sense refers to the crisis of the volatility of markets, and we are all engaged—all engaged: farmers, processors, industry bodies like ours—in assessing and managing that process. So it is a transitory arrangement coming out of what you might consider to be the relative stability of the markets that we had when the price was heavily subsidised, and when we had support schemes and community budgets and that kind of thing, so we had to make that transition. So it is less a crisis—although I am not denying that there are some real problems—but more an evolution to a new set of circumstances, which, frankly, we think are going to continue in the future.

Q57 George Eustice: Is there anything that you think Defra should be doing within the current legislative framework that would help support the industry?

Jim Begg: In terms of the price?

Q58 George Eustice: Just in terms of dealing with the crisis in the dairy industry; is there anything more it should be doing?

Jim Begg: As I say, we see the future very much like the NFU: the industry has a responsibility to move through the situation, to move to the new scenario, which I should also say we see as very positive. If you take a longer term view and you look at things on a longer term perspective, there are a lot of positives, which should see this industry develop, nurture and be prosperous in the future.

But in terms of the Government involvement, all we do ask from the Government is to ensure that there is no structure imposed in the industry that renders us uncompetitive in any way with the competition that we compete with in the marketplace, and that can cover things like the dairy package, because we believe that there are some aspects of the dairy package that that might do. All we ask from the Government in that sense is to recognise these and allow the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to prosper—farmers and processors—to get the wealth. The big issue for the dairy industry is getting more wealth. The key driver for the industry to
have seen prices go up as well. Those farmers that had fixed their input costs at the same time that they fixed the price that I was going to pay them for two years would have been in a good position, and those farmers that went on to that contract wanted to do it because they wanted certainty; they wanted to invest in their businesses. Moreover, they wanted to be able to prove to the banks that were going to lend them the money to invest in their businesses that their income was going to be secure. Not only did they have a processor with whom they had a contract that was going to take all of the milk that they produced—as indeed we do for every single farmer that supplies us, and my competitors would be in the same position—but we were going to guarantee the price.

I guess that demonstrates that whilst fixing the price might appear to be attractive, there are a number of moving parts in this industry and in these markets, and it is not always the solution. What you need is flexibility, and what my shareholders would not thank me for is not providing our business with a sustainable supply of milk, and that is the key point here. If I had to sum my job up, it is to provide a sustainable supply of milk that business. That is the key. There is no value in me, whatsoever, in taking advantage of farmers that supply me. Yes, I have to be competitive in a very competitive market, where consumers are under pressure, my customers are competing with each other and I am competing also to hold or grow my market share. But there is no value in my doing anything to damage that supply chain.

Q61 Tom Blenkinsop: In your written evidence you suggest that regulation in the form of compulsory contracts would increase instability. What was the basis for that assertion?

Rex Ward: I am a farmer, so I work from that side. One of the reasons that we help set up Milk Link 10 years ago was for stability and security of supply. Without a milk contract, I have cows with no milk to go. It is great when you have 10 people knocking at your door saying, “I will take your milk,” and in fact that is what happened when deregulation came in when Milk Marketing Board finished in 1997. There was a proliferation in contracts, the milk price went up to 26 pence a litre—this was 13, 14 years ago—it was very good because everybody was competing for your milk at that same time. If I wish to invest on the farm, which we have, we want to know that we have a security of supply and a long notice period.

Now, in a way, I have a milk contract with myself, because I am part of the processing business. Milk Link is a fully integrated processing co-op, similar to the European style. Any benefit that comes to me as part owner of that business, it is imperative that the content of contracts is it is imperative that the content of contracts is established on a voluntary basis. Would you advise your members to resist including conditions in contracts based on the four elements referred to the Commission, like price, volume, seasonality and contract length?

Mark Taylor: There are a number of things that would appear in contracts at the moment, so term, the price-setting mechanism is included in there as well. It depends on which contract you are looking at, because as I said earlier there is a big variety of those contracts, so that would vary from very simple mechanics to fixed prices at the moment. That evolution is already taking place quite quickly. Things like the micro-biological standard of the milk, the constituent elements of the milk, how much butterfat is in it, how much protein is in it, seasonality, profile
payments, there are quite a number of things included in those contracts already. All of those elements are discussed, negotiated with farmers and representative farmers. I met over 900 of our farmers individually last year, and the unanimous feedback that I got from those farmers was, “We want more simplicity in the way our contracts work. We like the fact that we can sell all of our milk to you and you will come and collect it, no matter how much we produce,” and my farmers produced 5% more milk last year than they did the year before that, a positive sign against a number of years of declining volume—across the industry, not within Dairy Crest. But simplicity is the overriding message that I get, so they are saying to me, “Yes, we want to engage with you and talk about these things,” which they do; “We want to be able to influence them,” which they do. We changed a range of factors in our contracts based on that feedback from those 900 farmers last year, and we will keep doing that. It is an iterative process.

What I would stress is that I believe that since we as an industry have had the signals coming from the EU, coming from Government about the desire to move to a free market—which we support—this industry has responded very rapidly and is continuing to respond. It does take time. Agriculture, as you know, is encumbered by long planning cycles, and that feeds through into the rest of the supply chain. So it does take time, but I believe that we are moving very fast and we will continue to evolve positively.

Jim Begg: Can I just take up another point about the transparency and the certainty, which was a fairly major point that was put to you previously. I think—and I hope my colleagues will back me up in this—that the degree of transparency and the degree of the provision of information about the way markets are likely to develop in the future between processors and farmers is greater now than it has ever been. It is regular, it is weekly, it is extensive, and it is all happening in the supply groups, which is where the trust is developed and the information is provided and the future is planned. Really, in a nutshell, it is a transformation almost beyond my recognition from the way it was under the Milk Marketing Board. It is a transformation almost beyond my recognition from the way it was under the Milk Marketing Board and the complete absence of contact between farmers and processors. I have to say, processors were just as guilty for not cultivating and realising that farmers were an integral part of their prosperity in the future, but they woke up, way before the dairy package came forward, and that has been the situation for the last five years. It takes time to develop trust. We very often go two steps forward and one step back on that, but the greatest chance that we have of moving forward productively and getting product into added value and paid premiums is through the supply group arrangements and through voluntary contracts worked out collectively between the dairy companies and the farmers.

Q63 Chair: If it was so bad before, is it the case that, because the Commission is threatening action, you have had to open up in terms of greater transparency? Rex Ward: No, if I can just go back. Obviously, when the Government split Milk Mark up into three parts, I was the Chair of 22 that formed Milk Link, which is really the milk from south of the M4. In that time we have had a farmer-controlled business; we had a number of contracts that we took on from the Milk Mark that was there. We then evolved those because there were just one or two various things and one size fitted all: there was a liquid contract and a constituent one. We have brought in a range of those over the years, and they have been going for seven or eight years at least, but it does evolve the same as my colleague has said here, as things go forward. There is also a difference depending on the volume you produce.

The seasonality has changed, but again, we do not change that; we have given a request that we have discussed with our farmers, and we do not alter the seasonality with less than 12 months’ notice, because it is those types of things. You cannot change when your cows are going to calve. But again, I think—and I am very proud of this—that our farmers now, we process three-quarters of our milk into product. They now understand what is the requirement of the milk to go into those products, what affects it, what things they can do on farm—we have done separate testing for casein, those types of things—so that we are producing the right milk for the right product and the right market. They understand that in statutory milk marketing days you had a volume of milk, it was collected, it went off, and you just got paid. They had no interest or understanding beyond the end of the farmyard gate. I think that is where we are: we are far more market related than that. But there has been such volatility in the last couple of years in all sorts of inputs. I think the main thing is—certainly speaking as a farmer—we want to have a bigger proportion of the end price at the front end, because times have been a bit hard and have not got any easier at the moment.

Q64 Chair: Mr Begg, you said it all happens at the supply groups. How many farmers are involved in the supply groups, and what about those who are not part of the supply groups? What happens to them? Jim Begg: Correct me if I am wrong, but I consider that pretty much all farmers are in a supply group. Secondly, all the farmers who are supplying the major dairy companies are in supply groups, and in the smaller dairy companies they have just as effective a means of communication. It is a transformation almost beyond my recognition from the way it was under the Milk Marketing Board and the complete absence of contact between farmers and processors. I have to say, processors were just as guilty for not cultivating and realising that farmers were an integral part of their prosperity in the future, but they woke up, way before the dairy package came forward, and that has been the situation for the last five years.
there must sometimes be a competing element between what you pay the farmer and what you pay your shareholder. My question quite clearly is, in this broad spectrum of interests you represent, what is Dairy UK’s position on the milk package proposal? You are painting a very rosy picture of everybody being entirely united on the whole thing, but there is obviously some difference between dairy producers represented by the NFU and perhaps you. What is the position?

Jim Begg: First of all, in terms of the structure of Dairy UK, don’t you agree that that is the right way to be going forward? In 97% of situations that come before the Dairy UK board there is no difference, conflict or variation in view about what is in the best interest of the industry in future.

On the issue of price, Dairy UK does not cover price other than when it comes up under the umbrella of industry schemes like this. This would have a material effect on the whole industry, across the whole industry, so we would get involved in that. But the absolute determination of price, the prices that are negotiated between farmers and our members, is not the shareholding of Dairy UK. We do not get involved in that, and it is obviously for competition reasons that we do not get involved. We have a very high penetration of the industry in the UK so we do not get involved. That is left entirely to the individual companies, and each has its own approach.

But on the question of the dairy package, which is a collective issue and will affect the structure of the whole industry, we have developed our position very much in line with the farm, the farmers and the processors, and Rex, who is the Chairman of our Farmers Forum is there to make sure that he supports all of these views. We have a united view about the dairy package. We have an agreed position on contracts. We accept pretty much all of the Commission’s proposals going forward, and all we are saying is the better way to do it is not the compulsory way but the voluntary way. We have an agreed position on the impact of producer organisations—which I presume you will come on to—and we have no disharmony there at all.

Do not forget, we are working for the industry. Our objective is to increase the pie: when we increase the pie, everybody benefits. That is the problem with this: it does not increase the pie. You see?

Q66 Neil Parish: Talking of the pie, you have led me on to another question quite neatly: how you slice up that pie. Do you get involved in that, because you are representing dairy farmers, dairy processors and almost—not quite—the retailer? When you see, perhaps, nearly a third of the price, perhaps, taken up by the processing element, is that not too high? I just pose the question.

Mark Taylor: I will just address your concern about the conflict between shareholders and farm-gate price first, and answer that by saying of course there is no conflict. I would say that, wouldn’t I? But the point I would make to you is that my shareholders are generally long-term shareholders. They want me to ensure that my milk supply is sustainable, and they understand that I have to pay a fair milk price in order to ensure that it is, or their returns come under threat. 25% of my shareholders are farmers as well, and those are farmers who have taken a greater interest in the business in order to share some more of the value that currently exists within that supply chain. That is one way that, just as in a co-op where farmers would potentially receive some form of dividend, they do that in the same way with a plc as well.

The other point I would make is the fact that I have to add around £80 million to £85 million of value milk is not negative: that is a good thing. I have to add £85 million of value before I get out of bed in the morning and then pay a competitive milk price. In Dairy Crest’s case, that is the highest price for cheese in the UK and right up there for milk—second out of the biggest three liquid milk processors, I guess. I would argue there is no conflict there. That drives us to be really good at adding value.

To the point that Rex was touching on a moment ago, I can remember when we set up the first of the dedicated milk boards in 1999—which I would be supportive of as well, by the way—and that was with Waitrose, closely followed by Marks & Spencer. Now that is a much greater feature of the market. It has been a positive development. Having more farmers aligned, as opposed to not aligned—the “haves” and the “have-nots”, I think, that Mr Hind referred to—has been a positive objective that organisations like co-ops and plcs alike have shared and driven towards. Only 30% of my milk supply is now not aligned.

Q67 Neil Parish: In fairness, you are not answering my question, are you? The question is, are you satisfied that the percentage of the milk price that you take as a processor is not excessive, and that enough is going back to the producer?

Rex Ward: I will come in to that as well; it is those two things. I can be naturally confrontational if I wish to, but just a little bit of history: when I first set up there was the federation of milk groups, which I belonged to, and then was the DIAL (Dairy Industry Association Limited), so it was the processors and the farmers. We put those two businesses together as Dairy UK. I sit on the board of Dairy UK and I represent Farmers Forum. The constituents of Farmers Forum are representatives from all the farmers and it has been a positive development. Having more farmers aligned, as opposed to not aligned—the “haves” and the “have-nots”, I think, that Mr Hind referred to—has been a positive objective that organisations like co-ops and plcs alike have shared and driven towards. Only 30% of my milk supply is now not aligned.
the European co-operatives because they have 40 years advance on us. There is a cost of everything: if you look at the returns and what we get out of everything we do as a processor in Milk Link, it gets a return back to the farmer.

**Mark Taylor:** I would like to see my share increase, if that answers the question more specifically.

**Jim Begg:** And another point maybe just again to elaborate further: where we also have a common view, and where it differs a little bit from the NFU is that we all agree that there is no systemic failure of the market.

**Q68 Chair:** Excuse me, could you just say that again? Because that is completely contradicting what the NFU said. The NFU said several times there was a systemic failure in the market.

**Jim Begg:** No, which is why I raise the point: there is no systemic failure of the market.

**Q69 Chair:** But you just said you agreed with them.

**Jim Begg:** No, where we disagree with the point that was put by the NFU was that we do not believe there is a systemic failure of the market. We believe we understand how the market works, and we agree on that. I think probably the main misunderstanding comes with the belief that when you determine the farm price you start with the retail price and work down. In fact it works the other way completely. You start at the bottom and you work up, and the farmer’s milk price is driven by completely different circumstances from the retail price, or even the price that the processor gets for his product. The farmer’s price is driven by world commodity prices, which is driven by the supply and demand. That creates the base. Processors pay premium over the base to get security of supply of milk. That is how the market works.

Now, you might ask how the farmer gets more from that particular market, and to do that he has to engage in the second phase of the pricing cycle, which is the way the processor earns from his customer and so on. That is driven by different circumstances: processors will invest in things—like, say, for example, a branded promotional campaign, or a new form of packaging—assumed to achieve a return back to the farmer.

**Q70 Neil Parish:** You talk about world prices. The last time we had high milk powder prices in the world, that drove the price of milk up. This time we do not seem to be seeing that. Is that because the processing sector is so dedicated to cheese and you just cannot get the cheese market up? Why is it that the price to the farmer at the moment is not higher, because you talk about world commodity prices: they are much higher than what farmers are receiving for milk at the moment.

**Mark Taylor:** The price that I have paid for milk for cheese has gone up by around 3.5 pence in the last 12 months. That is a significant increase.

**Q71 Neil Parish:** But it is probably still not the price potentially milk would be for milk powder.

**Jim Begg:** We will deal with this point directly; the fact is that you cannot take the market price at any one point of time and correlate it with the milk price. There are lags in the system: that is what causes the frustration for the farmers. They see market prices rising and they do not see the milk price rise. But the milk price rise does come eventually, and that works up and down: the lags are equal in application. The lags are long. In fact, our assessment and analysis suggests that the lags are something between six and nine months. In our submission to you, you will see a graph for which we used data from DairyCo, and that shows that over time—and this is why I say you have to take a long-term view of these things—these things balance each other out, sometimes to the farmer’s advantage, sometimes not, but the long-term trend is clear.

**Q72 Chair:** If your scenario is right, why have so many farmers left the dairy sector in the last few years? That is irrefutable evidence.

**Jim Begg:** Yes, but what I have to say to you is that there is nothing exceptional about the exit rate of British dairy farmers. The exit rate of British dairy farmers is actually less than the average for the European Community. It is roughly the same as the exit rate around the whole world. There are no exceptional circumstances there. Farmers are exiting for a whole variety of reasons, some of which are due to economic reasons, others are not. But the essence of it is that we have seen a rationalisation. We have seen a rationalisation in processing businesses as well, and that will continue.

Depending on your approach to these things, that is either a sign of increased competitiveness or a sign of a lack of vision. But it is happening all around the world, there is nothing exceptional about us, and we can demonstrate that to you with clear facts. So that is a natural phenomenon that is taking place in the industry worldwide.

**Q73 Chair:** I am just slightly confused: you are saying that, for the farmer to get more out of the contract, they have to invest in the processing side.

**Jim Begg:** Yes.

**Q74 Chair:** If they are telling us they are not earning any money under the contract because the inputs are higher than the—
Jim Begg: Than the milk price.

Q75 Chair: Yes—then how are they going to be in a position to invest? I am at a complete loss.

Rex Ward: Can I just go back on that? One point, just to do the abridged version from where it is. Northern Ireland is dependent on commodities: skimmed milk, powdered milk. Last time when it was high—2008—milk price to farmers went up immediately on a monthly auction system to 32 pence. When it went down again in November 2009, it went down to 16 pence, farm price. Now it has gone up again to 32 pence. That is why we have invested processing over here to take out that volatility, because at certain times of the year you will know that Westbury’s large dryer is empty. At the moment, with all the nice sunshine outside there, it is full. If we can sell that powder now at a higher price, that will come back into the market. But again, some of that is sold on forward contract, some is sold on spot, but it is there.

How can farmers invest in that? We as Milk Link, when we first started, we started with £6 million. We had no factories, we had a lot of milk, a lot of farmers’ assets, and we did an innovative thing: in fact we mortgaged our own farms. We used a five pence per litre guarantee so we could go and start borrowing money. But we also had to have a deduction off a very low milk price at that time, and that has only now ceased after 10 years, and we on average put in about six pence a litre out of our milk price as we went on to invest in processing. So that is what we as farmers have done: 1,600 of us. We did not ask for Government aid, we went out and did it. If you want to get to the Promised Land, you have to pay for it. It is who is going to do it? What we are asking, which goes back to Neil’s point, is we need more of the front end of the division. It is not for you here, but it is one of those things there, because it is a very, very capital-intensive business. We could all give up dairy farming tomorrow and turn our land into more profitable things, but that would cause you a great shortage of milk.

Jim Begg: But the issue that we have to focus on is the management of the volatility of input costs, because that is the biggest issue, in my view and in our view, affecting the industry going forward—how we do that, and how we manage it going forward.

Q76 Thomas Docherty: Sorry, Mr Begg, you did not answer the Chairman’s question about how you invest if inputs are greater than the price.

Jim Begg: Look, just like the market catches up with the milk price, so do costs, and at any one point of time you will never get a true analysis, but if you look at the position over a period of time, then you will see that the profitability is there. The cost issue is a difficult one, and we also struggle to try to understand the profitability of dairy farming. We rely on information like that produced by Defra, and that shows a clear profitability of dairy farming in terms of the revenue less the cost. So the margin that is left for the domestic income of the farmer plus investment is there. Now, if you look at the evidence and you look at the Defra evidence, I quite openly say that the income includes things like the direct subsidy, the direct payment. Even allowing for that, there is still a margin in there. So over a period of time, farmers have to be profitable. If they were not profitable—and it is our objective that they are profitable—we would not have an industry. They would have gone and disappeared by now.

Mark Taylor: Sentiment and confidence amongst farmers is a very key element to their decisions to invest. The last time we saw rapid inflation in commodity markets was in 2007. There was a different economic background immediately preceding that period, but we saw very rapid inflation in farm-gate costs, and those costs also needed to be recovered from the market. They were recovered, farmers’ prices went up, the two issues squared off, farmers began to invest. They were going to invest in putting a lot more heifers into the system to produce more milk, new parlours, etc, etc. We are in this increasingly more rapid cycle of volatility, have gone through, I believe, a similar phase now, and prices have increased.

Chair: I think we are starting to repeat ourselves, thank you.

Q77 Richard Drax: Just about your quote from your written evidence—that is Dairy UK’s—where you say that unless producer organisations are subject to “the normal laws of competition”, you anticipate “a significant reduction in forward investment by British dairy companies.” Why should a producer organisation with 33% of national production be so much worse for the future of British dairy farming than one with 25% of production?

Jim Begg: The answer to that is that we are not particularly precious about the scale of a producer organisation. The scale is almost irrelevant as long as there are clear and sufficient competition rules in place so a processor has the knowledge that, if a large-scale operation takes an action that renders him uncompetitive, he has a recourse to redressing that under competition law. That is all we are saying. We have no problem or objection to the establishment of producer organisations. We firmly believe that it is up to farmers and farmers’ organisations how they market their milk. So the creation of producer organisations is not a problem, but what we do say is that any organisation that is established has to come within existing competition policy, because if they do not then frankly I do not think the processors would take the risk of investing in an area where they had no recourse if there was a problem. I do not think they would do it, and I am pretty sure I am right with that circumstance. It is not the scale; it is not the 25% or the 33% that we considered important. It is the fact that national competition authorities have the right to intervene if there are reasons for investigating a potential abuse of competition in the same way as they do now.

At the moment we do not think that the Commission proposals say that. We think the Commission proposals present a stronger test of competition, and that is something of a concern to us, so we are still, if you like, lobbying in Brussels on that particular point. But the principle that anything goes as long as it is
covered by competition policy gives confidence and an incentive to invest.

Q78 Chair: Mr Begg, you are being very helpful. I wonder if you could just make your answers a little bit shorter, as we want to get everybody in. Thank you.  
Jim Begg: Yes, of course.

Q79 Richard Drax: Talking of Brussels, if the Commission’s proposed producer organisation thresholds are applied across the rest of the European dairy industry, what would be the effect of that consolidation on the UK industry and dairy market?  
Jim Begg: We want to ensure that nothing that is implemented in the UK creates a position where our processors and our farmers cannot compete with the competition elsewhere. To the extent that it does we would oppose it; to the extent that it does not then I think it is okay. I do not think from that point of view at the moment it is a major concern to us. We are more concerned from the specific case of the UK that on a case-to-case basis the national competition authority has got a chance to intervene.

Q80 Richard Drax: Is there pressure for further consolidation within the UK of the UK dairy industry?  
Jim Begg: Yes; well, when I say pressure there is a full and clear understanding that we will gain efficiency by rationalisation, and I think that is uppermost in everyone’s mind, and there is never a day goes by when people are not looking at the possibilities and all that kind of thing. It is a slow process, it takes a long time. However, I think that is the absolute objective, and that is the same everywhere.

Q81 Richard Drax: Would this consolidation benefit consumers?  
Jim Begg: It would drive greater profitability into the supply chain if you can gain efficiencies of manufacture. Do not forget that profit is a function of revenue and cost, and it behoves us to reduce our cost at the same time as increasing our revenue. It would bring more profit into the supply chain, and at the very worst it would bring more profit in without affecting the consumer at all, if you gain the efficiencies. But frankly, we and the NFU both agree that the industry needs more.

Q82 Richard Drax: Slightly just off that particular topic, do you support producer organisations having independent facilitators to resolve contractual disputes between farmers and dairies?  
Jim Begg: We will have a look at it. I am embarrassed to say that it is the first time I have heard that concept. I promise you we will look at that. On the face of it, it is not something that would immediately worry me.  
Mark Taylor: Do you mean somebody to negotiate for them?

Q83 Richard Drax: Yes. It is a question that you have not come across?  
Rex Ward: It depends how good you are at negotiating and what your fallback position is, doesn’t it?

Jim Begg: We will have a look at that one.  
Chair: If you have any further thoughts on that, perhaps you would be good enough to write to us, and then we could incorporate it in the inquiry. Thank you.

Q84 Mrs Glindon: What would the effect of ending milk quotas across the EU be on the UK’s milk prices?  
Peter Dawson: Perhaps I can answer that one. I think our analysis is very broadly similar to the NFU. I think the majority of EU Member States are already falling below quota, so the final abolition would not have any impact on those countries. There are a handful of countries where they are up against their quota limit, so you could expect to see a further expansion of milk production in those states, but I do not think we are expecting a major surge in output from those countries. That would have an impact on the supply/demand balance of the European Union. We have a few more years to go yet before the quota constraints are finally lifted and a few more quota increases, so I think the final act of abolition might be fairly muted in terms of its impact on the industry’s commercial environment.

Q85 Neil Parish: Just a supplementary on that one: at the moment the UK is not up to its quota anyway, is it? It does not produce up to quota, so I suppose the main impact will be how much more imports might come from the Netherlands or Denmark. What is your view on that?  
Peter Dawson: I think both the Netherlands and Denmark are amongst that population of countries that are up against their quota limits, but at this particular point in the price cycle it is quite clear that there is a huge expansion in demand from economic growth in the far east, so it would seem that there is still plenty of opportunity elsewhere outside the UK market for additional volumes from the European Union to be absorbed elsewhere, so additional milk is not necessarily going to end up in the UK market. The return they get from the UK market would not be significantly different from the return they get from any other European Union market. I do not think we need to feel that we are going to be especially victimised by the sudden abolition of quotas.

Q86 Neil Parish: Right, okay, my question now is that in your written evidence you state that “farmers are suffering a major squeeze on margins. Regrettably, as prices are determined by commodity markets, there is no automatic recovery of input costs in dairy. We submit that this situation does not demonstrate a non-functioning market.” So the question is, do you consider the current distribution of the value of milk through the supply chain to be sustainable in the long term? This deals with supermarkets, deals with the lot, as far as I can see.

Rex Ward: No, in a word.

Q87 Neil Parish: That is the answer I wanted, thank you very much. But seriously, how are we going to rectify that? Just now we were talking about the fact that dairy co-operatives up to 33% would be too big. We have one retailer in this country that has 30% to
32% of the whole retail market. I do not suppose you are suggesting splitting that up are you?

Mark Taylor: You were asking us question about farming organisations.

Q88 Neil Parish: No, it is a serious question. Basically Tesco has taken out the top end of the market, and fair play to them, but that does not drive the price up overall to the farmer. How do we get the price up not only to the farmer but the processors? You say as processors you are not taking too much out of the chain—you would say that. You were talking about world commodity prices; we see high commodity prices, yet we are not seeing high milk prices.

Jim Begg: It has got a lot to do with that. What I believe you cannot do is you cannot impose contractual terms, for example, that override the market, because that is just going to create a problem in another part of the forest. So you are looking very much at the development of world markets and the global prices, because that is the way the markets work. To be honest, when you look at all the different factors that contribute to the future, we think that we are on a rising price cycle. We are on a hugely volatile price cycle, but it is rising all the time, and that is going to deliver hopefully—without any guarantees, but hopefully—a greater return to the farmer on an ongoing basis. Beyond that, they have to get involved further up the chain, and they do: in co-ops, and in share values, and in their private investments.

Q89 Neil Parish: Sorry, we have done that one to death, if I may say so, and I do not disagree with you, but what I am saying to you quite clearly is that farmers can co-operate through and buy into processing, but in the end it is the price that the consumer pays, and then how much that consumer pays, then how much of that goes back down through the processor and back to the farmer, and I think that is absolutely key. So how do we get that sustainable market? You talk about markets should be increasing; well, we are in increasing markets now.

Peter Dawson: Perhaps if I can try and elaborate on this. In our view, the process of price formation in the dairy industry is fundamentally from the bottom up. It starts in the commodity markets, goes to the raw milk market, goes to the wholesale market and then is left up to the retailer to decide how they want to take a position in the marketplace with consumer. As such, what happens in the retail market is almost completely independent of what happens in the raw milk market and the income to the dairy farmer. So it is not a question of trying to appropriate additional margin from the retailer and distributing it back to the dairy farmer. In a properly functioning marketplace, that is simply not going to happen. The dynamic is in the other direction, and it is a problem of the industry addressing volatile commodity markets and the effect it has on farmers that we have to address, and there is not a ready-made solution to try to appropriate margin from the retailer. In terms of the functioning of the market, it is not there.

Q90 Neil Parish: The next question leads quite neatly into that: the Minister has said that it is indisputable that the retailer’s share of the retail price has risen, whereas the share taken by the producer has declined. Will the Commission’s milk package proposals or the groceries code adjudicator help dairy farmers achieve a fairer proportion of the retail price of milk?

Jim Begg: It is very difficult—and I apologise for repeating myself—for me to see how the Commission’s proposals will deliver that, because I cannot see how you can impose a contractual situation that overrides the market principle, which Peter has explained and I have explained; we have explained that three times now. That is a very difficult thing to see.

In terms of the groceries price adjudicator, we support that. The reason we support it is we think it will instil greater confidence that the supply chain is working. It will: if there are abuses it will come out. So that will help. I would be less than honest if I said to you that we thought it was going to fundamentally alter the distribution of the margin down the milk price, but it will help instil confidence in the system. But we support it.

Q91 Neil Parish: Final question: do milk processors receive a fair proportion of the retail price—turning my previous question on its head.

Mark Taylor: I think there was some analysis done recently that looked back over a number of years, and the proportion of the price that processors received had remained pretty much unchanged for 10 years or more. I think you asked the question earlier and I said, in summary, I would like my share to increase—or of course I would. I am sure farmers would like their share to increase too, and I am sure retailers would be in the same place.

Q92 Neil Parish: But I think farmers would probably argue that the percentage of the retail price they receive has decreased to a greater extent than yours.

Mark Taylor: I think the analysis that I have seen would support that.

Q93 Chair: Could I just turn to a question that the NFU invited us to put to you? Your representative, role, Dairy UK, on the Dairy Council. Would you like to comment on that?

Jim Begg: Yes, the Dairy Council is a wholly owned subsidiary of Dairy UK. It is fighting the case for the acceptance and for the promotion of British agricultural product, dairy products, with consumers. It is undertaking the science. As we become more exposed to an awareness of food by consumers, it is more and more important that we are able to provide scientific justification for the claims that we make about our products. Everybody knows that milk is good for you, that it is a healthy product, it is nutrient rich and that it is an essential part of our basic diet, but we have to continue to tell people that and we have to continue to provide the science that makes our case, and that is the function of the Dairy Council.

In terms of the image of the dairy industry, that is a function of everyone. You will notice that we all have
Proud of Dairy badges on. It is a function of everyone, it is a function of all the players in the industry, and because we are short of time, we might have elaborated on the other point, which is sometimes we get into situations where consumer opinions about developments in the industry differ from the science. If you take the question of large-scale farms, that is an issue there, where the science differs from the consumer perception. Cloning is another issue. These are difficult issues for the dairy industry, but we all have a responsibility to work very hard and to educate consumers to prevent, as in fact the NFU said, unrealistic and unfair prejudgement of these issues being taken by consumers.

Q94 Chair: But can I just look at the Danish model, where they have Caroline the Cow—Karoline-ko—which they use very powerfully as a marketing tool. Could we not learn from that.

Jim Begg: Yes we do, we do. That is another expression of confidence; when you see the industry prepared to invest in generic marketing, then that is a positive sign, and we are investing in generic marketing at the moment. There are two campaigns within the Dairy Council, Make Mine Milk and another campaign linking milk with sport as the Olympics come forward. So we are involved in that. Have a look at the buses. You will see all our promotional things going forward, all funded by the industry.

Q95 Thomas Docherty: Mr Begg, when we last met several months ago we had quite a long conversation about super dairies. That was previous to the Environment Agency decision. Do you think, in light of Nocton and the lessons that will be coming out of that, is the long-term future of the UK dairy industry dependent upon super dairies?

Jim Begg: It is not dependent on super dairies because there is an economic value to every type of farm, and every type of farm, every size of farm, has got provenance that can be developed to gain market premiums. What is absolutely crucial is that we do not deny ourselves the opportunity of having the establishment of large-scale farms. Large-scale farms offer cost efficiencies. We must get cost efficiencies going forward. This is exactly what I mean: we lost that opportunity, there were clearly consumer concerns, clearly ethical concerns. We did not believe the science matched that, but ultimately, we have to respect what the consumer thinks. We are not a production-driven industry; we are a market-driven industry.

Q96 Thomas Docherty: Sorry Mr Begg, but forgive me if I am wrong, it was the regulator that torpedoed it. It was not the consumer; it was the regulator.

Jim Begg: It was a technical issue relating to the Environment Agency, but I think we would be kidding ourselves if we did not accept that there had been a fairly strong consumer reaction against that whole concept. Again, I make the point: where consumer perception and science differs we need to prevent that from affecting our progress, and I regret what happened at Nocton.

Q97 Thomas Docherty: Do you think that Defra, or the Government more generally, has a role in getting across those messages?

Jim Begg: Yes I do, to be honest, and I think it is the one area where we would look for Government support. There is another area in which we would look for Government support, which is all to with what you talked about earlier—labelling and things like that. We have to make sure that we are not prejudiced by legislation that comes forward. In the case of super-dairies, yes, we would have preferred a stronger independent voice.

Q98 Chair: Finally, you did say, in the context of the questions you have answered, that relations have improved in terms of negotiating. Bearing in mind that it is a perishable product that the farmers have to sell, and perhaps you are not covering every farmer in the membership of your organisation, are you prepared to go the extra mile to try to reach a compromise if you do not wish to see regulation at European level?

Jim Begg: Yes; it would be a very unwise processor who did not take the relationship with farmers very seriously, and they would find out very quickly, to their cost, that that was the wrong course of action. They are the future. We have no business without them. They have to be profitable, and it behoves them to work together to get the best they can out of the market, every single time.

Rex Ward: Could I just use one example that came to us a month ago: one producer supplied all his milk to a very small bottler. He did not have a contract. The bottler sold his business to someone else and he had 24 hours’ notice to find another milk supplier. We are dependent upon super dairies?

Chair: Well, thank you very much for being so generous with your time and participating in our inquiry. Thank you very much for being with us. We stand adjourned.
Tuesday 3 May 2011

Members present:
Miss Anne McIntosh (Chair)
Barry Gardiner
Mrs Mary Glindon
Amber Rudd

Examination of Witness

Witness: Christine Tacon CBE, Managing Director, The Co-operative Farms, gave evidence.

Q99 Chair: Good afternoon and welcome. Thank you very much indeed for being with us and participating in our inquiry. I think I am right in saying that you have rearranged your diary to be here, so we are particularly grateful. Just at the outset, would you like to comment on what particular difficulties the dairy sector is undergoing at the moment, in relation to other aspects of farming?

Christine Tacon: Yes, shall I just say what I do first? Would that be more helpful?

Q100 Chair: That would be very helpful if you would.

Christine Tacon: I am Christine Tacon. I am not from a farming background myself, but for the last 10 years I have been running the Co-operative Group’s farming business. My previous experience was as a production engineer, but I spent four years as marketing director at Fonterra, so I have an understanding of the New Zealand industry from that before I joined the Co-op. My position as managing director of the Co-op Farms is on our food executive board as well, so I will be able to give some insight on the food side. As farmers, we are not in dairy, but I have said that in my written evidence and I can talk about why we are not. We were in dairy when I joined the business, but we are not now. We are large fruit and vegetable, potato, cereal and arable farmers, largely growing fruit and vegetables to sell in the Co-op stores.

Q101 Chair: Why did the Co-op choose to come out of dairy?

Christine Tacon: When I joined the business in 2000 the whole farming business was losing money. I should explain that the structure in the group is that we do pay a market rent on the land that we own, but we also farm other people’s land, which clearly comes in at market rental or under contract farming agreements. In order to get the business back into profit, we were looking at every area of the business and, of all the areas, in dairy it was the most difficult to see how we would be able to make a suitable return on our capital. I can go into more detail if you want to ask any questions, but that was the main reason why we came out. It took me about two and a half years to take that decision. We looked at lots of different solutions, including whether we should go into processing, such as added-value products, and also whether we should go to a New Zealand grazing system, where you go for spring calving. We could not find any way to get the return on capital we were looking for as a business.

Q102 Chair: A lot of the thinking, particularly in the dairy industry, seems to be that the best way to add profit is to add value. Looking to Commission proposals, what measures do you think could be taken to enable that shift into value-added production to take place?

Christine Tacon: One of the things we need to understand is how much of liquid milk production the UK could conceivably put into added-value; 50% of what is produced is liquid milk. I do not think the consumer wants added-value, they are quite happy with what they have. The added-value is really quite niche, such as niche yogurts and cheeses and so on. Although I do not think that is a solution for the whole sector, it is certainly a solution for some small family farms, which are able to produce some outstanding products for local consumption. I do not think it is a solution for the industry.

Q103 Chair: Just out of interest, how much land do you actually farm?

Christine Tacon: We farm 50,000 acres, of which a third is owned by the group and the remaining two thirds is owned by other landowners.

Q104 Amber Rudd: How does that place you in terms of landowners relative to other landowners in the UK? Are you in the top x%?

Christine Tacon: In terms of what we physically farm and claim subsidies for in our own right, which is the EU definition of a farmer, we are by far and away the largest farmer in the UK. We are about twice the size of the next one. There are other farming businesses that will farm a bit more than us on different sorts of agreements, but you then also have a business like the National Trust, which actually owns more land, but does not farm it itself. It is all a bit confusing, but we are the biggest commercial farmer in the UK.

Q105 Chair: Is it spread across the UK?

Christine Tacon: Yes, about a third of it is in Scotland. We are not in Wales and we are not really in the south-west, although we are in Herefordshire.

Q106 Chair: Excellent. The British Retail Consortium describes the UK dairy sector as “well placed to meet increasing global demand”. What do you think the Government could be doing to increase the UK’s dairy exports?

Christine Tacon: At the end of the day, if you want to export you have to be globally competitive. The key areas that are the most competitive in the world are New Zealand and the USA. So we are particularly grateful. Just at the outset, would you like to comment on what particular difficulties the dairy sector is undergoing at the moment, in relation to other aspects of farming?
to trade skimmed milk, butter and cheese, which are basically commodities, you have to be able to produce at the same prices as them. New Zealand, Southern Ireland and maybe areas of Pembrokeshire are naturally going to be the most competitive because they have the perfect climate, but you cannot expand that. The Americans are hugely efficient because they have very large units, typically of 3,800 cows. They are very competitive and we actually have to be as competitive as that if we want to trade in the commodities. If we want to trade in the added value then that is different; apart from Stilton and such things, we do not have that many exportable added-value brands that already exist.

Q107 Chair: Are you surprised that there are not more co-operatives in this country, particularly in the dairy sector, such as you get in Denmark and other parts of the European Union?
Christine Tacon: I think it is a tragedy that we do not have a co-operative model in the UK. When you look at Fonterra and the very big co-operatives, they have been hugely influential in adding value and passing know-how back down to farmers. The farmers themselves are not necessarily particularly efficient; the UK farming industry is actually very efficient in its own right, but the co-operative structure has helped the farmers enormously. It just seems to be a feature of UK farming that we are not good at co-operating.

Q108 Chair: Do you believe that countries like Denmark and New Zealand do so well because they use co-operative structure?
Christine Tacon: Absolutely, definitely.

Q109 Chair: Would you like to expand on that? It would be helpful.
Christine Tacon: Fonterra, for example, has a dairy research institute dedicated to finding other uses for milk products. They are making plastics out of milk; they are making ingredients that will thicken yoghurts that are being bought by the likes of Danone to thicken yoghurts. All of this is being created in New Zealand. They are also naturally extracting the calcium from milk to create ingredients to enrich products with naturally produced calcium. The dairy research institute was set up with the sole objective of trying to add value to milk because the New Zealand Dairy Board’s statutory duty was to find a market for everything that New Zealanders could produce, so they were trying to find other uses. So a vast amount of work is being done and a huge amount of know-how is being passed back down to the farmers.

Q110 Amber Rudd: Can you give examples of how improved dialogue between suppliers and retailers are enhancing the sustainability of the UK’s dairy sector?
Christine Tacon: The industry? I will talk about the industry rather than specifically the Co-operative if you like?
Amber Rudd: Yes, please.
Christine Tacon: There are certainly quite a few retailers, such as Sainsbury’s, who have been working with their milk pool. Sainsbury’s has been supplying farmers with free veterinary advice and also has an ambition to help them reduce their carbon footprint. It has been working directly with them to help them measure it and then to make improvements. The Co-op, which has just made a new contract with Wiseman, is doing the same thing: working with Wiseman and paying for the carbon audits or the E- CO2 audits to help them reduce their carbon footprint. So even just on that basis there are improvements. I think all of the retailers are working with farmers on areas such as locomotion, to try and help with the hip problems that cows have as well.

Q111 Amber Rudd: So those are examples of making the supply more environmentally sustainable; are there examples of efforts to make it more commercially sustainable?
Christine Tacon: I think that all the people with milk pools are passing an additional premium to their suppliers. However, you should be aware that this is all for the liquid milk part of the sector. So yes, if you are in a liquid milk pool with a major retailer you are getting advice and you are also getting a premium, but not everybody is in those pools.

Q112 Mrs Glindon: With regard to the European Commission’s milk package, you state that the Commission’s proposals have been “monitored from afar rather than integral to developing business strategy”. Will the proposals not have a significant long-term impact on your business?
Christine Tacon: Are you talking about the proposals saying that there have to be contracts?
Mrs Glindon: In relation to what the measures hoped to achieve: stabilising the market, improved transparency, particularly through the chain, and that sort of thing.
Christine Tacon: In reality, I think these will work as a proper market. I cannot see it making a significant difference in the UK.

Q113 Barry Gardiner: I want to look at the whole issue of contracts, the proposals for them and your response to them. You have said that you think that there is a danger the prescriptions of the EU may stifle the relationship, stifling innovation and efficiency. Can you imagine there ever being a contract that did not actually stipulate the end point of the contract?
Christine Tacon: You mean in terms of when the contract comes to an end?
Barry Gardiner: Yes, when it runs to. It is a sensible thing to have in a contract isn’t it?
Christine Tacon: Yes, or to include how you terminate it. Certainly when I look at my farming arrangements, I expect them to go on for decades, but they are all reviewed every three years and we have a timing for when we are going to review them.

Q114 Barry Gardiner: Do most contracts deal with the issue of price?
Christine Tacon: In farming they do not tend to. Bear in mind that we grow apples, broccoli, peas and potatoes and none of those have a fixed price. They might have a margin agreement in them, but they will not have prices. I do not think I have any contracts that have prices in them.
Q115 Barry Gardiner: Do they include volume?
Christine Tacon: They do include volume. If the volume is not fulfilled, there is no comeback. It is a commitment to saying, “We think we are going to need this much,” but there is nothing that says what happens if we use less or what happens if we need more. They are a guide on both sides for how much we think we are going to need.

Q116 Barry Gardiner: Are these four principles—seasonality, end of contract, price and volume—that the EU are saying should be in the contracts not sensible things?
Christine Tacon: No. I would hate to have a contract saying how much of something I have got to produce, because if you get hot weather like this you will get lower yields. As a producer you would end up being on the wrong side and you might have to buy product in at a premium price to fulfil a contract. So I think that these variable contracts have actually evolved to protect both sides.

Q117 Barry Gardiner: What precisely is it about the EU contracts that you do not like? Is it having to have the contract in the first place or is it the elements that they are saying ought to be in there?
Christine Tacon: The contracts that already exist, particularly the ones that we have, have termination clauses in them.

Q118 Barry Gardiner: You got out of the dairy farming sector precisely because you could make no money on the existing contracts. Does that not look like you are saying that contracts are all right as long as you are on one side of them, but not if you are actually the farmer trying to produce this stuff?
Christine Tacon: We did not get out because of contracts.

Q119 Barry Gardiner: Well, you got out because you said you were making no money.
Christine Tacon: We got out because we were making no money out of it.

Q120 Barry Gardiner: Presumably you were making no money out of it because of the relationship and the structure between the farmers—Christine Tacon: No, because there were other people who were prepared to produce at a price that I could not afford to produce at. The difference is that you have a lot of family farms who will not factor in a rent for the farm; they will not factor in a labour cost that I would factor in. So I would actually end up competing with people who were not on the same basis. One of my main concerns was that I could not compete with family farms at the prices that they said they could produce for. I do not think that has anything to do with contracts, it is to do with the competitive marketplace.

Q121 Barry Gardiner: But equally those family farms would say that they are not making any money either.
Christine Tacon: They were at the time.
Barry Gardiner: At the time?

Q122 Amber Rudd: Which year was that?
Christine Tacon: About 2003 was when we came out. So I do not think it is an issue of contracts; I think it is an issue of whether you are competitive.

Q123 Barry Gardiner: So what changes would you suggest the Commission makes to its proposals for an EU-wide contract to ensure that innovation and efficiency are not stifled?
Christine Tacon: Allow each region to do what they want to do. Every dairy farmer in the UK will have a contract with their supplier at the moment.

Q124 Barry Gardiner: Do you not think there is an imbalance in the relationship between the farmer and people like yourselves?
Christine Tacon: Are you talking about me as a retailer now?
Barry Gardiner: Yes.
Christine Tacon: Of course there is an imbalance, because of the size. You are actually going through your processor and it is the processor that has the relationship with the retailer. I find it quite difficult when you are trying to solve all of the problems. If you are a retailer tendering your business and you have one processor offering this price and another processor offering that price, you might say that it is important that they are doing work environmentally and those sorts of things, but at the end of the day you will take the best offer. You are not actually negotiating with an awareness of what price is going to go down to the farmer.

Q125 Barry Gardiner: Would you support a modification to the proposal that stipulated that the written contracts should be voluntary in the way that you have outlined, but that the producer at least should have a right to demand one?
Christine Tacon: To demand a contract?
Barry Gardiner: Yes
Christine Tacon: Yes, but I think most producers have them in the UK.
Barry Gardiner: Sorry, not that I am being—Christine Tacon: No, that is fine.

Q126 Chair: Looking at your written evidence, am I right in thinking that your contract is like a model contract, it is more transparent than existing contracts?
Christine Tacon: The difficulty with ours is that we are just changing to Wiseman, starting in August, so we are still putting the details of that contract together.

Q127 Chair: We heard evidence last week that indicated that at the start of existing contracts there is no transparency on price. Is there going to be more transparency with your contracts?
Christine Tacon: Not as I understand it at the moment. A clear price premium will be paid, but not, as I understand at the moment, in the drafts of them. To be honest, if you are a farmer you are not necessarily looking for a fixed price. Your biggest worry is what your inputs are going to be; at the
moment a lot of our input prices are going up. For example, fertiliser price and everything is going up. The last thing I want to do is be in an agreement in which I have a fixed price, because that could be eroding my margin. Inputs can go both ways.

Q128 Barry Gardiner: I understand the principle, but why is it that farmers, in the form of the National Farmers Union last week, seem to think that the existing arrangements are not operating in their favour in the way that you would suggest they ought to be? Christine Tacon: At the end of the day, you are competing on the global market as well. Liquid milk is a bit different from the rest of the milk chain and I do not know whether they were talking about the rest of the milk chain or liquid milk. The liquid milk pools do tend to be working a lot better, but if you are talking about contracts for milk for cheese, butter and skimmed milk powder, I do not know that they exist. At the end of the day, the processor can buy from anywhere in the world.

Q129 Barry Gardiner: In your evidence, you said that you, as a retailer, do not necessarily know the price that the farmer is being paid. Yet if I contrast that ethical blindness, if I might put it that way, with the Wiseman contract and what seems to be ethical foresight there, do you not think that as a responsible retailer you ought to know what price the producer is being paid here and if it is a reasonable one? If you are looking to have an ethical supply chain, should you not be looking back down that supply chain to say that the price that the farmer is getting is a reasonable one and it does ensure that they get a margin over their inputs and that you think you are running a decent supply chain and not ripping people off? Christine Tacon: I should say it is not that we do not know. We do not set in the contract what the price is, but we do know what price the farmer is getting at the moment. We would know those figures, but it is not set in the agreement with Wiseman. As I said, it is a new contract we are putting together from August. As part of those agreements, in the future we will be having discussion groups with farmers and what I like about that is that it is not necessarily the price, but understanding all the input costs. That is one of the things that in our farming business we control to the nth degree. We believe that once we start to get involved in these groups the economies of scale and buying power we can use from our farming business with the dairy farmers can help them with some of their input cost management and buying power as well. So we are quite excited about some of the economies of scale. We are talking about something that is coming as opposed to something that is here today, unfortunately.

Q130 Barry Gardiner: I have one final question. Would an EU-wide contract framework make it more difficult for you to specify additional elements, such as welfare, as you have done with the Wiseman contract? Christine Tacon: No, I do not think so, you can always add to things can’t you?

Barry Gardiner: Good, thank you.

Q131 Mrs Glindon: There is reference to the Co-op Farm’s experience of Producer organisations (POs) in the horticultural sector and UK growers’ concerns about their impact on competitiveness, which you referred to earlier. If other European countries adopt the producer organisation model suggested by the Commission, this will result in a significant consolidation of the industry in Europe. What effect might this have on the competitiveness of the UK dairy industry? Christine Tacon: First of all, I would like to talk about the impact of producer organisations in the horticultural sector. I have a lot of experience of this; we are in them in apples, peas and strawberries. It was brought in by the European Commission with an intention to encourage consolidation, so the words are almost identical to what they are trying to do with the dairy inside. In reality, what happened on the continent is that they tended to get some very big distributors that consolidated. So the distribution chain got consolidated, not the production. The producer organisations pull down significant grants, which are a percentage of turnover. Therefore, if you actually look at it as a competitive thing from our side of the channel, you see all of these competitors being able to pull down grants and you need to do the same. What happened in the UK was that the industry was fairly well consolidated already. If you talk about soft fruit, there are probably only three big soft fruit suppliers, so it had already been consolidated. There was then a concern about how to compete when they were pulling down this massive grant, so you ended up with a restructure of what we did, to be able to pull down the grants in order to compete. This actually has not created consolidation, but it has maybe enabled some growth. You may also be aware that the Rural Payments Agency has had an absolutely terrible time trying to monitor what is happening on the POs. At the moment it has paid as much in fines on disallowance to the EU as the EU has ever paid out in grants. All of us are currently either deregistered or being looked at all over again; it has caused absolute chaos in the industry. You have this situation where something that was set up to produce one effect in the EU has created a chaotic situation in the UK and we do not actually know where we are, going forward. Even at this moment, six years after it has been launched, we are all in chaos. I am quite frightened at the idea of the EU bringing something in with this wonderful end-goal, and when we try and interpret it in the UK it is very difficult.

Q132 Mrs Glindon: So in relation to competitiveness it is not helping? Christine Tacon: It has just caused chaos. Across the EU it has done very little, but it has created a consolidation with businesses like The Greenery, which you may not have heard of, but is a massive fruit and vegetable distribution arm which is bigger than the entire UK production of fruit and vegetables put together. That is one business and that pulls down...
a grant of 2% of turnover, which we then have to compete against.

Q133 Chair: Sorry, who set that up?
Christine Tacon: The Greenery.
Chair: Who set that up, who is in it?
Christine Tacon: It was set up as a result of bringing in the producer organisation regime.

Q134 Amber Rudd: Who is in it? Is it just an organisation made up of different entities?
Christine Tacon: No, it is a distribution arm for lots and lots of continental farmers.

Q135 Chair: Continental farmers?
Christine Tacon: So it doesn’t exist in the UK, this is a Dutch business. A Dutch business importing to the UK is one of our biggest competitors.

Q136 Barry Gardiner: Why does it get its grant from the EU?
Christine Tacon: Under the producer organisation regime and under the fruit and vegetable regime, which is a producer organisation. So the idea of a producer organisation getting grants to help people consolidate does not necessarily have the right competitive outcome in the UK and the retailer just factors it into the price that you must be getting this grant. So if you are not getting the grant you need to find a way of getting it.

Q137 Amber Rudd: So what is the upside to this particular set-up? You have described to us the chaos and the downside, what do you think was the upside?
Christine Tacon: I suppose the theory was right.

Q138 Amber Rudd: The theory, but not the practice?
Christine Tacon: Yes. The difficulty is that the UK farming industry is pretty efficient as it is already. It had already consolidated, therefore grants to encourage consolidation—
Amber Rudd: Worked against us?
Christine Tacon: Yes.

Q139 Chair: There is nothing to prevent our producer organisations setting a similar Greenery up in Holland and other parts of the EU and obtaining an EU grant to compete.
Christine Tacon: The established businesses we already had tried to do that and then found out that they had fallen foul of the principles of what the EU was trying to achieve because the business itself did not consolidate with anybody else. The objective of the grant was to get farmers to consolidate. If you have already consolidated, then it actually makes it very difficult to still be competitive if you do not pull down the grant.

Q140 Mrs Glindon: From what you have just said, the Co-op farms have always been protagonists for enhanced co-operation between farmers. How would you see the producer organisations enhancing this collaboration, or do you see that at all?
Christine Tacon: I worry about it. I think that farmers should collaborate anyway because it is the right commercial thing to do, not because there is a grant to be had if you do it.
Q141 Mrs Glindon: So, in other words, the producer organisations would not enhance that as things are?
Christine Tacon: I would worry about it having a similar effect to that in the fruit and vegetable sector.

Q142 Chair: In your written evidence you say, “Increased, and necessary, collaboration amongst farmers and growers is, in our view, possible within the framework of existing competition law”. The evidence we heard last week was that there seems to be either a misunderstanding or an anxiety about forming co-operatives among farmers. Is there something we could do to make it clearer why co-operatives, for producer organisations, marketing organisations or distribution organisations could be formed within the constraints of EU law in this country?
Christine Tacon: I am always quite shocked at the limited understanding about what a co-operative is. Just after foot-and-mouth, as a charitable thing the Co-op put two people into Cumbria to try and help farmers co-operate there and some people actually thought they had to sell their farm in order to join the co-operative. They just did not understand what it was all about. More education of what it can be is great. In Denmark, when they are looking at whether something is anti-competitive, they compare the size of the business to businesses in the EU; when we are looking at it in the UK we do not tend to do that. I think the law is okay, it is just about how we are interpreting it, whether people have to be given choice within particular regions or whether it is sufficient to look at it within the EU.

Q143 Chair: I am baffled because I am half Danish and I have seen how well co-operatives are doing there with a little bit of pump-priming from the state. I do not know if there is something in the psyche of our farmers that prevents them, because they are so proud and so independent, or if it is just that they do not understand the legal structures on co-operatives, or if it is a little bit of both.
Christine Tacon: I think it is mostly the first and a bit of the latter. We have done a huge amount in our business to try and get people to co-operate with us, to buy with us and to do things with us. Fundamentally, I think a lot of farmers farm because they want to be independent. I have had people saying, “Yes you have demonstrated that if I buy with you I will be able to buy cheaper than I can on my own, but I am worried that my son will not learn how to negotiate”. They are just desperate to be able to maintain that independence going forward.

Q144 Chair: Would you describe The Greenery as a co-operative?
Christine Tacon: Yes, but it is a distribution co-operative as opposed to a producer or grower one. It is not the growers that are co-operating, it is the
distribution that has been made phenomenally efficient.

Q145 Chair: When you explained that it was chaotic, could you just be clear: which part of it is chaotic?

Christine Tacon: The Greenery is a brilliant solution.

Q146 Chair: So is it the way we are left to our own devices—

Christine Tacon: It is the way that we already have a consolidated industry—[Interrupt.]  
Chair: I am sorry to interrupt: could mobile phones be turned to silent or off? There will be a fine if that happens again.

Christine Tacon: For example, with strawberries there were three large organisations that had very efficient workings with retailers. It would be anti-competitive if all of those three consolidated and we had one supplier of strawberries.

Q147 Chair: If we just stick to milk?  
Christine Tacon: You asked me why it was chaotic. What was chaotic was that these three businesses that were already big were saying, “Crikey, we have to pull down these grants because we cannot compete with people who have access to the grants”. They were trying to work out how to do it within the rules of the regime and then the EU auditors did not like how it had been done so we ended up in chaos ourselves. It is nothing to do with milk, though.

Q148 Amber Rudd: There has been much discussion about the retail price of milk and who gets what out of that price. I would just like to ask you about some of those issues coming out at the moment.  
To what extent do you think the retail price of milk is affected by the farm-gate price?

Christine Tacon: In theory it should be, but in practice it is such a competitive product in front of consumers that, even though you might end up with retailers with milk pools trying to increase price, what we have had in the last couple of years is the discounters coming in with really cheap prices, presumably having bought through processors who were not buying from milk pools. You cannot have a major retailer selling at a significant premium to the processors bidding for your business, at the end of the day you are trying to get good-value milk for your consumers. You are trying to balance how cheap you want to go and what welfare you are going to insist on. What is happening is that the retailers are actually seeing their responsibility for their processors and then making sure that the welfare standards of this milk that is coming in is okay. That is where the balance has been, but because they all got worried about the price, they have just been putting the price premium on. So they are focusing on the premium rather than the actual price.

Q149 Amber Rudd: So the farm-gate price is perhaps dictated by the retail price?

Christine Tacon: I think the farm-gate price is dictated by the global price. A point I thought you might be interested to know is that, if you look globally, only 7% of milk is traded. I do not know if you have had this information before, but only 7% of milk in the world is traded, of which 40% comes from New Zealand, about 25% from the USA and 25% from Europe. Really what seems to happen is that the price of milk seems to be driven by this 7% that is globally traded, particularly for those outside of the milk pools getting their premiums because there is always that amount of milk that will move around. In years when the global supply—

Chair: Excuse me, is that liquid milk?

Christine Tacon: No, this is all milk, so this includes milk powder. It is largely traded as milk powder, butter and cheese. In a year like 2007, when there was just 0.3% under-supply of milk globally versus the demand, the price doubled. In 2009, when there was 0.3% too much, it plummeted. So a tiny proportion of the global milk is traded and if there is even just a slight imbalance in supply and demand it has a massive impact on the milk price. That is what tends to drive the farm-gate price, which of course has nothing to do with the input, the climate or whatever else is happening here.

Q150 Amber Rudd: So you could say it is highly leveraged in a way?

Christine Tacon: It is an enormous impact, yes.

Q151 Amber Rudd: We have had some comments from our Minister recently that the portion of the retail price that is going to the producer is insufficient and is declining. Do you think that is correct?

Christine Tacon: The facts are there, yes.

Q152 Amber Rudd: Do you think there is anything we can do about that?

Christine Tacon: If you are a retailer and you have processors bidding for your business, at the end of the day you are trying to get good-value milk for your consumers. You are trying to balance how cheap you want to go and what welfare you are going to insist on. What is happening is that the retailers are actually seeing their responsibility for their processors and then making sure that the welfare standards of this milk that is coming in is okay. That is where the balance has been, but because they all got worried about the price, they have just been putting the price premium on. So they are focusing on the premium rather than the actual price.

Q153 Amber Rudd: In order to be fairer to the producers?

Christine Tacon: To be fairer to the producers, but also to distance themselves from what they want to have as a commercial relationship with the processor.

Q154 Amber Rudd: If the producers are not getting sufficient payment, it is just not sustainable.

Christine Tacon: You mean the producers?

Amber Rudd: Yes.

Christine Tacon: I do not think there is any doubt that the processors are getting sufficient. Well, the other thing is: should every dairy farmer have a sustainable business? There are some of them that are small family farms on their own land and really it is a lifestyle choice for them; it might be that other members of the family are out bringing in another income. They will not be infinitely sustainable, although they will be sustainable for a long while. What tended to happen when we were exiting was that there were many other businesses exiting. People who were looking at dairy as a business were exiting, so you ended up with small family farms and other
people saying that they had to be super-efficient and had to get to 750 cows or 1,000 cows in order to make money.

Q155 Amber Rudd: I see, so it is an evolution of the process in a way?
Christine Tacon: I think it is. I am not sure whether you are going to ask me a question about what the Government can do, but I do not think we should accept that every dairy business should be here in even 10 years’ time.

Q156 Chair: If we were to go down that path, what happens in upland areas?
Christine Tacon: They are probably the most sustainable ones. They are probably the ones that actually are okay because they own the farms. It is the people who want to go into dairy farming as a business and, dare I say, the tenant farmers, particularly if they are paying high rent, who will struggle.

Q157 Amber Rudd: Do you think that the Commission’s milk package proposals will affect the share of the retail price of milk?
Christine Tacon: I doubt it.

Q158 Amber Rudd: You do not think they are going to be particularly affected?
Christine Tacon: It might make a short-term difference.

Q159 Amber Rudd: According to Dairy UK, the reason why farmers receive such a low share along the supply chain is that milk is primarily a commodity product.
Christine Tacon: I think that was my global argument.
Amber Rudd: That is what you were saying basically isn’t it?
Christine Tacon: Yes—that if they are producing in the US for 20p then why would somebody pay 30p in the UK?
Amber Rudd: And you would not—
Christine Tacon: At the end of the day, it is all very well to say that, but what if there arises a global shortage of milk? Then you can get these huge fluctuations in price.

Q160 Chair: I was just going to ask: what if you suddenly cannot import it? Surely we want to be self-sufficient or more than self-sufficient and then export out?
Christine Tacon: I do not think there is an argument for being self-sufficient in the UK. I think you need to try and be self-sufficient in your liquid milk because of the shelf life, but there is no need to be self-sufficient in butter and cheese. Only about 50% of all milk produced goes into liquid milk so you do not need to worry about that in the short term. Then you also have some new brands coming in that have much longer shelf life, so that actually lays us open to more competition from the continent.

Q161 Chair: How do you de-commoditise milk?
Christine Tacon: Should you?

Chair: Yes, I mean—
Christine Tacon: You are assuming that we should de-commoditise milk.
Chair: Should we?
Christine Tacon: The thing is that the general public wants to buy green, red and blue milk don’t they? Some of them want to buy higher welfare and they might choose some brands because they think they are higher welfare and, to a degree, I think they are choosing their retailer on the assumption of higher welfare. However, I do not think you are going to be able to take something like milk and de-commoditise it in the eyes of the public. Is that what you meant?
Chair: Yes, thank you.

Q162 Barry Gardiner: Can I just pick up on that briefly? What would the size would the dairy have to be in the UK producer arrangements if we were to be self-sufficient in liquid milk, but clearly not concerned with anything beyond that? What sort of dramatic cutback would there be?
Christine Tacon: Well, at the extreme it would be 50%.

Q163 Barry Gardiner: Because 50% of our milk at the moment is liquid consumption?
Christine Tacon: Yes, 50% is liquid.

Q164 Barry Gardiner: I am not trying to put words in your mouth, but the logic of what you are saying seems to be that we should be getting anything other than liquid milk from wherever we can in the world, or if we can produce it at a profit that is well and good.
Christine Tacon: Yes, I think it is the latter point. If you cannot produce at a price that is competitive with the rest of the world, then your business model is at risk. I should say that the New Zealand model cannot be expanded, it is a natural advantage that they have. You cannot double the size of New Zealand, you cannot get to 750 cows or 1,000 cows in order to expand. At the end of the day, the global milk demand has gone up. The American model can be expanded. That is 3,800 cows on a unit, with milking 23 hours a day with 72 points—that is where the magic number comes from. You can replicate those, but you will need four of those, you will not get bigger than that, but the model can be expanded. At the end of the day, the global commodity price will probably be driven by what the US can produce for. Although they can produce for 20p at the moment, it is also worth knowing that they generally have up to 5p of financing charges on top of that. So you then get a figure of 25p and there are many businesses in the UK that can produce at 25p.

Q165 Barry Gardiner: That was not what I wanted to ask you about.
Christine Tacon: Sorry, but I did answer the question.
Barry Gardiner: That was just a pick-up. The area that I wanted to ask about was future developments. The Co-op prides itself on being an ethical, responsible organisation. You have talked in your written submission about technological progress. Among all the different elements of technological progress, of course, are the super dairies, intensification, cloning and some issues on which I may have no problems, but many people in the
Christine Tacon: Certainly I have not heard any support of cloning at all within the Co-op. We are a consumer-owned Co-op with 6 million members. The members are the general public and we do generally try to follow the advice of our members. I am not sure whether we have specifically asked their advice on cloning, but certainly within the Co-op I have not heard any support for it.

Q166 Barry Gardiner: The Food Standards Agency in the UK has said that its assessment of the technology is that food produced from clones and their offspring is entirely safe and that any ban on food produced in that way would be disproportionate. Christine Tacon: Again we would fall back on saying, “What do our members want?” Our ethical superiority has come from consulting with our members and saying, “What do you feel happy with and what do you want?”

Q167 Barry Gardiner: You would then say that selective breeding over hundreds of years is categorically different from doing it in a laboratory? Christine Tacon: I think we would need to ask again on some things. It is one of these things where you could ask the question and know what answer you are going to get, but, to a degree, we may need a better education so that people do understand these things. Do you know what I mean?

Q168 Barry Gardiner: So what technological developments are you supporting? I think we have heard a green light for 3,800 intensification?

Christine Tacon: No, no, you have not. The sort of technology that we are talking about is the understanding of nutrition and breeds. Certainly when we did our cows we had milking three times a day and we were getting 10,000 litres per cow. A lot of people are getting nothing like that performance. So it is about understanding all of the things to measure, understanding the importance of monitoring herd health and doing something continuously about herd health as opposed to getting the vet in when something goes wrong. It is almost more important to have somebody there regularly just to get an idea of something and find things early. That is the sort of technological thing that I think we could make a difference with in the very short-term.

Q169 Barry Gardiner: So no to super dairies?

Christine Tacon: I think you have to bring the public with you on super dairies. A proposal that initially had cows never going outside was quite difficult to justify to anybody who knows anything about the countryside. I also think that if you had said that the cows would go outside at certain times of year when the weather is nice and that sort of thing, and that all the methane from the cows would be collected and it would be the lowest carbon footprint milk in the UK, you start to realise how you can take people with you. However, you have to get the animal welfare bit right.

Q170 Chair: What percentage of cheese and processed milk products that you sell is produced from UK-produced milk?

Christine Tacon: I am afraid I will have to come back to you on that, I do not know the answer.

Chair: Could you drop us a line?

Christine Tacon: Of course I will, yes.

Q171 Chair: Do you anticipate Defra’s voluntary principles on country-of-origin labelling for dairy products affecting your buying decisions for dairy products?

Christine Tacon: The Co-op is very, very hot on labelling. We have always been very strict and in fact some of our packaging is a bit tiresome to read because there is so much about where absolutely everything has come from on the label. So no, I do not think it will make any difference because it is something that we are very strict about already.

Q172 Chair: Increasing importance being placed on local things by consumers obviously brings real benefits to UK farmers; do you see a market for local milk in the future?

Christine Tacon: It already is for Scottish milk and Welsh milk, so it is regional rather than local. As you probably know, there are some brands on the shelves—I think we have had Yorkshire milk in the Co-op before. You were talking about de-commoditising and, at the end of the day, milk is milk to a lot of consumers so if it means that there is a premium to be paid then it is up to them to decide if they want it or not. I do not think you could ever just have local milk.

Q173 Chair: Do you think there is a need for EU action on labelling?

Christine Tacon: I think they are looking at it at the moment; I am not quite sure how far they have got. My personal view is that what people can currently do, particularly with meat, is a disgrace. At the moment you can rear an animal in one country, process the dead animal in another country and say that it is the produce of the country where you have processed it. Some of that is so misleading and upsetting for consumers that it can actually do a lot of damage. People are looking to see where things come from, but you can blatantly lie, which is what I see it as, about the fact that this is British pork when it is not.

Q174 Chair: The only thing I would say is that our farmers do very well out of UK lambs being exported, fattened and processed as French, so I have to say that I am very relaxed about it. We had conflicting evidence last week from the NFU and Dairy UK as to whether there is a systemic problem in dairy farming and dairy production. Do you have a view on this, given the fact that you have come out of it?

Christine Tacon: There is a chunk of people who are not making money and are looking for somebody to try and give them a solution to make money. Some of those people might not like the solution, which might be that they would be better off going into sheep, or...
consolidating with the guy next door so one can milk the cows and one can look after the dry cows. So they might not like the solution, but I do not think they should be given a right to survive when there are people at both the smaller and the larger end of the market who are being competitive and are surviving. You will hear it as a stuck record in farming that there is not really enough independent advice—what used to be Government-sponsored advice—to help people. These are very proud people whom we are trying to help.

**Chair:** Thank you very much for being with us today, for being so generous with your time and for both your oral and your written evidence.

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**Examination of Witness**

**Witness:** Hermanus Versteijlen. Director of Economics of agricultural markets and single CMO, European Commission Directorate General for Agriculture, gave evidence.

**Q175 Chair:** Thank you very much indeed. Can I welcome you, Mr Versteijlen and thank you very much indeed for being with us this afternoon. For the record, would you like to give the Committee your full name and position?

**Hermanus Versteijlen:** My name is Hermanus Versteijlen and I am a civil servant in the European Commission, working as a director of agriculture markets. That covers all markets ranging from animal products to arable products, fruit and vegetables, wine and so on.

**Q176 Chair:** Thank you very much for being with us today and contributing to our inquiry. First of all, would you like to make a comment about the present state of the dairy industry across the EU, as you see it?

**Hermanus Versteijlen:** The dairy sector, as such, is in a relatively good state at the moment, in the sense that milk prices paid to farmers are at reasonable levels. We also expect for the near future that this will remain the case. We do, of course, see that there are differences in the European Community in prices. We also see that the average milk price paid in the UK, as compared to the rest of the Community, is less than the average paid in the Community. The average in the Community at the moment is about 33 cents, while here in the UK you pay 29 cents on average.

**Q177 Chair:** What do you put that down to?

**Hermanus Versteijlen:** I think it is partly historical, in the sense that there is a lot of milk being sold in the liquid market, as was discussed here before; according to our figures, it is about 53%. Compared to other situations, that is a bit abnormal. Typically, in other situations you would see only 20% to 30% being sold in the liquid market. From my background, I am Dutch and there the liquid market is seen as the last end of the market; it is not the premium market. On average, I would say that 45% of milk in the European Union is turned into cheese; into added-value products. Here in the UK it is much less, it is about 27%, if my figures are correct.

**Q178 Chair:** If you feel that the price slump of 2009, which prompted the formation of the high level group on milk, has largely recovered, would you like to give your reasons why you think measures outlined in the milk package are still needed?

**Hermanus Versteijlen:** It is always a bit of a fragile situation in the milk sector. Relatively small quantities can give rise to disproportional price fluctuations and what we see is that the price risk is very much carried by the farmers. If you then look at price developments at retail level or at processor level, they form a more or less constant line. If you look at the same time at the price development at farmer level, they are much more erratic, going up and down. You see time lags, with farm prices being converted into consequences at the retail and the process level.

So the price risk we have seen over the last two or three years, the brutal fluctuation of prices and price volatility, has been very much carried by the farmers. We also think it is important in this context that we are going out to quota. We still have a quota system that took care of stability and we have never had such enormous price volatility as we have seen over the last three years. We still believe that we have to continue to get out of quota because quotas do not fit any more in a situation where, as a result of globalisation, our borders are opening up. They are already open to a certain extent, although not so much for milk. We want to integrate more into the world market, so the quota system cannot exist any more. On the other hand, we see that going out of this quota environment we have to take care that there will be better mechanisms for adapting supply to demand and improving, in that context, the position of the farmer in the chain so that he can better negotiate his price.

**Q179 Chair:** Given that there is a growing global demand, what do you think you can do at the EU Commission to increase EU dairy exports?

**Hermanus Versteijlen:** Earlier we had our export refunds; we do not use them any more, although we still have the possibility to do so. What we have in fact done is quite important. We had reforms over the last 10 years in the dairy sector; we adapted our internal price level towards the world market. On the other hand, the world price level has converged very much to our price. If you look at the present price situation, the European dairy sector has become quite competitive as compared with the world market. At the moment, we are exporting important quantities, especially of cheese, powder and even butter, without paying any refunds. This shows that we are quite competitive. We are exporting 600,000 to 700,000 tonnes of cheese without any export refunds so we can really compete, and that is the result of our policy over the last 10 years in the milk sector.

**Q180 Chair:** Do you find it surprising that there is currently no transparency in the contracts? The NFU
Hermanus Versteijlen: We see quite different situations in terms of contracts in the European Union. On the one hand, the co-operatives have their own structure. On average, in the community 58% of milk is processed by co-operatives, while in the UK it is about 30%. So in terms of co-operatives you are different. On the other hand, you have the private sector and there you see situations without any contracts and not all the elements of the contracts are very well harmonised. I think we have a responsibility to try and come with a proposal for a contract that contains at least minimum elements that are important for both actors.

What is important in this context is that these contracts are not only there to improve the situation of different actors in the chain—the producer and the processor—but they should also contribute to the better adaptation of supply to demand. I will give you an example of this. When the milk prices were at their lowest level, in 2008, we saw that in eight Member States 6% to 7% more milk was produced than in the previous year when milk prices were at their highest. There were clearly no signals from the processors or co-operatives to the farms to say that they needed to adapt supply to demand. The farmers also, although they have all their cows lined up and organised to produce a certain amount of milk, can still influence the flow by a couple of percentage points based on their policy on feed and so on.

So we think that if you then improve the contractual situation there should be better contacts between the different contractual partners about the volume. Then, as a counterparty, there should also be better information about the price. We think that any processor, either co-operative or not, should be able to determine over a certain period what sort of outlets against what sort of price he has. That should be converted into a raw material position on the basis of which he can then have contracts with farmers. Also in that contract, even on a monthly basis, the volume is determined as well as the price so that the farmer has a better indication of what his situation will be.

Mrs Glindon: You have outlined the model for the EU framework in relation to milk contracts. Do you think it is realistic, given the variation in the industry across Europe, to have a single framework and model? For example, in the UK the majority of milk producers already have a written contract.

Hermanus Versteijlen: What we put in our proposal are our minimum requirements, but we do not determine the parameters to be decided by the negotiating partners. We do not say anything about the price; we say that a price or a price formula should be there, that a volume should be there and that a date for duration should be there. All of those elements are supposed to be freely negotiated between producers. It is a minimum requirement, but it is up to the actors to fill in the contract itself based on those minimum requirements.

Q182 Chair: How much support has the Commission received from other Member States for the milk package across Europe?

Hermanus Versteijlen: If I look at the development in the Council, we normally go to the Council and then we have working groups. There has been quite a favourable reception for our proposals. Do not forget that these proposals were prepared by a high level group in which all Member States participated so, of course, the report of that group was adopted by consensus. We converted that into proposals so you would not expect all Member States to be against it later on. There has been quite a favourable reception for the proposals. Of course there are certain things that they would like to adapt. There is always a discussion: we have the 33% issue, trying to answer to what the maximum size of a producer organisation can be in a Member State, whether it should be 33% or a little bit more or a little bit less.

Another issue in this context is that, after the Lisbon agreement, we have to reorganise our legislation into what we call implementing powers and delegated powers. They determine the role that Parliament and Council have to play in the context of Commission decision-making. There is quite a wide general discussion on that subject between the different institutions, but whenever we make our proposal for the future, in this case the milk sector, we also have to put these elements. Those elements always give rise to discussion between Member States, but they are not directly linked to the substance of the milk package. So that is as regards the Council, but now of course with this proposal we are in co-decision with the European Parliament. That is a new situation after Lisbon. Earlier, and in all my career, we were in the situation in which we made a proposal, Parliament gave advice, then the Council decided and the whole thing was in the official journal after six months. Now we are going through the process of a first reading and second reading in Parliament, and Parliament is fully co-deciding on this proposal.

I happened to be in a Parliament meeting yesterday at which Mr Nicholson presented his report and different amendments were discussed. There are 307 amendments to the report of Mr Nicholson that still have to be organised into mainstream amendments. Then he can finalise his report by the end of May if everything goes well. I would say, and the President Mr De Castro also concluded, that there is a broad agreement in the Parliament on our proposals. Certain parties are more ambitious and other parties want to change figures, so there are always the usual opinions, but fairly speaking they support our proposals. So if everything goes well we could even conclude in the first reading, by the end of the year.

Q183 Chair: You mentioned price, what do you think the other minimum requirements on the face of a contract should be?

Hermanus Versteijlen: Volume, and also the timing of delivery is very important. I gave you the example of the first three to four months of the quota year in 2008, where we had 6% more. It is very important that, also in the context of co-operatives, the delivery right and delivery obligation is re-discussed. The
delivery right is a situation where the farmer delivers all of his milk and he determines how much milk a processor then has to convert into milk products. Then the price is based on that value-added situation later. So that has to be improved a bit. So I would say volume, then the timing of volume is important, and then the duration.

Q184 Amber Rudd: Do you think allowing Member States to choose whether to make written contracts compulsory or not risks creating distortions among Member States and problems between them as a result?

Hermanus Versteijlen: We proposed, of course, to leave it to Member States.

Amber Rudd: Yes, to make it voluntary.

Hermanus Versteijlen: So I do Member States said that they had nothing against contracts, but they would like to have it, for subsidiarity reasons, decided at a national level. So let us say that the best situation would be for the Member States to decide on the basis of their own national situation. For instance, here in the UK you are more advanced in contracts than in France or in other countries. You come out of a different historical situation from the Milk Marketing Board; you have fewer co-operatives than in the rest of Europe. So your situation in terms of contracts is different, therefore we left the choice to the Member State.

Q185 Amber Rudd: So the Commission has done its own assessment on the basis that if we allow Member States to make their own choices, that will help with innovation. In some cases like the UK they want it to stay voluntary and do not want compulsory contracts. Have you made an assessment of what the difference is?

Hermanus Versteijlen: In this context, we only want to make an effort to harmonise the situation in the European Union. Therefore, we give an instrument that we think is useful to do that. The users then have to decide themselves to what extent they want to use this instrument, and that is also a decision to be taken at Member State level. We think those contracts can be helpful, but, in the context of subsidiarity, we allow the Member States to make their own judgment.

Q186 Amber Rudd: The National Farmers Union Scotland has proposed a new market-related formula, which it argues would be a fair and reasonable starting point to set a foundation for contracts. Would the Commission support a universal pricing formula approach?

Hermanus Versteijlen: Uniform price formula? Not necessarily. I think we would have to look at the formula itself, to what extent it imposes and what the duration and elements of it are, but in every contract it should be clear to the actor what the price formula is and on what basis a price is determined. That can be either a fixed price or a formula that is part of a contract. If there is a certain harmonisation there on the basis of certain elements, then I do not think we have anything against that, but I cannot have any opinion on that until I know what the formula is, what duration it is for and what it imposes.

Q187 Chair: Are you able to estimate how many Member States make contracts compulsory at the moment?

Hermanus Versteijlen: I do not know. I think it is more likely that the southern Member States tend to make them compulsory.

Q188 Amber Rudd: Which ones?

Hermanus Versteijlen: The southern ones. France already did so. In principle there is nothing in European law at the moment to prohibit Member States making contracts compulsory. It is possible to do so and that is why we think that our proposal is also important and that where those contracts are made they should be in a harmonised model. An important factor in this context is the free negotiation of the elements. A couple of Member States will ask whether they can fix the duration of the contracts.

Q189 Mrs Glindon: Would you agree that allowing producer organisations to capture up to one third of national production could create a monopoly that is not consistent with the concept of a market-led dairy industry?

Hermanus Versteijlen: We do not think so because with 33% you have an option, for any processor, to negotiate a price with three different producer organisations. So there should not be a monopoly and, if there is any indication that in a certain area this would still lead to a monopoly situation, we have proposed a safeguard for national competition law. Authorities could then look at very specific situations to see that no monopoly is being created or where a processor would have difficulties in sourcing his milk.

Q190 Mrs Glindon: The threshold is 33%, which is perhaps higher than our Government would have suggested. Why was that 33% of national production chosen?

Hermanus Versteijlen: There have been quite some discussions about it. In the Parliament it runs to 75% and to 38%. 33% is 100 divided by three.

Q191 Mrs Glindon: A mean amount of those?

Hermanus Versteijlen: Yes. What we think is important in this context is that we have a harmonisation of conditions to have a producer group around the community. This proposal is a derogation from normal competition law. Normal competition law typically defines, on an ad hoc basis, what is called the relevant market. As we found out in the high level group, it leads to different situations between Member States. Every competition authority in each Member State is defining its relevant market and that can differ then within the milk sector. So in order to harmonise the legal situation of producer groups in different Member States we made these proposals and that is why we obtained this derogation from normal competition law. This is not something extraordinary in the agricultural sector.

Q192 Chair: Why do we have to harmonise?

Hermanus Versteijlen: Because otherwise producer groups could be treated differently in different Member States. Their legal situation should be clear
about on what basis they can ask for recognition. Maybe they do not start because they do not know to what extent they will be allowed or not. Now we have clear parameters which they can use.

Q193 Mrs Glindon: Going on from that, can I just ask what impact assessments have been used to examine the likely effects on competition and pricing of the formation of producer organisations?

Hermanus Versteijlen: We acquired some evidence in the high level group on our proposals and what to do. So we did not make a specific impact assessment here on this particular situation of the influence of 33% of producer groups.

Q194 Mrs Glindon: So did you look at different Member States to look at the impact? I was just wondering how representative the impact assessments were across the Member States?

Hermanus Versteijlen: In the high level group, we had different statements and witnesses from competition authorities in different Member States reported on their situation. For instance, I remember there was one from Germany and there was one from France, who reported what I was just saying about the situations being different. European competition law intervenes only if there are cross-border effects for the rest. If there are not cross-border effects, it is the Member State’s competition authorities who determine what the relevant market is.

Q195 Mrs Glindon: How much demand do you anticipate from European Union producers to set up the producer organisations?

Hermanus Versteijlen: I am curious about what will happen now. There was nothing against setting up producer organisations until now; they can do it, but within certain limits from a competition point of view. Our proposal has given a stimulus to do so. Whether in the end they will do so depends on to what extent they are able to work together. I have also seen many witnesses saying that for producer organisations to negotiate a common price with processors is not always easy either. One producer organisation member has told me that he negotiated the price and his farmers were always unhappy about the price, but if he could obtain 1 cent more than the neighbour then the farmer was happy, and that was the basis. So there will always be discussions, as there are co-operatives and producer groups and to an extent they will obtain a better position. In the context of rural development, we will also make proposals to stimulate setting up producer groups by administrative support, not making any investments, but setting them up. So in the future our legislation will stimulate working together and will also fall more and more under the second pillar of rural development as an item to be used by farmers. So from our side we will do what we can to have farmers working together and to improve their bargaining position vis-à-vis processors and retail.

Q196 Mrs Glindon: I know that you touched on competition law before, but the UK Government argues that producer organisations should still be subject to national competition law. How would this affect the EU common market if some countries allowed large producer organisations and others did not?

Hermanus Versteijlen: If our proposal is adopted by Council and Parliament, the UK can no longer apply its own competition law. European competition law on the basis of the 33% will be applied.

Q197 Chair: Are we not understanding the competition rules in this country? I spent six months in DG Competition. I think I understand the rules fairly clearly and I do not understand why we cannot form co-operatives in this country. I asked the previous witness whether this was something to do with our lack of understanding of EU competition laws or something in the psyche of the UK farmer. Do you think there is something we could be doing to explain this? If we are not exporting, if the milk or dairy product is not crossing a border, why can we not have more co-operatives in this country?

Hermanus Versteijlen: I do not think the position on co-operatives in the UK is linked to competition law.

Q198 Chair: One of the witnesses seemed to think that EU competition law prevents it.

Hermanus Versteijlen: No, no, not at all.

Q199 Chair: Could we just get that on the record?

Hermanus Versteijlen: Let’s say that there are certain exceptions in European agriculture law for co-operatives. Co-operatives are fairly well treated and you know as well as I do that there are many well organised and big co-operatives. So I do not see that the situation should be different here in Britain. We never contest—my colleagues from competition law—the situation of co-operatives. I think that the situation should be different here in Britain. We organised and big co-operatives. So I do not see that exceptions in European agriculture law for co-operatives in the UK is linked to competition law.

Q200 Chair: Can we just have a statement on the record that there is nothing in EU competition law to prevent the formation of co-operatives in this country, either at distribution, producer or marketing level?

Hermanus Versteijlen: There is nothing in law to prevent it, unless of course they do unlawful things. That always has to be checked and notified, but if you had a normal co-operative working as anywhere else in the community I do not see why in the UK it should not work.

Q201 Amber Rudd: In the UK, the retail price of milk received by the farmers has declined in the last decade, while that of supermarkets has increased. Is it the same in the rest of the EU or are we unique in having this particular development?

Hermanus Versteijlen: I am not sure whether you are unique, maybe. What I see when I remember the graphs that we produced was a steady increase of retail prices for agricultural products, also for milk and also for processor prices. As I said before, when
you see the milk price of farmers you see a time lag in the retail price as compared with the development in the milk price paid to the farmers. Sometimes you see small reactions, but a common phenomenon in the UK is to use milk as a kind of attraction product, especially local milk, to attract people.

**Q202 Amber Rudd:** A loss leader?

**Hermanus Versteijlen:** What do you call it?

**Amber Rudd:** Loss leader.

**Hermanus Versteijlen:** The loss leader. You see milk prices coming down. The liquid milk price has also come down another 4p per four-pint bottle over the last month, which is a bit against the normal trend of milk prices that are now paid to farmers. Any retailer will of course try and translate that reduction to the ones that deliver the milk; he will try to obtain his raw material or his product as cheaply as possible. So indirectly it has an influence.

**Q203 Amber Rudd:** My point is that the proportion of the money that the producer gets is slowly diminishing compared to what the supermarket gets. We think it is a problem in the UK, but is it a similar problem in the rest of the EU?

**Hermanus Versteijlen:** In the context of different forums, we are looking at that margin distribution between the chains. There is a forum that has been constructed of the different actors in the food supply chain to look at the development of margins and so on. They have a whole programme for 2011, and if you like I can give you more details.

**Amber Rudd:** Yes, it would be nice if you could let us have that information.

**Chair:** If you could give us that in writing that would be very acceptable.

**Hermanus Versteijlen:** Yes, there is a certain Mr Jim Paice, Member of Parliament, who is part of this forum. It is a decision of Council and I can give you that in writing if you like.

**Q204 Amber Rudd:** Apart from the milk package, does the Commission have any other ideas for improving competitiveness and encouraging innovation in the dairy sector?

**Hermanus Versteijlen:** With our milk package, we have put some ideas on the table. We will always continue to have new ideas, but not for the moment. There are of course always all the possibilities in the second pillar to improve competitiveness by farmers and so on. It is a matter of how you take them up within the Member States’ programme.

**Q205 Chair:** You mentioned that contracts should include price. A formula relating to margin be permitted under the Commission proposals?

**Hermanus Versteijlen:** As I said, it is to be freely negotiated between—

**Chair:** But it is something you would encourage?

**Hermanus Versteijlen:** There is nothing against it. There is a situation here; I think Tesco is doing that on that basis. Although I think it is a bit of a pity that an entrepreneur is being paid on what his production costs are, I understand that here in Britain farmers are quite happy with that situation—that they have their production costs plus something.

**Q206 Chair:** The previous witness spoke about the Greenery organisation. In your view would dairy producer organisations be eligible for the same grants for consolidation that were offered in the fruit and vegetable sector? So would dairy producers be eligible for the same things?

**Hermanus Versteijlen:** No.

**Q207 Chair:** Why?

**Hermanus Versteijlen:** The fruit and vegetable sector has a specific market organisation, which is not there in the dairy sector. In the fruit and vegetable sector we have support for producer organisations. Producer organisations consist of farmers, and the support is that if farmers work together in producer organisations to concentrate the offer and to improve the added-value on the offer, we are ready to pay something like 4% on their turnover on condition that this 4% is 50% of the expenditure of their actions.

**Q208 Chair:** This is for dairy?

**Hermanus Versteijlen:** This is only for fruit and vegetables. Such a system does not exist in milk.

**Q209 Chair:** The whole thrust of the evidence we have been hearing for milk and dairy is that we are only going to increase profitability if we increase added value. I personally do not understand why we are seeking to increase added value in fruit and vegetables when we know that we need to increase added value in milk and dairy as well. So would you now come back and perhaps reconsider?

**Hermanus Versteijlen:** No, because we spent €850 million in the fruit and vegetable sector to stimulate certain actions of producer organisations. I was a bit surprised by the previous witness’s statement on the Greenery. The money was used for distribution. The money, in principle, is used to improve the working methods of the members of a producer organisation. For instance, they have to improve their environmental methods of producing. It is a compulsory action. It can be used to withdraw certain products in an excess situation. It can be used to improve packaging and to add value up to the outlet of a producer organisation. So that is where it is used. It is really there to add value to fruit and vegetables in the fresh state.

**Q210 Chair:** So you do not see a parallel with adding value when there is clearly a need in this industry?

**Hermanus Versteijlen:** In the milk sector, the only way the milk producer can add value is if he starts processing at his farm. The number of those who process, for instance, into their own cheese is very limited in the community. Some 95% to 98% of European milk is delivered to dairies—so to the industry. We normally do not have improvement programmes for industry. Industries themselves have to add value to the milk. That is why it is important, especially in the UK industry, to invest in added-value. So it is not for milk producers to do that. A milk producer is not in a position to add more value...
to his milk. Of course his milk has to be of good quality and so on.

**Q211 Chair:** I would be very grateful if you could send us a written note on that. I am not getting the difference and I would be very grateful if you could do a written note for the Committee’s benefit.

**Hermanus Versteijlen:** I think it is fairly clear. We have different market organisations. You have the fruit and vegetables organisation, which has a certain support—

**Q212 Chair:** But is it because the markets developed differently in the different—

**Hermanus Versteijlen:** No, but in the milk sector, for instance, as a support we have a safety net intervention, we have export refunds and we have private storage. For historical reasons, all market organisations have different support systems. In fruit and vegetables all the support was concentrated on producer organisations. Now we are setting up producer organisations in the milk sector, but the only thing we will do is stimulate their bargaining power. We might give an aid for setting them up, but there it finishes. We are not going to pay for investment in processing or anything like that.

**Q213 Chair:** I just think that it would be helpful because I do not see the difference personally. Could I just turn to milk quotas? You touched on a change in behaviour. How do you and the Commission anticipate that EU milk production will change following the abolition of milk quotas in 2015?

**Hermanus Versteijlen:** We have done studies on the change in attitude. You must not forget that when we abolish milk quotas we will be in a situation where there is more milk quota available than milk produced. In the UK, you produce 9% under the quota already and the general situation in the community is about 5% to 6%. A couple of Member States are close to their quota and risk paying superlevy; this year there are about five. However, for the rest they do not, so on a general basis we are going for what we call a soft landing. That means that the quota rent is supposed to be zero. That is a price difference between a situation with or without a quota. There should not then be any upsurge in production because there is not any additional stimulus to produce milk.

**Q214 Chair:** You did say that, even though the price was lowest in 2008, bizarrely, production was up. So what I would like to ask is what the impact on one Member State would be of another deciding to increase substantially its own production once the quotas are lifted, and what would the Commission do?

**Hermanus Versteijlen:** Of course.

**Chair:** If one Member State decides to increase substantially its own production once the quotas are lifted, would the Commission look to intervene in those circumstances?

**Hermanus Versteijlen:** Yes, no Member State has a right to intervene above what is allowed already in our legislation. They have no right to stimulate production that is not—

**Chair:** But after the quotas have gone?

**Hermanus Versteijlen:** Yes, after the quotas have gone. It will be a free market and no Member State has a right to stimulate production.

**Chair:** Okay. Thank you very much for being with us and for being so generous with your time. I personally would find a background note very helpful, as broad as you are prepared to make it, on what support is given to fruit and vegetables as opposed to milk, just for our better understanding. We thank you very much, Mr Versteijlen, for being with us today. Thank you very much indeed. We stand adjourned.
Tuesday 10 May 2011

Members present:
Miss Anne McIntosh (Chair)
Thomas Docherty
George Eustice
Neil Parish
Dan Rogerson

Examination of Witnesses

Witnesses: David North, UK Corporate Affairs Director, Tesco Stores plc, and Andy Bloor, Chairman of the Wiseman Tesco Sustainable Dairy Group, gave evidence.

Q215 Chair: Good morning, gentlemen. Thank you very much for being with us and participating in our inquiry. For the record, would you like to introduce yourselves and give us your positions, just so we have them formally?

David North: Morning. I am David North. I am the UK Corporate Affairs Director for Tesco.

Andy Bloor: I am Andrew Bloor. I am the Chairman of the Tesco Sustainable Dairy Group. I am also a first-generation milk producer from Cheshire.

Q216 Chair: You are both very welcome. What would you describe as the problems facing the dairy sector at the moment?

David North: Having studied the work of the High Level Group and the Commission’s proposal, I think that they identify pretty well that the problems that producers have faced are about market uncertainty, a desire to have greater confidence, a desire to have greater transparency in the market in their relationships with their processors, and a desire for greater collaboration across the industry. We put in a written submission because we thought that our experience in setting up the Tesco Sustainable Dairy Group was quite a good model. We set that up in 2007, when the industry was facing similar problems to some of those that it faces now. What producers told us then was that they wanted a system that was more transparent, that provided greater certainty, and that provided them with the confidence to invest. So we introduced the pricing system based on a transparent calculation of the cost of production. We are currently paying 29.78 pence per litre under that scheme, one of the highest in the business. We are the only people who do it on the basis of a cost of production. We have got 700 farmers in that scheme, and they react very positively to it.

Q217 Chair: Mr Bloor, did you say you were first generation?

Andy Bloor: That is right, yes.

Q218 Chair: How many of those do you think there have been in recent years?

Andy Bloor: Very few probably. That is a concern, and, again, something we are working with, in the group, will be looking at the next generation.

Q219 Chair: We have had conflicting evidence as to whether or not the UK dairy industry has systemic problems. Do you believe that the UK’s dairy industry has systemic problems?

David North: Let me try to answer that first of all. If we collectively grasp it, there is potentially a bright future for the industry. If you look globally, we operate in 14 countries around the world, what we see is that the demand for milk and dairy products is set to increase, I think by about 18% to 20% by the end of this decade. If you look at the benchmarking studies you will see—and I am sure you know this—that the UK industry is efficient and it compares well with almost any industry around the world. It is increasingly market-oriented. I think that is the result of pain over the past decade in terms of CAP reform. It produces a very high-quality product. I think there is something approaching a consensus within the industry that what we need to do to grasp those opportunities is to have better collaboration, better transparency, a greater focus together on how we can go on improving quality, how we can help producers to withstand volatility, and how we can bring down some of the costs that they face. If we do that, the future is a bright one.

Q220 Chair: Do you believe there is room for more co-operatives in this country?

David North: If I may, our own experience is that co-operation, collaboration, call it what you will, within our dairy group has been very beneficial. It is not simply about building trust on the issue of price, although I think Andrew would agree that is very important. It is also about the other ways of collaboration; so that farmers get together. We are doing work with the Dairy Centre of Excellence that we have at Liverpool University where collaboration moves into the area of how we can improve nutrition for the dairy herd, how we can improve feed, efficiency and production, herd health and all of those issues. Then there are issues for the future like CO2 emissions and tackled climate change.

Andy Bloor: One of the spin-offs that has come in the four years I have been working with Tesco, over and above the confidence from both sides—the commitment and the confidence is nearly as important as the milk price—is that Tesco are backing the guarantee to pay no less than the minimum average cost of production. We have gone from the scenario where producers will be ringing our representatives up and querying the milk prices: “Why is it there? Is it going to go up? What is the future in the near term and the long term?” We have now got producers ringing up and saying, “What can we do to help Tesco sell more of our milk?” A complete change.
Q221 Chair: Mr North, how could we increase collaboration? Why is it not happening more broadly across the industry?

David North: It is happening in our supply chain and within our dairy group, and we have seen the benefits of that decision that we took in 2007 to have our own dedicated supply. That is 700 members: very few of those members ever want to leave our dairy group, there is a waiting list of people who want to join, and 90% of members are positive about it. I think the NFU dairy board chairman has said that this could be a model that others should adopt, and he has urged others to adopt it. There are different routes to cooperation and collaboration. There are those that focus on co-operatives or on producer groups, and there is a model like ours, which works through the supply chain, and our experience is that is working very well.

Q222 Chair: Do you both believe that Defra is doing enough to help the dairy industry? What could or should Defra be doing to help the dairy industry at this time?

Andy Bloor: It is difficult to see where you can build this confidence, because milk production is a long-term commitment, and it is not a case of in and out: “I cannot sell the milk today, the price is pretty poor, and I will sell it tomorrow.” It has got to be sold and got off farm. What we found within the first year, or probably three years, of this group was that farmers were in the position to start reinvesting, which was something they had not done for a number of years. So it was a dream initially that you would be able to ride around the countryside and be able to pick out a Tesco farm, and that is already happening within four years. So the commitment is there from both sides: the confidence is as important as the price, and the group in itself, production-wise, is growing by 3% a year. As David said, people were a little reticent at the time of signing, and some did not sign, and would like to join even at this point.

Q223 Chair: From the point of view of the Government and Defra, do you think they could be doing more?

David North: I should declare an interest, if I can, which is that I used to work in Defra some years ago, so I know that the Department is focused on this sector, as it is on others. It is a difficult position that it is in, trying to balance EU proposals against the needs of the industry. On the whole, it is well focused on that. The opportunity for Defra is to look beyond the immediate term, and, for example, to address the big question—that we do have a trade deficit in terms of the value of dairy products—and to go ahead and see if we can together address that trade deficit so that it gets eradicated over time and becomes positive for the UK.

Q224 Neil Parish: You talked about the dedicated supply chain that you have. Now the European Commission’s milk package: will it make it more difficult to keep this established or less? What is the future for your dedicated supply chain?

David North: I do not believe it would make it either more difficult or less difficult, but I think one would need to see whatever was finally adopted. It proposes a model of contract between the processor and the producer. Our model is slightly different from that. I do not think the proposal would impinge on our model.

Q225 Neil Parish: You said that you have 700 dairy farmers in the dedicated system, so how much milk do you have? What I am trying to get to the bottom of is what sort of size are those dairy farms? Are they the larger ones on the whole?

David North: Andrew will know the details better than I do. We have a range of size of production within the scheme, a range of efficiency within the scheme, but I think Andrew would probably be able to talk more expertly than I can.

Andy Bloor: The herd size varies from 55 to 890, and they were not picked at the time to join the group on numbers or efficiencies; it was based on areas, to get the efficiencies of haulage and transport. So there is a real mix right across the whole piece.

Q226 Neil Parish: I can understand Tesco doing that, but naturally you are picking the farms that have better access to major roads and where the farmers are together in order to have that milk supply. That is good from Tesco’s point of view, and nobody is knocking the fact that you are giving a good price for the milk. The only argument could be that, by doing what you are doing, you are taking out particular areas where, shall we say, it is cost-effective for you to do so. That then has a knock-on effect on people that may not be farming in an area where transport is so easy to get the milk to process.

Andy Bloor: Firstly, in defence of Tesco, they did not pick the suppliers. The processors picked who would be offered a contract, and it ranges from Scotland all the way down to Devon, so it is country-wide; it is not selected. I appreciate there will be some in some areas that would not be offered a retailer contract, yes.

Q227 Neil Parish: I take it with the dedicated supply with Tesco you do it through more than one processor then, do you? I imagine there are different processors in different parts of the country. Is that right?

David North: That is right—three processors.

Q228 Neil Parish: Three processors, which are whom?

David North: Which are Robert Wiseman, Arla and Dairy Crest, but in different proportions.

Q229 Neil Parish: You probably do not want to tell me, but do you pay the same price to each of those three processors? As an industry, you are guaranteeing a price to the farmer; you probably do not necessarily want to say whether you are giving the same price to the processor?

David North: The way that the scheme operates is that we have an independent calculation through using a cost tracker of the costs that farmers bear. That includes fixed and variable costs, overheads, and unpaid family labour as well, and the response we get from members is that that gives producers the confidence to invest for the long term, which is very...
important to them. The contractual relationship between us and processors is entirely separate from that, and that was deliberate, so that we give the reassurance that the producers are seeking.

Q230 Neil Parish: That leads me neatly on to the next question, and that is that ASDA recently has started a bit of a price war, and is selling four pints for £1.25. I take it you last week dropped your four pints from £1.53 down to £1.35. So what I am trying to get at is that, when this happens—and supermarkets will have price wars—who pays for it? Do you then turn round and try to squeeze the processor, because, in a way, if you have got a guaranteed price to the farmer, you cannot necessarily squeeze the farmer at that moment, but you probably are looking to save some of the money when you are slashing the price. So it must put pressure back on the processor, is that right?

David North: First of all, the farmer, as you rightly point out, is not affected by the retail price under the scheme that we operate. That price is determined on the basis of the costs borne by the farmer. It is true to say at the moment, and this has been particularly the case for two or more years now, that our customers, customers of all retailers, are looking for the best value. It is true that milk is one of the products that they compare when they are comparing between retailers, and therefore there is, at the moment, a good degree of competition on the price of milk. What that leads to is, again, as you rightly point out, some promotions and a degree of promotional activity, which means that the price can vary. I think if you went down to our store just round the corner, our Express store, you would find that the price per litre was around £0.87. As you say, on promotions, particularly for multi-buy, it will be lower than that, but the position for the processor is insulated from that.

On your point about the relationship with the processor, the Groceries Supplier Code of Practice, to which we are a signatory, would prevent us, and does prevent us, from saying to any of our suppliers that they must take part in a promotion. Now, if a supplier chooses to take part in a promotion in order to sell more of a product, then that is a feature of the market.

Q231 Neil Parish: Yes, but surely if you are buying your milk from the processor, I do not think supermarkets have ever been averse to saying, “We are having to sell the milk for less when we sell it in the shops, so therefore we want to buy it for less.” I think I would be slightly naive if I did not believe you would have carried on that process.

David North: I come back to our setting up of this scheme in 2007; I think we went into the dialogue that we had with producers at that time with our eyes open. We knew that would be a cost to our business, and I think if you look on the website of the Tesco Sustainable Dairy Group it points us to bearing a cost of around £35 million a year in operating the scheme. So the business is investing in the scheme because we believe it delivers better security of supply for our business, better quality, and helps to differentiate our product, and gives our consumers confidence.

Q232 Neil Parish: Wiseman’s are saying that their profits will be down over the next 18 months because of this particularly tight market within the supermarket trade in particular. Surely that bears out the fact that there must be pressure on them to supply your milk at a slightly cheaper rate to you?

David North: I cannot speak for what any processor has said. What I have heard them say is that, in a situation of some market volatility, whether that is to do with commodity prices or consumer demand, there will be pressures; there are pressures on a lot of businesses in a more difficult economic environment. What I think is absolutely true, however, when you look across the industry, is what the NFU have said; they would like to see more schemes like ours rather than fewer schemes. I notice that, previously, the dairy board chairman, Mansel Raymond, said, “I just cannot understand why more retailers and buyers of milk and dairy products are not showing the same level of commitment to their farmer suppliers.”

Q233 Chair: Can I just come back to what you said about the cost tracker? In your written evidence, you say that the guaranteed price for milk is independently reviewed twice a year, taking into account farm input costs and market prices. The most volatile aspect must be the fuel costs. In the middle of this price war, is the farmer actually having the costs of fuel, which must have gone up dramatically in the last year or two years, paid as part of the price. Mr Bloor?

Andy Bloor: We review it, as you say quite rightly, every six months, and because in January we felt that feed, fuel and fertiliser costs were going off the piste from where we expected them to be, we had an interim review, and we had an increase of 0.6 at that point. Then the whole issue of cost was reviewed again in March, predicting a price forward to March 2012, so we are now running with that price of 29.78p and that will be reviewed again in September, when actual accounts will be delivered to an independent body for the account year ending April this year.

Q234 Chair: Is that standard practice in providers other than Tesco?

Andy Bloor: No.

Q235 George Eustice: One of the things we have picked up in quite a lot of the evidence is a concern that although prices vary and go up sometimes at the retail end, that does not get passed on to producers. I know that your system that you have just described as a sustainable dairy scheme is very much focused on cost, but to what extent does the retail price influence the price paid to the farmer, or does it have no influence at all?

Andy Bloor: In the interim review that we had in January, where we had a small increase, the actual price to the consumer went down. Now, that did not reflect on our payment from Tesco. At the time when the system was set up, if we had based it on the cost of production, and cost of production went down as opposed to the market going up, which has not happened unfortunately—a lot are still paying below the cost of production for the price of milk—there would be a market element. So there was a market...
tracker to prevent that happening. We talk about price negotiation; it actually has got to the stage now there is that much trust it is not a negotiation: it is what the market tracker says or what the cost tracker says. We, as producers’ representatives, need to understand how that price is made up from things are actually happening in our own businesses and what other producers are telling us. We are totally insulated from what happens at the retail end or processor end.

Q236 George Eustice: But if, say, costs had remained static, and the price had gone up by 10p a litre, or the market price had gone up, how much extra could that farmer expect? What are the weightings in your formula, roughly?
Andy Bloor: In the first two years we were paid a market tracker over and above the cost of production, but as the cost of production has overtaken the market price, we are, at the moment, solely based on the cost of production. But should other farmers start getting paid more, and that goes above our average cost of production, then the market element will come back into it.

Q237 George Eustice: Yes. But in my example therefore, where costs are static, the market element is what determines the percentage?
Andy Bloor: It would vary on what our costs were in relation to whatever the situation is at that time.

Q238 George Eustice: Do you think the Commission’s milk package proposal would affect the share of the retail price that farmers receive? Do you think it would have any impact on that?
Andy Bloor: I think what producers would look to, and this was the difference prior to this scheme, is the ability to identify why their price was going up or why it was coming down, more importantly, or why it was static. The Commission in its proposals is trying to find something by which you can actually identify that and measure where the producer’s price should be. That would be a massive step forward for all the producers; that is why I think David has referred to the NFU and one or two more pointing to all the producers; that is why I think David has referred to the NFU and one or two more pointing to this scheme. It is very difficult to interfere in markets.

Q239 George Eustice: Leaving aside Tesco and your own project, is the distribution of value within the supply chain unfair generally in the dairy industry?
Andy Bloor: I think to expect them to operate below the cost of production is unfair.

Q240 George Eustice: Is that not what most, or a lot of them, are doing?
Andy Bloor: We have identified our costs and there are five or six other groups, consultants, on a regular basis declaring what they believe, whether it is the NFU or DairyCo, or different consultants—Kite and what have you. So it regularly, over the recent history, has come out that their cost of production, excluding the cost of unpaid family labour, has been, in the main, higher than what they have been paid. We have recently seen a few small increases, so, thankfully, it is going the right way.

Q241 Dan Rogerson: In terms of the pricing structure that you have got for working with the farmers, presumably issues like quality and the counts will affect the prices for individual farmers as well, so it is not just entirely based on the cost of production, there are other issues?
Andy Bloor: There is a set quality across the board to achieve the price, and then that is within the individual group. The individual producer will move a little bit in that, so as long as his quality is right, that will be fine, yes, and then he will get that price.

Q242 Dan Rogerson: If capital investment is required in some particular area to deal with an issue, or to do something, how would that be—
Andy Bloor: In the cost tracker, there is a figure for depreciation, that is right, of the investment.

Q243 George Eustice: Mr North, is this an approach that you would consider in other sectors of the farming industry for other suppliers? I mean, for instance, veg suppliers, things like that? Is it so successful that you think it could be replicated?
David North: Since 2007 we have extended it a little bit; as we have brought in more brands of milk and we have extended it to cream, for example. The question is often put whether we should extend this into cheese, and Andrew and I were having a discussion about that again yesterday. There are practical difficulties in respect of cheese, which derives from the number of dairy farmers, or number of milk producers in any case, who would supply a single cheese maker.

In terms of other commodities, when we set up this scheme in difficult circumstances in 2007, we were very much focused on the specifics of milk production, and I think the questions from the Committee have highlighted those again. This is not solely true of milk producers, but I think milk producers feel it to quite a significant degree, whether it is fuel cost increases that all producers feel, whether it is downward pressure because consumers are having a hard time, whether it is world price variations, or whatever. What milk producers told us was that they wanted the basis for long-term investment, and that the best way of doing that was to pay for the milk on the basis of a proper calculation of the cost.

Q244 George Eustice: What are the obstacles to doing it in, say, beef or something like that? I am just trying to get to the bottom of where its limitations are.
David North: There are two points: one is that the scheme, to pay for the cost of production, particularly fits the milk production sector; and secondly, there are practical difficulties when you look at the cut of a beef animal or whatever, or indeed dairy production, that would mean that it is more difficult practically to introduce a scheme like this.

Q245 George Eustice: Why do you think that other supermarkets have not followed this same model, given that it has been running for some time?
David North: I honestly think, and I am sorry if this sounds like a glib response, that you would have to ask them why. We found it to be a very good scheme, and it is very heartening listening to Andrew and to others talk about how it is a good scheme from the point of view of the producer as well.

Q246 Chair: Could I just be absolutely clear that your dedicated supply group supplying liquid milk is supplying liquid milk only? Are you treating prices for milk and for cheese products exactly the same, just in response to what you said?
David North: No. This is the supply of liquid milk.

Q247 Chair: What about prices for cheese products, milk that goes to cheese? Are they different suppliers? Are they subject to the same contract—the same price?
Andy Bloor: No. You have got the standard cheese, but also there is a massive range of regional cheeses that are made in small batches. So with this scheme, while we have never ruled it out, and, as David said, we have talked about it on a number of occasions, it would be a lot harder to be able to pull all those regional cheeses in under the umbrella. There are different costs with different cheeses, different areas, smaller amounts. So as things stand at the moment this scheme does not cover the milk for cheese.

Q248 Chair: So are they disadvantaged?
Andy Bloor: If you would try to reflect the price that they receive—I am talking outside the Tesco Group now—for milk is lower, but as opposed to trying to supply the liquid market with milk throughout the year at an even level, they can produce milk on a lot cheaper basis in the spring. Therefore, I suggest—I do not know, but I would suggest—they could probably operate at a lower cost anyway.

Q249 Chair: I am aware of the position of regional cheese, because obviously we do quite well out of them in Yorkshire, but what about commodity cheeses and suppliers of milk for commodity cheeses? Are they excluded from your arrangements, or do you have a separate arrangement?
David North: They are not in the scheme that covers liquid milk; that is true. You rightly highlight regional cheeses, territorial cheeses, to which we are committed: all our territorial cheese, by its nature, is from the UK; all our farmhouse cheese is from the UK. We have good long-term relations with regional and territorial cheese producers. I think you highlight the right challenge. Andrew has explained, and I have sought to explain, that it is more difficult to apply a scheme for the commoditised product, as it were, but we all have a challenge to make sure that more of the milk that is produced goes into those specialist, high-value product. This is not a zero sum game; the more that we can get more added value product, the better it will be for everybody in the chain.

Q250 Chair: Looking specifically at Tesco’s products, who sources milk for your commodity cheeses? Are they different suppliers?—do you remember that? Sorry, we promised not to do that, but that kind of cheese you are saying would not necessarily be sourced by UK milk producers?
David North: Well, all of our liquid milk obviously is from the UK—

Q251 Chair: No, no. Let’s park that on one side. If we just look at commodity cheeses, which Tesco sell quite a lot of and we like buying, who sources your milk?
David North: It depends what you mean by commodity cheese. Most of the cheese that we will sell as cheese in our stores—

Q252 Chair: Would it be regional? Cheddar?
David North: That will be regional, it will be farmhouse. Obviously if it is brie or whatever that is a continental designation and that will, by definition, not have been sourced from the UK. In terms of what you call commodity cheese that goes into processed products, etc, that will not all be from the UK.

Q253 Chair: So Philadelphia cheese, for example? I have not seen an advert for a long time, but “It is your birthday, isn’t it”—do you remember that? Sorry, we promised not to do that, but that kind of cheese you are saying would not necessarily be sourced by UK milk producers?
David North: In that specific example I would have to come back in more detail, yes.

Q254 Chair: Could you look at that, and could you let us know just in your Tesco stores what percentage of the market, whether we call them basic cheese or you call them processed cheese, it is for sales of cheese, and where you source the milk from? Just for the purposes of our inquiry, we would find that very helpful.
David North: Yes.

Q255 Thomas Docherty: Just sticking on the cheese for a second, as I think about my local Tesco, I struggle to understand why you do not have a similar arrangement for your Tesco’s own brand Scottish cheddar cheese as you have for the Tesco’s red, green or blue label milk that I buy 20 metres down the aisle. Why have you done this for liquid milk and not done this for Tesco’s own cheese?
David North: As Andrew has set out, it is more difficult to do it for cheese, not least because the milk that goes into the production of cheese will tend to come from in some cases quite a large number of milk producers. Where we have specialist cheese producers—as I have said, we do have long-term relationships with specialist producers—the aim there, rather than focusing on the cost of the liquid milk that goes into that production, is about the value of the product, increasing the sales of those products,
increasing the marketability of the products, and in that case everybody involved with that product benefits.

Q256 Thomas Docherty: You obviously have your own brands of Tesco cheese, cheddar and so forth, and you shift quite a lot of that cheese. We do not just see this inquiry as being about the bottle of milk or the packet of milk; it is also about the dairy farmer who is trying to sell cheese, and one other piece of evidence we have had very clearly in the last three or four weeks from farmers repeatedly is they actually do think that broadly there is not a bad system now for the liquid milk supply chain. But the cheese sector is nowhere near the same. All the stuff over the last three years, not just you, but Sainsbury, Asda, and so on, says that consumers are switching to own-brand products. I am struggling to understand why Tesco, as one of the biggest cheese sellers of own-brand cheese, has never done it, because my conclusion, quite frankly, Mr North, is that is because the media is interested in liquid milk but has not been paying attention to the cheese, and that is why you have not given the same support to dairy farmers who sell you milk for cheese as you have to those that sell you milk for milk.

David North: Yes. Well, at the moment we are I believe the only major retailer who operates a scheme like this in respect of liquid milk. If I understand the question, it is: why have we not extended a unique system into cheese? Again I come back to the difficulties of doing it in respect of cheese. We sell about 22.5 million litres of milk; one can predict that on a weekly basis. In respect of cheese production—and, again, Andrew is a lot more expert on this than I am—trying to set up a dedicated supply chain in respect of the milk producers for production of cheese in practical terms would be much more difficult.

Q257 Thomas Docherty: My understanding is that all four big players—well, all five including the Co-op now—have their own dedicated supply chains for dairy, do they not? I know that Sainsbury certainly do; I know that Asda do, and I think Morrisons do. The actual mechanism that you might use is perhaps unique to Tesco, but would it not be disingenuous to suggest the other three do not have a dedicated supply chain?

David North: I was focusing less on whether they have a dedicated supply chain. I was focusing on their pricing model within that supply chain.

Q258 Thomas Docherty: Okay, that is fair. Moving away from cheese, you will probably be aware of the evidence from Dairy UK, both the written and the oral evidence that they have given us. Do you agree with Dairy UK that the farm gate price for milk, and I assume they mean liquid milk in this case, is driven by the commodity markets?

David North: I think if you look at the statistics on that you will see a correlation between the average farm gate price for milk and commodity prices, yes.

Q259 Thomas Docherty: Yes, you would. How would Tesco accommodate changes within the commodity price when you are setting your milk supply contract?

David North: We have set up a scheme that is calculated on a different basis. Again, it came from feedback from producers when we set up the scheme, which is that fluctuations in commodity prices that then led to volatility in terms of the farm gate price for liquid milk were not a good basis for producers to make the sorts of investments that they wanted to make in order to keep either their production, or UK production as a whole, efficient and world leading. That is why we proposed, and have been supported by our producers, a different model, which focuses on the cost of production plus other costs that enable the producer to invest for the long term.

Q260 Dan Rogerson: I want to follow up on the discussion generally about how your scheme works and the effect it has for farmers who are within it. We still get, however, the evidence that comes back in terms of liquid milk about the retailer portion of the price that the consumer pays going up, the processor elements fluctuating a bit, and there being a sort of general decrease in the proportion that goes to the farmer. Are you saying that, if the liquid milk market operated on the model that you are describing here and everybody did that, you would see that change and we would get a better model? Are you saying that what you do takes you away from what is there; that Tesco do things differently?

David North: We do things differently. Our current price at the farm gate is 29.78 pence per litre, which includes I think half a penny for those who are in our cost tracker scheme. That is, at the moment, about three pence above the average price in the market. I think what it has done is remove some of the volatility that milk producers said made it more difficult for them to invest.

Q261 Dan Rogerson: I accept that. What I am getting back to is this issue of the three tiers of where the milk price goes. What I am saying is, would you expect that, if we were to look at Tesco and we had the figures available to us, we would see a very different trend? I appreciate this is relatively new in terms of the history of the market, but would we see a very different trend in that those three things would be shared out a lot more equally, and that therefore you would be the good guys and the other retailers that are not going down this model will continue to see the retailer proportion increase and the farmer proportion of the milk price decrease?

David North: The way I would see it is this, and I hope I am not repeating myself: if you look at it from the position of the dairy farmer, what they said they were finding difficult was that they had to deal with volatility, whether that volatility was—

Q262 Dan Rogerson: No, I accept the volatility. It is not the volatility question I am asking though. The question I am asking is about this issue of the proportion of the price that is paid by the consumer, and that there is still this trend, as DairyCo provided for us, which shows that the farmer proportion has been a downward trend, if you like, when you split it
three ways between retailer, processor and producer, and that the retailer proportion has gone up during that period. Are you saying that in your model, if we were to look at the Tesco liquid milk model now it is on this basis, that would not be happening?

David North: Yes. I think I am saying, and forgive me, that my point about volatility is relevant in answering your question. Mr Parish’s questions earlier were about the fact that retail prices had come down, and whether that was putting pressure on producers. Sometimes the argument is put the other way: that when retail prices go up producers do not benefit sufficiently from it. What I was saying is that we have a different cost model for producers; it gives them the opportunity to invest for the long term. If they are able to do that, we can then focus where I think we should be focusing in this country in terms of milk production, which is about how we can add value, whether it is through products or through the efficiency of production, and then that will be to the benefit of everybody in the sector.

Q263 Dan Rogerson: I am still struggling to see, though, whether you would argue that, once your scheme has bedded in over, say, over a decade, we would see that trend reflected differently in the proportion of where the money goes between the three people in the chain as distinct from where the rest of the market is. Because if that is true then I would say, “Great, this is something we ought to be advocating for everybody,” which is the crucial thing for our report. If it is not true then, while it helps with the volatility, we will still be seeing this issue that, while there are fluctuations in the market, the long-term trend is the retailers taking a bigger slice of the price.

David North: Well, I am not sure I would start with the premise that the retailer is taking a bigger slice of the reason that Mr Parish identified earlier on about volatility is relevant in this regard, that would affect the price of these imported products from the rest of the EU?

David North: There are so many points to consider in answering that. I do not think I could give you an answer, to be honest.

Chair: Okay. You could write to us on the first part, if you would, thank you.

Q269 Chair: How much do you actually import of dairy products that you sell? What percentage or proportion do you import from the rest of the EU?

David North: I would have to come back to you with a figure on that.

Q270 Chair: If the package proposed by the Commission was implemented, do you believe that would affect the price of these imported products from the rest of the EU?

David North: There are so many points to consider in answering that. I do not think I could give you an answer, to be honest.

Chair: Okay. You could write to us on the first part, if you would, thank you.

Q271 Neil Parish: I think you have answered some of this next question, and this is that the Commission’s proposals are that the contract should deal with price, volume, seasonality of delivery, and contract length. Do Tesco’s direct contracts fulfil all of that?

David North: I believe they do. Andrew?

Andy Bloor: The initial contract is with the processor, which covers seasonality and the quality and what have you, and then there is the other side, the commitment to Tesco. The proposals talk about terms of leaving and such like, and the price being declared in front and not being retrospectively cut is more than covered in the Tesco contract in relation to the scheme that they are proposing, yes.

Q272 Neil Parish: Can you explain exactly how the contract works? Being previously a dairy farmer, when the spring comes and the grass grows hopefully the milk comes forth relatively easily and relatively inexpensively. So at the moment you are offering a pretty good price, I would suggest, for spring milk. Under the contract to farmers, do most of them or all
Q273 Neil Parish: So basically if you produce more spring milk and less autumn milk and winter milk, will you not necessarily receive the 29.78 pence?  
Andy Bloor: Because you are producing it at slightly the wrong time. But, as I said earlier, you can produce that milk slightly cheaper, so the producer has got the choice.

Q274 Neil Parish: I accept that, but it is interesting that you supermarkets are a bit like politicians, aren’t you? You can also make headlines basically, because it depends naturally on the contract; you have to fulfil the contract, which is fair enough. On the contract itself, how long do dairy farmers have to stay in the dedicated supply group, and how easy is it to leave? I do not think they necessarily want to at the moment. That is another aspect of flexibility of contract.  
Andy Bloor: David has referred to the difficult times similar to those we are in now when the contract was first offered. There was a rapid increase in costs in 2007, and a lot of farmers were very reticent in signing. We had a period of nine months where they said, “Well, this is strange that a major supermarket should come along and want to change the system when the price of milk is slowly going up.” So, over a period of time, I would say six, seven, eight months, producers were offered the contract, and some declined, a small number, and the majority went with it. Those that declined, nearly every one of them, have since said, “I was wrong, could I join?” That has not been possible, because the volumes are fixed. We have got a situation with six months’ notice; the producer can leave within six months should they want to.

Q275 Neil Parish: What about the other way round: if Tesco did not want to buy the milk?  
Andy Bloor: Two years’ notice.

Q276 Neil Parish: I do not know whether other questions might cover it, but this is on the grocery food adjudicator, when he or she comes into play. Are you happy that your contracts will meet any of the rules that might pertain to that person?  
David North: I think that is probably for me to answer. We have not yet seen the detailed proposals on the role of the adjudicator. I think our position has been made clear on the record that we do not think there is a need for an adjudicator on top of the grocery supply code of practice, but we would have to wait for the details. I think they are due to be published relatively soon.

Q277 Neil Parish: Yes, of course, many of us do believe there is a need. It will be interesting to see. One final question, going back to the cheese market and the processed market, is it too cruel to say to you that really one of the reasons that Tesco and others, the big buyers, do not actually go into the cheese market is that you like to play the market and buy the cheese as cheaply as possible through the market system? And, of course, that is probably what is affecting the dairy trade and dairy farmers most, because while we welcome the amount—  
Chair: Could we keep the question short, please?

Q278 Neil Parish: Yes. While we welcome the amount of milk that you take out for liquid, of course there is still a bigger percentage of the milk that is actually processed, and I think that is a worry to us. So, as a farmer, are you pressing Tesco to go into that space?  
Andy Bloor: We have been having conversations with Tesco every six months, and we quite rightly identified that it would not be as easy, but that does not mean that it will not be done, and, as I say, over the last six months we have been in discussions about whether we could do it, and we will look down that route.

Q279 Neil Parish: So perhaps Defra should have helped encourage that?  
Andy Bloor: Yes.

Q280 Thomas Docherty: Just finishing off on the point about the group first of all: you have about 700 members at the moment. Am I right in thinking you have said that level is now capped, because you have got a fixed amount of milk that you need and that 700 can now produce it? Is that correct?  
David North: It reflects the amount of volume that we need. It has actually increased I think a little bit since 2007, so it is not capped on any statutory basis. It reflects the amount of milk that we can sell.

Q281 Thomas Docherty: What do you look for in suppliers, say farmers, to join your group? If, for argument’s sake, you needed another three farmers, what are the criteria that you would use for joining?  
Andy Bloor: I think that decision would probably, and David, correct me if I am wrong, be for the processor. The processor would look at their milk quality, seasonality, butterfat, somatic cell count, bactoscan, and I would guess that was how they would select. Possibly where they are based with regards to picking up a neighbouring farm probably would be another factor they would look at.

Q282 Thomas Docherty: One final question on the general group. Does Tesco put much investment, either through time or financial, into helping the 700 farmers to grow their businesses in, for example, the way that Sainsbury’s do?
**David North:** I think Andrew is keen to answer that.

**Andy Bloor:** The whole package: we talked about price and we talked about this confidence and commitment to long term, but there is a package where we have three working groups. One is looking at the environment, trying to reduce the carbon footprint; there is another one looking at encouraging the next generation; and the third one is animal health. The retailers invested considerable money in Liverpool University, and we deliver ideas to them—by we, I mean the farmers. Liverpool University is challenged with exercising due diligence and testing those systems, and then delivering them back to the producer. We deliver them back with workshops and annual conferences, where we have key speakers from within Tesco and from outside the industry, and we have regional conferences.

So there is an ongoing desire to drive individuals’ business, and we need to give them the tools and the measures of how they can improve their business, and where we are at the time. So you referred earlier to dedicated groups; the actual Tesco one is the only one that is actually dedicated in that the milk comes from the actual farm. The others work with a group of farmers, but not necessarily dedicated. So we have a dairy group or a development group. It is not absolutely cast iron that milk comes from those farms, whereas Tesco can say that milk comes from that farm. Tesco have invested a considerable amount of money over the four years in that side of it, in getting our businesses more efficient.

**Q283 Thomas Docherty:** Mr Bloor, when you join the production cost based contract, that obviously restricts your ability, I would imagine, to benefit from sudden global milk price increases. Is that a fair assessment?

**Andy Bloor:** No, because we have got the market tracker that would come into play. So if commodities moved up, or what other milk producers were receiving, that would reflect in the market tracker, and did do in the early stages of the four years.

**Q284 Thomas Docherty:** The Co-operative have argued in their submission, which, again, I assume you have had some sight of, that a prescriptive EU-wide approach to contract negotiation risks stifling innovation and efficiency. Does Tesco agree with the Co-operative?

**David North:** I think broadly, yes. I think that from talking to Andrew about his experience of being a dairy farmer and being at the sharp end of regulatory change over the past 20, 25 years or longer, I think a point I made to the Chair earlier was that legislators have to be pretty confident that what they are going to put forward is genuinely going to be beneficial and will not require a very rapid change that simply distracts or imposes costs on the producer. I found it very interesting, looking at both the written and the oral evidence before your Committee, that while a lot of your witnesses understand the reasons behind the Commission’s proposal in terms of reducing volatility, increasing confidence and so on, not all of them are sure that the specific proposal in respect of contracts will actually deliver that.

**Q285 George Eustice:** Coming on to the Commission’s other proposal, which is about encouraging producer organisations, and specifically allowing them to cover 33% of national production, what is your view of that? Is that the solution in order to give more clout to the producers?

**David North:** I do not know, is the honest answer. I think it is one potential route. I do not think I have a strong view on it, because we, as it happens, have taken a different route through our scheme, which is to have a dedicated supply chain approach, and we think that has delivered the sorts of benefits that the Commission wants to achieve, whether it is about certainty and confidence, or whether it is about some of the improvements in productivity, efficiency, knowledge and health that Andrew was talking about.

**Q286 George Eustice:** Do you think it would have an impact on the retail sector or, indeed, the dairy sector in the UK if that was happening in other European countries, and they were consolidating and becoming more competitive?

**David North:** I think if you had producer consolidation at that level it would have an impact, yes. What impact it would have on the arrangement that we have got for liquid milk I think is a different question, because we have a different type of arrangement.

**Q287 George Eustice:** But you would not then share Defra’s concern that this might undermine competitiveness by allowing them to have too much control of the supply?

**David North:** I think it is probably for Defra to take a view on that.

**Q288 George Eustice:** We have been told quite a lot that UK dairy producers should be looking at adding value to products. What scope do you think there is to go further down that route to help the industry by adding value to processing and things like that?

**David North:** I think potentially there is a lot of scope to do that. As you will know, we talk to a lot to consumers. A lot of their focus at the moment is on value. We introduced a new milk brand recently, where the milk is filtered so that it has a longer life for the customer. That has been attractive to customers. We introduced a new yoghurt, it is called Yoo Yoghurt, entirely supplied from UK milk. We have introduced that in new flavours. That drives up the value of the product, and in the end is to the benefit of the industry.

**Q289 George Eustice:** Why do you think the industry generally in the UK has lagged behind other European countries in this regard? Some say that others have been better at adding value.

**David North:** I think that is the $6 million question, because when you look at milk production in this country, when you look at a league table of efficiency, when you look at a league table in terms of productivity, then UK milk production comes out I think pretty well on any global comparison, with one or two exceptions. The long experience of the pain of
CAP reform probably has not yet set the industry up to benefit from that, but there just is a lot more to do.

Q290 George Eustice: We opened by asking you if there was anything further that Defra could be doing, and I know in your evidence earlier you talked about the importance of reducing the trade deficit in milk. Is there anything specific that you think Defra could do in that regard?

David North: I am speaking personally now. I think Defra has an opportunity to broaden its horizon and to look globally. One of the points that Andrew mentioned in respect of the work that we are doing at Liverpool University is about climate change and CO$_2$ emissions. We have taken the decision to put the carbon label onto our standard milk, which shows that there is 900 grams of CO$_2$ per pint of milk. We have done a lot of research into that. We have found with great interest that that is much more about the primary production stage of milk production, the emissions of methane, or whatever, from the cows themselves. Now, both in terms of reducing cost, in terms of UK leadership, in terms of reducing CO$_2$, that is something that Government can play a big part in alongside us.

Q291 Chair: Thank you. Could I just press you very briefly on the research and development investment that Mr Bloor referred to that Tesco have made. What tangible benefits do you think have reached the dairy industry because of the research and development you have done?

Andy Bloor: In the market or within Tesco?

Q292 Chair: Well, both. I mean, how does it impact on you as a farmer supplying Tesco?

Andy Bloor: We have seen a dramatic improvement with regards to herd health, and therefore that will be keeping the costs down on that side of it. The research that seems to be going on within the industry—I am probably being a little bit cynical—seems to be going round telling us how we can produce more milk and grow the crops better, whereas we feel that it should be going to the area of developing more products: niche markets, higher value. I think if you talked to the average producer they would say that the money that they give to DairyCo, which continually regurgitates past information, would be better centred on developing more markets and a better high-end product.

Q293 Chair: If you look at other innovations, like super-dairies, should it be the role of retailers? Should it be the role of Defra? Who should be responsible for explaining why that model could be innovative to the general public and the consumer?

David North: In terms of identifying opportunities for the industry and for the supply chain as a whole, I think that is a role that we should all share. Coming back to Mr Eustice’s question earlier, we have seen the coalition Government in respect of public health come forward with a responsibility deal. I actually quite like the idea—whether one calls it a responsibility deal or whatever—of Government departments, in this case Defra, identifying a question that cannot be addressed either by Government alone or by producers alone or by retailers alone, and saying, “What can we do to address that collectively?” I think that is a really exciting area, and a really exciting role for Government. When we look at the producers within our scheme, we still see a huge variation in terms of the cost of production—I think that is right Andrew—as Andrew was saying earlier, in terms of herd size. There is so much more that can still be done at each level of the chain, and we can absolutely work together on it.

Chair: I think that rounds up very optimistically the way forward. Thank you very much for being with us, and being so generous with your time and contributing to our inquiry.
Wednesday 18 May 2011

Members present:

Miss Anne McIntosh (Chair)

Tom Blenkinsop
Thomas Docherty
Richard Drax
George Eustice

Barry Gardiner
Mrs Mary Glindon
Neil Parish
Amber Rudd

Examination of Witnesses

 Witnesses: Rt Hon James Paice MP, Minister of State for Agriculture and Food, and Andrew Robinson, Head of Livestock and Livestock Products, Department for Environment, Food and Rural Affairs, gave evidence.

Q294 Chair: Minister, welcome. I apologise for the delay, which was partly because of our business and the vote. Thank you for your patience. For the record, would you like to introduce yourselves?

Mr Paice: I am Jim Paice, Minister for Agriculture and Food, and to my right is Andrew Robinson, head of our livestock division.

Q295 Chair: We are very grateful to you, Jim, for participating in this inquiry into the dairy industry. At the outset, would you like to outline what you see as the current challenges to the industry, and in particular how the present drought conditions are impacting on the dairy sector, in addition to other issues?

Mr Paice: I am happy to give the Committee some of my thoughts. I suspect that virtually all dairy farmers would agree that the fundamental problem facing the industry is the price they get for their milk. I have no doubt that is the origin of your inquiry. Behind that rather simplistic statement is a range of issues that need to be addressed, some of which are outside the Government’s capability. There is the issue of the quite divided marketplace. There are those who have dedicated milk supply contracts with particular supermarkets and who generally get the higher end of the price bracket, and those right down at the other end of the price bracket who sell their milk into, usually, some form of processing outlet—for example for basic cheddar cheese or even skimmed powder—and in many cases get 5p or 6p a litre less than the others, which is a dramatic difference, although that market has been much better recently. There are issues to do with the costs of production, competitiveness and a huge variation in the industry between those who are surviving at what are not particularly good prices and those who are not.

As you say, the more immediate issues relate to the weather. It depends very much on which part of the country you are in. It has been extremely patchy. I understand that the south-west is reasonably okay. The first cut silage has been early, which in itself is good. The sugar content is very high, so it bodes well for the quality of the silage in the winter, but clearly they need rain to get a second cut of silage to get the extra volume they need. Other parts of the country have suffered more and will face shortages of silage or possibly hay.

The other consequence of the drought is that there will be a serious shortage in the eastern cereal-growing counties of straw, which is usually then exported to the west of England to the livestock areas for the winter. I suspect that that will prove to be very expensive come the winter. Of course, this is on the back of a particularly hard, long winter over which cattle were fed. Feed stocks on farms are relatively low; they are not holding much winter feed from last year. Frankly, it is very mixed, so it is difficult to draw a single picture that encompasses a dairy farm in the east of England—there are still a number—right through to the south-west or up to the north-west.

Q296 Chair: Perhaps you would clarify one thing for us. We have conflicting evidence of whether or not there are systemic problems in the UK dairy industry.

Mr Paice: It depends on how you define the terms “systemic problems” and “the dairy industry”. If I talk about the dairy industry, I include the processing sector as part of it, but if we stick to the on-farm, milk producing side, I do not think there are systemic problems any more than in any other dairy sector—certainly across Europe. We have one of the highest average herd sizes and one of the most efficient dairy producing sectors. It worries me that, despite that, our dairy industry is finding life very difficult. We can grow better grass than any other country in the EU, but if we lose the market or processing sector and is where we have lost the milk producing side, I do not think there are systemic problems any more than in any other dairy sector—certainly across Europe. We have one of the highest average herd sizes and one of the most efficient dairy producing sectors. It worries me that, despite that, our dairy industry is finding life very difficult. We can grow better grass than any other country in the EU, apart from the Republic of Ireland, and we ought to be able to compete.

If you extend the definition of the dairy industry to the processing sector, which I personally would, there are some very real issues. Obviously, on the liquid side, we have very large buyers: the supermarkets, which clearly largely control the liquid market. There are only three major processors that bottle for those supermarkets, and obviously they have to compete with each other for those very substantial contracts. Arguably, there is some imbalance there. The processors would say that there is no problem; I am not sure I agree with that. In my view, we have a bigger systemic problem behind that with the rest of the milk, which is going into either the spot liquid market or processing sector and is where we have lost ground. We can all dispute or debate the reasons for it, but the fact is that 43% of our milk is going into processing and we should be doing far more than that.1 We are importing very large quantities of added-value dairy products—cheeses, yoghurts and that sort of thing—on which we ought to be competitive. I think the failure has been one of innovation, although that is improving consistently.

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1 See witness correction at Q298
and, more significantly, of investment in large-scale, modern processing plants. There are exceptions. Dairy Crest's plant at Davidstow in Cornwall is absolutely state of the art. It is a fantastic, modern cheese factory, and that is why Davidstow cheese is such a brand name. There are others—it is wrong to identify just one but it is a good example. Generally, we have not got high-capacity, modern processing plants and cannot compete in that sector.

Q297 Chair: In my experience, UK farmers tend to be terribly proud and independent operators. Is there more that we could do to encourage them to form co-operatives and come together in that way?

Mr Paice: I am tempted just to say, "I wish." I think the independence of British farmers is not unique to dairying; it is right across the piece of British agriculture, and partly because we have always had larger farm sizes. If you go back to the 1960s and 1970s when we first joined the EU, there was a massive number of very small farmers—what we might have called peasant farmers—across most EU member states. Our farms were smaller than they are today, but they were still multiple sizes larger. For that reason, there was greater incentive for them to combine as co-operatives, which is what they did. There have been so many attempts—I will not regale you with ancient history—by Governments of different complexions to encourage co-operation in this country. There have been some superb successes, but I am afraid the history is littered with a lot of co-ops that have failed. We now have two very successful ones: First Milk and Milk Link. As you know, Dairy Farmers of Britain collapsed a couple of years ago. Milk Link, which now owns a pretty modern dairy in Devon and a lot of other facilities, is paying a dividend to its shareholders. I think that is one thing farmers need to think about as a co-operative. It is their business, and they should measure its success not just by the price they get for their milk, which does tend to be a bit lower than some others, but also by their share of the profits. They are now getting a dividend. I understand that First Milk faced some financial challenges a year or two ago. It is getting stronger now. It has a new and very good chief executive, and is beginning to claw its way back into the market, but we have only those two.

Chair: I think we will return to this a little later.

Mr Paice: I am sure that we will.

Q298 Neil Parish: You have already answered quite a lot of my question, which is very much about adding value to milk. Dairy producers have been told for years to add value. I go straight to the last part of my question: what is Defra doing to assist the dairy industry to move from liquid milk to more value-added products to improve profitability?

Mr Paice: First, perhaps I may correct what I said earlier. Some 47% of our milk goes into processing and 53% goes into the liquid market—I got my sevens and threes the wrong way round. I have to face up to the fact that the powers of Government today are limited in this regard. Clearly, we are not able to set milk prices. Although there is still the relic of a basic intervention price for butter, it is extremely low—so low that it is frankly of little consequence. I am not suggesting that we should go back on that, but that is the situation we face. As Minister, I inherited the Dairy Supply Chain Forum that was invented by one of my predecessors, which tried to bring together all the sectors involved from the retailers through to the producers, and obviously the processors, the co-operatives, and the private and plc processors etc. I felt it had lost its way. I was not particularly inspired by the first meeting. We had a further meeting in January-February, and tomorrow I am to have a discussion about how we can engender far greater interest in it. I really do think it is for all the industry to share the issue that milk production is going down for no justified reason and we need to reverse that. It is obviously important for our own dairy farmers and also for wider economic reasons, but I think the industry has to share the problem. Some sectors of the whole supply chain have not yet accepted that there is a problem and say that eventually supply and demand will work themselves out. I think that if we wait until then, it will be too late for countless small dairy farmers. I am putting great store in this forum. I have reduced its size, although not in numbers of organisations. I have said I want only one person from each organisation—a senior director-level representative—to try to get some bite into it. I hope that the next meeting in June will take that forward, but it is a matter of persuading them—hopefully this Committee's inquiry will help in this—that the solution is largely in the hands of the industry. Ministers do not set prices any more. We cannot force farmers to co-operate, which is important. I and the Secretary of State have said many times that we strongly support co-operation and farmers working together as buying or marketing groups or whatever, but we cannot force them to do it.

Q299 Neil Parish: But is it just in the farmers' or processors' hands? Why are we falling back in the processing market compared with our continental partners? Is it the fact that supermarkets keep the price of their valued products like cheese and what have you low? They bid in the commodity market and keep low the price of a commodity cheese, for want of a better word, which is one of the major supermarket brands. Is there not more we can do there so it does not go down to the lowest common denominator? For instance, will the food adjudicator be able to do anything about that?

Mr Paice: I do not think that there is anything we can do to stop supermarkets wanting to stock low-priced cheeses, and they will shop around for that. It is not something against which we should particularly argue.

Q300 Neil Parish: But it drives down the price, does it not?

Mr Paice: It does, but the problem is that we are not able to compete. You say that it drives down the price. It does, but at the same time some of that market is being filled by countries that pay more for their milk and they are still able to compete. It is not just the price of milk—that was the point of my earlier comment—because there are countries in Europe that...
pay farmers more for their milk and then undercut us in the supermarkets. That is where we are losing out. In my view, we have not had investment in the processing sector. These processing factories have to be very large with a massive economy of scale. It is true that mainland Europe is a better location than the UK because it is not just for the UK market. Having said that, Müller came here 20 years ago and built a superb plant in Shropshire, and it is continuing to expand while paying a reasonable price for its milk. Therefore, that can actually happen, but we need investment in major processing kit. You asked about the adjudicator. I do not think that it is directly a matter for the adjudicator. The adjudicator’s job will be to monitor the grocery supply chain code of practice, which is all about the terms of trade. He will not be able to say, “You’re not paying enough,” or interfere in margins or the pricing mechanism.

**Q301 Richard Drax:** For years, all farmers have been told to add value. It is one thing to be told it; it is quite another for most farmers actually to do it. It is cost intensive and expensive. Money is very hard to get. All kinds of impositions are placed on farmers: nitrate zones; lack of capital grants; and the high tax that business men face. There are lots of things that are within the control of the Government to help the dairy industry generally. I am sure that you acknowledge that most farmers—I think the average herd is 113 cows—simply will not have the clout to add value. There is a co-operative element here, but you well know that farmers are not very good at doing that.

**Mr Paice:** I hope that I did not give the impression that I was talking about individual farmers adding value. Some have been very successful with their own ice cream, artisan cheese or whatever, but that is not an opportunity open to most. I was not suggesting that. I think that the co-operative approach is the way you get the investment. When First Milk and Milk Link were set up, I know that there was a lot of resentment among farmers about having to buy shares and things like that, and there was the obvious tragedy of those who lost a lot of money when Dairy Farmers of Britain went down. However, Milk Link is now delivering a dividend—it is working. It has made some big investment in processing plant, and I think it is beginning to work out after a very long period of difficulty in the industry. I do believe that is the right way forward, but it is not for every individual to set up his own plant. Clearly, that is out of the question.

**Q302 Amber Rudd:** Do you share the NFU’s concern that we are losing critical mass with the dairy industry? Is there a point at which you see production continue to fall. It has increased. The tipping point?

**Mr Paice:** My primary concern is to try to get the industry back into where an efficient producer of any size can make a profit in the marketplace. That is why so much of what we are doing aims at those areas that the Government can influence: trying to help them to drive costs out of the business and to become ever more efficient.

**Q303 Amber Rudd:** Is there a point at which you would want the Government to get involved in any way if the number of dairy farmers who left the market continued?

**Mr Paice:** I do not think that I can give you any threshold figure, if that is what you seek, as to the point at which the Government intervene.

**Q304 Amber Rudd:** The tipping point?

**Mr Paice:** Basically, the situation is that increasingly the Government do not intervene in the agricultural marketplace, and I do not really envisage that situation changing. The number of dairy farmers has fallen dramatically over the past 15 years or so, but while the actual production of milk has gone up, it has been by nothing like an equal proportion. Indeed, in the past 12 months, it has picked up a bit.

**Q305 Tom Blenkinsop:** Earlier you said that there was no investment in the processing sector.

**Mr Paice:** I did not say none, but it is inadequate.

**Q306 Tom Blenkinsop:** In order to try to help the dairy market and also dairy exports, you want to drive out costs. Do you think that the rise in electricity and energy prices in general is going to help the dairy industry and increase exports?

**Mr Paice:** Of course, rising energy prices do not help any industry sector apart from energy, but somebody famously said you cannot buck the market. Energy prices are rising, I think the counter to it is to reflect on the role that dairy farming and other sectors of agriculture can play in the renewables market, and the Government’s current review of anaerobic digestion and the incentive of feed-in tariffs for AD plants is a factor. It could well be of value to a number of dairy farmers. Some are already making an investment; others may wish to, and to use their own slurry and other materials. I think there are ways they can balance out some of their energy costs. Last week I launched the dairy industry’s action plan to implement the road map on being greener as a sector, and a lot of that is about seriously reducing energy consumption. Dairies do use a lot of energy in their electrical equipment for cooling and things like that, but there is a lot they can do. Again, there are pioneering investments.

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3 Note by witness: This should be 500 million litres.
farmers who have really worked on that, although others have not.

Q307 Tom Blenkinsop: Of course, when we purchase equipment or recapitalise so that less energy is used, there are capital allowances. How do you think the reduction in capital allowances will affect the dairy industry and also dairy exports?

Mr Paice: I am not going to be drawn too far into Treasury and tax issues. Obviously, the Government face very difficult decisions. The Chancellor had to make some changes, but there are still serious tax allowances.

Q308 Tom Blenkinsop: But do you think it will increase exports or not?

Mr Paice: Exports?

Tom Blenkinsop: Yes—or help the dairy market in Britain per se?

Mr Paice: Of course, increased tax allowances will encourage short-term investment. Alternatively, you could argue that Government grants would do it, but the reality is that today the Government are not in that flush position where we can necessarily be generous, either in allowances or more Government grants. There is money available. The Rural Development Programme for England still runs. We are bringing it back in-house. It can make grants towards energy saving. It is a feature of RDPE. If farmers want to invest in it, they can make an application, so there are grants available.

Q309 Chair: Are you concerned about the trade deficit, which is more than £1 billion a year?

Mr Paice: I am concerned about the trade deficit right across the food sector. Clearly, there are lots of foods we want and will continue to import, but we see agriculture and the food industry—not just dairying—as a growth sector where there are lots of overseas markets to which we could increase our exports.

Q310 Mrs Glindon: Will the implementation of the European Commission’s milk package proposals help to stabilise dairy farmers’ incomes? 

Mr Paice: There is a lot of debate over the answer to that question about the package. We are broadly in support of it. I do not believe that it will make a dramatic difference, but clearly there are bits that might well help. The key areas relate first to the issue of contracts, where the Commission is proposing that individual member states should have the power to make contracts between their milk producers and processors compulsory. It is stipulating precisely the issues that should be in those contracts; it is not stipulating the detail. For example, price should be covered in the contract. It does not stipulate what price, formula or anything else—simply that the contract should cover price. That is the big one, but there are others such as volume as well. We are relatively open-minded about this. If it goes through as we currently see it and member states are allowed to make contracts compulsory, we will consult the industry and others over it. I am pretty dubious, frankly, as to whether it would make the difference that I know the NFU believes it would make. I do not think it fully appreciates how little information could be forcibly put into the contract. Most British dairy farmers already have contracts. In a lot of other countries it does not apply, but most British dairy farmers do. Farmers will complain about those contracts—they will say they are locked in to a particular price, cannot get out and have to sell to an exclusive processor—but that is the nature of contracts and it is not unique to the dairy industry. I know that a lot of producers in the fresh produce world are locked in to one supermarket that will not allow them to sell their lettuce or whatever to another one, so this is not unique to the dairy sector. We are supportive of the overall package and trying to make it work—there are one or two other areas to which we can come back, if you wish—but on contracts, which most people see as the major part of the package, we will consult the industry if we end up with the obligation to make them compulsory. I do not share the industry’s optimism that it is the panacea to some of their problems.

Q311 Mrs Glindon: In spite of what you have said, do you think the package could make our dairy industry more competitive relative to the rest of Europe?

Mr Paice: It could if the farmers want to take the opportunity. One of the other issues in it is that it is said in the proposal at the moment that producer groups—co-operatives, if you want to call them that—could take over up to 33% of the national market. We think that is a bit high; we believe it should be 25%, more in line with other competition law. There are some who think it should be 50%. I do not know where it will end up, but—and this is the big but—in the UK, the maximum market share of each of those two co-operatives is about 10%, so we are far short in the UK whether the limit is 25%, 33% or 50%. When the industry asks why I object to 33%, I say that when it gets to 24.9%, it should try to persuade me that it should be 33%. It is 10% at the moment. That is where the opportunity is. If our producers got together and formed bigger producer groups, whether they were based on existing ones or were new ones, so that they started to have serious clout in the marketplace, up to whatever percentage is finally agreed, that would be when they would be able to make a real difference to their own welfare and developing exports or whatever, and to generate income for investment in processing. However, I am afraid it is for the industry to come together.

Q312 Mrs Glindon: The Commission argues that the milk package proposals would enable the whole dairy supply chain—down to retailers—to benefit from greater transparency. Do you agree with that assessment?

Mr Paice: Yes, we strongly support the transparency proposals—very much so.

Q313 Mrs Glindon: Do you think that the lack of transparency is a disadvantage?

Mr Paice: Yes, it is.
Q314 Mrs Glindon: Finally—I feel like this is an interrogation on the milk package—do you think that if there was more transparency in the dairy supply chain, it would help us to be more comparable with other dairy and agricultural sectors?

Mr Paice: Yes. I think transparency is an excellent tool for comparison work, and therefore for benchmarking to see how well you are doing compared with another industry. Transparency about stocks is also very important because the level of stocks can influence price, and therefore if the stock levels that exist are transparent, it is easier to read the market. I think there is a lot to gain from transparency, so we support it.

Q315 Chair: How can we achieve that transparency when there is a shroud hanging over confidential information such as price? How would you like to achieve transparency?

Mr Paice: If I may, I would like to ask Andrew to fill in some detail about precisely what the Commission is proposing on the subject, but clearly there will always be commercial constraints on transparency.

Andrew Robinson: What the Commission is proposing on transparency is very specific. It is saying that information about the volumes of milk delivered from producers to the purchasers of the milk should be conveyed to the Commission so that it has a picture of what is being produced by individual member states, which will help particularly in knowing how production in individual member states compares with those threshold limits to which the Minister referred.

Q316 Chair: I am not sure I understood what you were saying. Just for clarification, you said that certain continental countries were paying their farmers more for their milk, but that they were going on to undercut our farmers—?

Mr Paice: No, not undercutting our farmers but undercutting our processors. In other words, they can sell their cheese to our supermarkets cheaper than we can.

Q317 Chair: Is that allowed? Is that not state aid?

Mr Paice: No, there is no state money going into this.

Q318 Chair: This is purely the producer organisations.

Mr Paice: Whether they are producer organisations or private sector organisations, it is just efficiency of production. It is to do with their processing or manufacturing costs of their cheese, if you like.

Q319 Chair: I just wondered whether countries like Denmark might possibly give a little marketing money to their milk producer organisations.

Mr Paice: You would know more than I do about what the Danes do. If they are doing that, clearly it is state aid.

Q320 Chair: I just wondered. If it is a level playing field, there is no problem.

Mr Paice: We are not aware of any.

Q321 Neil Parish: I take you back to the co-operatives. You made some interesting comments about how, if the co-operatives grew, you would look at them again. Under the previous Government, when Milk Mark had 37% of the milk, it was broken up by the Office of Fair Trading because it was said that they had a monopoly. I never believed it did have a monopoly, because Arla in Denmark has most of the Danish milk and is still not considered a monopoly because of the European market. It is all very well when they have got 10% or 11% now and get to 20%, but do you see a cut-off point?

Chair: We are coming to co-operatives in a moment, so do not feel that you have to expand too much at this stage.

Mr Paice: It does not apply just to co-operatives. Our view is that under general competition law in this country—it is still largely a national issue—market share of about 25% is a pretty dominant position. As far as concerns the dairy package, we do not think there is justification for an exceptional rule for agriculture in terms of competition law, and that is why we would prefer the 25%.

Q322 Neil Parish: So is Tesco over-dominant at 32%?

Mr Paice: I am not going to be drawn on that.

Q323 George Eustice: I want to return to the issue of contracts that you just mentioned. Correct me if I am wrong, but I detected perhaps a slight softening in Defra’s position. There is certainly a nuance between what you said and what we had understood previously. You said you were open to the idea but that you did not necessarily think that it would help that much, whereas previously we have seen on-the-record stuff from Defra saying that it could actually be detrimental and stifle innovation in the industry. Has there been a slight move in your position?

Mr Paice: Like so many of these things, as to what would be in the contract, the devil is in the detail. As the Commission’s proposals are today, I do not think that they would particularly stifle initiative. Do not forget that these proposals have been changing so, like with all things, you have to respond to the latest situation. Part of the root debate with the NFU is that the detail that is allowed to be put into the contract is now very limited in the Commission’s proposal. The proposal simply says that member states may make contracts compulsory or not. The contracts aspect of the proposal stipulates that when they are made compulsory for all deliveries from producer to processor, they must be made in advance and written—something with which we would agree—and include price or formula, volume, timing of delivery and the duration. But it does not lay down the detail of how you arrive at the price; it does not lay down the duration—it could be a week, a year or whatever. It would be up to the individuals to sort that out, so in that respect it would not be stifling initiative. Earlier it was thought that some of the terms of the contract would be laid down at national or European level, which would be very stifling. As to whether I am softening the line a bit, I want the dairy industry to be helped by this package. Although the Government are
pretty sceptical about the value of the contract, I have said publicly that we will consult the industry if this is where we end up. This is a European matter and none of us ever knows what it will end up looking like until the process is over, but if we end up with member states being able to make contracts compulsory, we will consult the industry on that.

Q324 George Eustice: To press you, do you not oppose the principle of having a compulsory contract? Do you not even oppose those elements being in it? Mr Paice: I do not like the idea, but if it could really help the industry, I am open to persuasion. I cannot speak for the whole of the Government. It is one of those things where, if we get to that stage, the Government as a whole would have to consider it.

Q325 George Eustice: Do you oppose the principle that there must be compulsory contracts? Mr Paice: I think all farmers should have contracts with their suppliers. The fundamental problem is that virtually all British dairy farmers have contracts and most cover these issues. They cover the form of price, how much it is and the duration.

Q326 Chair: Is the Commission seeking more transparency? Do you think that is what lies behind it? Mr Paice: I do not think so. Some countries do not have contracts at all, so there is no doubt that this would be a dramatic step forward for a lot of member states, but not for us. The debate is about how far the Government or Commission go in laying down what is in the contract. As we read it, if we did make it compulsory—that would not make much difference because most of them have them—we still could not say, “You must arrive at the price by x formula,” or, “The contract must be so many months long.” We would simply say, “There has to be a heading in it—price—and it is up to you and your processor to haggle over how that is to be set,” which is where we are today.

Q327 George Eustice: You would not favour something under which there had to be a consistent formula throughout which the price was arrived at. The NFU told us that sometimes farmers were trapped in contracts whereby they were forced to supply just one processor for a long period of time with no guaranteed price, and without even a predetermined formula for arriving at the price. You can see why that situation could create a very anti-competitive system: you have a processor with all the clout and a supplier who is locked in but with no negotiating position whatsoever. The problem is that farmers just become price takers. If you had a very clear formula to arrive at the price, or at least one that was set down, it would be a step forward, would it not? Mr Paice: It would be a step forward if that was in the contract, but if you are suggesting that the Government should lay down that formula, that is the Government going straight back to fixing prices, which we moved away from six years ago and would be counter to other EU legislation. It would be outside the green box and back in the red box in World Trade negotiations as well. I do not really see that as being on. If I may say so, that is the weakness of the Scottish proposal. NFU Scotland has come up with a formula that it thinks should be adopted across the piece. There is nothing to stop individual farmers and processors from adopting that formula, but I do not think that there is any way it can be imposed.

Q328 Chair: Is not the issue at the moment that the NFU is concerned that under the present contract the price can be changed retrospectively? Would you welcome EU law in this regard? Mr Paice: What is interesting on this one, because we have not seen the legislation—I am afraid I do not know the answer to it—is where the interface will be with the grocery market adjudicator. One of the key points in the Competition Commission’s report that gave rise to the new code and the adjudicator was to do with issues like back-dating changes to the contract, retrospective price changes and things like that. The Competition Commission accepted that that was wrong, and we anticipate that the adjudicator will have a say in that. That related to contracts with supermarkets as an example in terms of the retailer as opposed to the middle man—the processor. However, until we see the legislation—it is not our Department but BIS—we do not know, but we are in the realms of what the Competition Commission says is wrong in terms of a contract with a retailer. There is a bit of a read-across there. My personal view is that it should equally be wrong. I do not think you should ever have retrospective changes to a contract. I think you sign a contract and accept it.

Q329 George Eustice: I am not a huge fan of prescribing either. As a Conservative, freedom of contract is a very important thing. I pressed the NFU on this point and asked why it did not publish a standard contract saying what the terms should be and then get all of its members to say that that is the contract they are adopting as of next year and move things that way. I said that it had tried that but it was warded off it because of competition law—it was told that this would be an anti-competitive attempt to form a cartel. It was warded off doing something as simple as that. It seems to me that we have double standards where we allow huge power to be concentrated in the hands of retailers so that they have clout and in the hands of the processors so that they have clout. They then have powerful negotiations between one another but, at the other end, any attempt by farmers to come together in the way you have just advocated is kyboshed and they are told it is anti-competitive. Mr Paice: I am not sure I can really comment on that. I was not aware that they were told that it would be anti-competitive as a cartel. Off the top of my head, I cannot understand why. I am not sure I can make a cogent response.

Q330 George Eustice: That is my memory of the NFU’s evidence. Perhaps that is not so. The final point it made was that there was legislation to protect consumers for the very good reason that, unlike most businesses, consumers are quite often in a less informed, weaker position. Therefore, we have judged
that it is important to have consumer protection legislation; in fact it is quite often Conservative Governments who have pushed that forward. The NFU says that the same principle should apply when you have smaller retailers who lack clout in the market, and that is the principle of having more prescription in terms of what the contract should include.

Mr Paice: I thought you just said “small retailers”. Do you mean small producers?

George Eustice: Small producers, yes.

Mr Paice: I can follow the argument. If we were one of the countries in Europe where nobody had contracts, I might take a different view, but virtually every dairy farmer in this country does have a contract. There is an issue about how much they can work together, but despite what the NFU apparently said to you about its contract—of course, it would be a cartel if they got all their members to sign it—if it got 20% to adopt it, as I read it, that would be permissible within competition law. Maybe the fault was that it was trying to get everybody to do it, but there is absolutely nothing in competition law today to stop up to 20% or 25% of dairy farmers from working together as a cohesive group and demanding the price they want.

Andrew Robinson: It is around that figure.

Q331 George Eustice: For instance, if the legislation did not prescribe the exact formula for arriving at the price but the NFU did for all its members, would that still be a breach? Obviously it would still require its members to take it up and run with it.

Mr Paice: I would not pretend to be an expert on competition law. I can see that if the NFU was trying to encourage all its members, which would be 70% or 80% of milk producers—I do not know the figure but it must be in that sort of area—it could be argued that that would be an attempt to form a cartel because it is such a monopolistic situation.

Q332 George Eustice: You said earlier that most of the contracts already had a clear formula for price, duration, termination and those sorts of issues. What percentage do you think do? Have you made any estimate of that?

Mr Paice: I do not know. They are confidential.

Q333 Barry Gardiner: Our briefing said that although most UK dairy producers had contracts, most of them did not include price or volume. Your remarks seem to contradict that. I just wonder whether we have any way of knowing whether your briefing or ours is right.

Chair: Is not the issue that they are confidential?

Mr Paice: Of course that is a factor. I defer to Andrew, but it is one of the things that farmers complain to me about. That is my understanding. I have been to a number of big meetings. I can think of one a couple of months ago where they all complained that they were tied into a price and contract for 12 months. The fact is that the milk price should have gone up a lot, but it has not and they are tied into the old price. That implies to me that the price and the duration were fixed, but—

Q334 Barry Gardiner: I thought we heard in a previous session that it was not so much tied to a fixed price as to an amount over the cost of production.

Mr Paice: Yes; there might be a formula.

Q335 Barry Gardiner: I say that just for clarity.

Mr Paice: Yes—price or formula.

Q336 Barry Gardiner: Absolutely. I agree with your earlier point that the virtue of a contract is that both parties get a degree of certainty and that is why you should not do anything retrospectively. Equally, if you signed up to a contract where you thought it was a reasonable premium over your costs of production, you should not then moan about it. It is a contract and it is certainty on both sides.

Mr Paice: I would not disagree with that.

Q337 Barry Gardiner: If Defra decided not to make written contracts compulsory, what incentive would there be for processors to include the elements of price and volume in their arrangements—let me call them “arrangements” if they are not written contracts?

Mr Paice: I cannot see why a producer would say, “I’m going to sell you all my milk but have no idea what you will pay for it.” If you say that there is no written contract, that would be effectively what they would be doing. If we were in a country where there were no contracts, we might take a different view.

Q338 Barry Gardiner: If we go to the nub of the decisions that you have to make here—I accept that you do not control this market, but there are decisions that you have to make in respect of what Europe has recommended here—you seem to be saying that most do have contracts and most seem to have a formula or price mechanism that is delivering, and that you do not want to interfere in the details of those contracts, but that whether or not they are compulsory, you are glad they are there.

Mr Paice: Yes.

Q339 Barry Gardiner: What levers do you have as Minister that can improve the situation for the producer? What can you do? We know that you have a decision to take about whether or not it is compulsory and whether it should include price and volume.

Mr Paice: If there is a compulsory contract, price and volume will have to be in there—or a reference to it.

Q340 Barry Gardiner: So what can you do? Do you have any lever that you can pull in and around this issue that will make a blind bit of difference to the farmer?

Mr Paice: I think that you know the answer as well as I do, Mr Gardiner: not a lot.

Q341 Barry Gardiner: That’s not what you used to say to me when you were on this side.

Mr Paice: As you are learning, that’s the joy of opposition—irresponsibility.

Chair: That is now written into the record.

Mr Paice: The reality is that we no longer fix prices, and nor should we. I do not have weapons
I am afraid I am not a competition lawyer and I do not feel able to comment on that.

Mr Paice: If I may say so, I think that there are two or three separate points here. The first point—I hope that I have not confused the Committee—is that the role of the adjudicator and the grocery supply chain code of practice is between retailers and their suppliers, so strictly it does not affect the dairy industry. Even if the milk producer knows that his milk is part of a dedicated supply chain to, say, Sainsbury’s, his contract is with the bottler, not Sainsbury’s. Therefore, strictly it does not apply, and I would not want the Committee to be misled about that. However, there is obviously a huge similarity in the situation. It is quite clear from the report of the Competition Commission and the code of practice that some of the practices adopted by supermarkets of retrospective price changes and changes to terms of the contract are deemed unacceptable in that context. I think it is reasonable to read across. We have not seen the legislation that BIS is drafting. Although, as we understand it, the power of the adjudicator will not directly affect the relationship between a dairy producer and a milk processor, I think it is reasonable to say that there will hopefully be a spin-off or spillover—however you want to describe it—of the principles that are being adopted at that level. As I understand it, third-party complaints will certainly be possible. If a dairy farmer believes that the contract between the processor and supermarket is disadvantaging him, he will be able to complain to the adjudicator. We have to be clear that the adjudicator will not have a direct influence over a contract between a milk producer and a processor, but I think there will be a spin-off.

The second point is about the word “retrospective” that all of us have used. In my view, that is clearly wrong. Another issue is that it is retrospective in terms of the date of the contract, but quite a lot of producers will have a contract that allows the processor to change the price—in other words the price is not fixed. It is not retrospective in terms of milk that has been previously delivered, but in terms of the duration of the contract. In other words, you sign a contract that says that the price is 25p a litre, or whatever, but the processor has the right to change that at any stage. I paraphrase, but that is what I am saying. We can argue about whether or not that is retrospective, but, to pick up Mr Gardiner’s point, it provides no certainty to the producer.

Q344 Chair: To turn to Mr Eustice’s point, what is a little concerning about the NFU producing a template contract for its members to abide by is that the evidence it gave us was that, as a trade association, it was bound by competition law not to bring together individual undertakings—individual farm businesses—to do something that might constitute a cartel. The question is how we can get round this.

Mr Paice: I am afraid I am not a competition lawyer and I do not feel able to comment on that.
Q345 Chair: I cannot believe that it would corner such a big part of the market given that there are other sources, but you might want to think about it and write to us.

Mr Paice: We can certainly ask our lawyers to produce a note on it.

Q346 Chair: I am still not clear about which aspects of UK or EU law it is frightened of breaching, if it would help individual contractors.

Mr Paice: I will write to you because I am afraid I do not have the knowledge to answer that.

Q347 Neil Parish: Earlier, when I asked about co-operatives, you talked warmly about the need for more co-operatives of dairy farmers. What is Defra doing to facilitate that?

Mr Paice: It is exhortation, frankly—it is the only instrument we have. As far as we know, there are no legal or other obstructions. To go back to Mr Gardiner’s earlier jibes, before the election I looked very carefully at it. There are some issues about co-operative law that ought to be modernised to do with shareholdings, voting rights and retained profits, but I do not think that they are serious enough to discourage people from forming a co-operative—it is simply a case of whether they can be persuaded to do so. If there is evidence to the contrary, or if the Committee comes to the view that there are things that we should be doing, I would obviously be delighted to know that. However, to the best of my knowledge, there is nothing to discourage or prevent farmers from working together as a co-operative, if they so wish.

Q348 Neil Parish: One of the solutions could well be to have a big co-operative and processor in the dairy industry to try to help with the overall price. You have 10% or 11% for the two co-operatives at the moment. If they combine together, that takes it to 20% to 22%, so if they are successful, it is not too long before they get to the 25% threshold. I am not going to let you off the hook. If a national retailer has 30% of the whole retail trade, in your eyes that is not a monopoly, but I am afraid I am going to duck that question; it is for them to decide.

Q349 Neil Parish: But if they combine.

Mr Paice: If they were to combine, yes, the issue might arise. Do not forget, on that subject, that the last time they discussed merging, the Office of Fair Trading agreed to it. They decided not to pursue it, but it was agreed. As far as concerns Tesco, you will know that competition laws are applied by the Competition Commission and the OFT, and they have to decide the way forward. But my understanding is that you are comparing a bun with an apple inasmuch as we are talking about a single commodity—milk—whereas your 32% of the total grocery trade, or whatever it is, is just that: the total grocery trade. Therefore, the issue that the competition authority would look at would be what percentage it had in a commodity or particular sector rather than the whole retail group. That is my understanding of competition law, but I stress I am not an expert in competition law.

Neil Parish: I still do not accept the situation, but I understand your answer.

Mr Paice: I understand your question.

Q350 Neil Parish: We have two farmer-owned co-operatives at the moment that almost compete against each other. You could argue that that keeps the price down rather than drives it up. Therefore, ultimately, is the solution a bigger farmer-owned co-operative that could have a benchmark and a base price in the market that helped to produce that?

Mr Paice: I do not wish to see a headline in the farming press saying “Minister urges co-ops to unite”. I am afraid I am not going to duck that question; it is for them to decide.

Q351 Amber Rudd: The NFU has proposed some amendments to the Commission’s proposals, such as the use of independent facilitators. Are you arguing with the Commission for their inclusion? I am taking us back to the producer organisation proposals. The NFU has proposed some amendments to the proposals, including an independent facilitator. I wondered whether you would be pushing that case.

Andrew Robinson: It is not a point we have argued. I presume that it is for the facilitator to help a producer organisation to negotiate the sale of their milk with a buyer. If that is the case, it is not something that we have argued for.

Mr Paice: Are we aware that it was pushing for it?

Andrew Robinson: We have been asked whether we would make help available to assist organisations to improve their negotiating abilities, specifically in relation to RDPE funding. What we said was that in terms of the direct employment of negotiators, we did not think the programme allowed us to provide direct help. That sort of help does not seem to be eligible under the present rules, but it might be possible to give help for the employment of consultants to help with that process.

Q352 Barry Gardiner: We heard from Christine Tacon—you adverted to this when you talked about liquid milk not being exported or imported—that by and large we could produce for our liquid milk consumption—we are self-sufficient in that.

Mr Paice: Yes.

Q353 Barry Gardiner: But there might be sense in treating all the rest—powdered milk and so on—as part of the commodity market and, therefore, not producing so much milk within the UK. I think she argued that very rationally on good economic grounds, but what she did not mention, which is why I want to give you the opportunity to counter it, in effect, was...
the impact that that would have from Defra’s point of view on landscape, biodiversity and countryside management.

**Mr Paice:** I am familiar with the case that you relate. I come back to your specific point. I would say that there is an economic argument as well. If you accept my earlier assertion that we can produce milk more competitively because of our good climate and grass growing, in theory we ought to be able to turn it into a retail product at a price the consumer will pay and that will be competitive—that makes economic sense to me. Therefore, I think it would be bad for the economy if we accepted Christine’s philosophy. However, you are absolutely right to move on to the issue of what we would do if we did cut our dairy herd by close to 50%, which would be the consequence of that if we let it happen. It would not be a decision; it would happen through the marketplace. The big question then is: what would be the replacement land use, assuming that most of those producers are stuck with grass and are not in areas where they could convert? If they could convert to arable, I am sure that they would, as many already have. Others, obviously, would look at other grazing stock—beef and sheep—and some may well turn over. It is difficult to be specific about whether they would alter the biodiversity of the landscape because it would depend so much on the farm and what alternative enterprises were available to them. You may find in some parts of the country—I think we will begin to see this—an increasing growth of energy crops, for example miscanthus on very poor land, which feed-in tariffs will encourage, and perhaps short rotation coppice on wetter lands. It is very difficult to draw a conclusion. Some might say that the land would not be farmed at all—I do not accept that as an argument—which would be advantageous for biodiversity. I think it would be farmed in some way or another. I take the view that a mixed, varied landscape is good for rural tourism. It is what the public want to see, but I also think it is good for biodiversity. In terms of biodiversity, a monolithic landscape—whether it is grain, grass or anything else—is not the best environment.

**Q354 Barry Gardiner:** In a debate in European Committee A, you said that “the share of the retail price taken by the retailer has declined.” Do you consider that trend fair or sustainable?

**Mr Paice:** No.

**Q355 Barry Gardiner:** Do you consider that the farm gate price of milk should be more closely related to the retail price?

**Mr Paice:** I do not want to get into a debate that could be construed as wanting to fix a formula, but I think that the producer deserves a share of a retail price increase. Obviously, there are other factors that cause a rise in retail prices, because the cost of buying the milk from the processor is only part of the retailer’s expense and there may be other reasons why they have to put the price up, but when the product is still pretty close to the material that left the farm, as opposed to a quiche or something, it is difficult to justify such a substantial increase in the retail price without increasing the price to the producer.

**Q356 Barry Gardiner:** In that case we are back to levers in a sense—not necessarily new ones but others. How could that be achieved? With liquid milk, for example, how could one ensure that the farm gate price more closely approximated to the retail price?

**Mr Paice:** I am not sure that there are any very clear levers if we exclude Government intervention in the market by dictating margins, formulae or something like that. The real answer to your question is that the market itself would resolve it. A lot of people are speculating that if dairy farmers continue to cease production and production continues to decline—I have heard it advocated, and that might be an angle of Christine Tacon’s proposal—supply and demand will work out and the cost to a retailer of importing milk from abroad will be such that they would rather put up the price to a domestic consumer, but we are so far from that point that I do not think it is particularly helpful.

**Q357 Barry Gardiner:** Neither you, I nor the entire Committee would want to see a yo-yo effect whereby we see farmers going into liquidation before European imports come in and the price goes up. That is a counsel of despair.

**Mr Paice:** It is. I am not advocating it; it is a view.

**Q358 Barry Gardiner:** Given the problem that you acknowledged and clearly identified in your speech in European Committee A, and given that you want to see those prices more closely approximated, is it only an ideological reluctance for the Government to be seen to be interfering in the market that is stopping you from providing a resolution to the problem that farmers are facing?

**Mr Paice:** I think it is more than ideological. I made the point that it was the same policy that your Government pursued, but we are not going to argue counter-ideologies. We would certainly be in breach of EU legislation—and probably international legislation—were we to start dictating margins or interfering in proportions of the retail price that the farmer got, which is what you would be doing. I will look to Andrew to make sure that I have got that right.

**Andrew Robinson:** I think that is right.

**Q359 Barry Gardiner:** Mr Docherty has arrived and I know he was very keen to ask this question of you.

**Thomas Docherty:** No, carry on.

**Barry Gardiner:** In that case I shall continue. Will the Commission’s milk package proposals affect the share of the retail price of milk that is received by farmers?

**Mr Paice:** Only if the farmers use the opportunities within it to form co-operatives and producer groups, and that is down to them, not the Government. It creates the opportunity for it to happen.

**Q360 Amber Rudd:** What is Defra’s view of the appropriateness of super-dairies in the UK?
Mr Paice: We do not have a particular view on the subject. In the one application that was made—it has now been withdrawn—at Nocton, we studiously avoided any comment that could be construed as support, primarily because, under current legislation, it is a planning issue. Frankly, even if we had supported or opposed it, we would have no regulatory levers to pull. In terms of the ethics and all the rest, which I suspect you are thinking about, we have, as I have told the House on a couple of occasions, some research going on related to these very large-scale dairy issues to do with zero grazing, the concept that cows do not go out to grass, and levels of lameness and animal welfare conditions. There is separate research—we are not funding it but it is still very relevant—going on at Harper Adams in Scotland into behavioural issues of cows in large-scale dairy units. Do they want to go out to grass? How far will they go to get grass compared with silage in a trailer in front of them? We are trying to ascertain real facts and scientific evidence with all of these kinds of questions.

The advice that we have received so far from the Farm Animal Welfare Council, which is endorsed, I believe, by the RSPCA—I do not want to use its name incorrectly—is that animal welfare is a function of the quality of management, rather than size. You then move into ethical issues about whether cows belong outside, to adopt a short phrase that a number of people use. My view is that you have to recognise that today’s cows have been genetically developed for a very different lifestyle from perhaps even when we were kids. They are much more genetically driven for the key features of yield and the ability to convert feedstuffs, particularly concentrate feeds, into milk. I think we are talking about a different type of animal. The final point I make—this may sound pejorative—is that I think the public debate over the Nocton proposal demonstrated the gulf of misunderstanding among the general public about today’s dairy farming as it is, let alone that proposal. Quite a lot of the criticisms people were making—that this would mean x, y and z—already apply.

Q361 Amber Rudd: Do you see it as Defra’s job to try put the record straight and communicate some of these facts so that there is a smaller gulf between the need to innovate and consolidate on the one hand, and the public’s perception on the other?

Mr Paice: We will certainly wish to make the public aware of the results of this research.

Amber Rudd: Good.

Mr Paice: I think I have said in the House that if the research shows that, given the present picture, there are very good welfare reasons why large-scale dairying is wrong, or that cows should be able to go out to graze, we would have to communicate that and probably bring it into our policy, but we are working on the basis of our knowledge at the moment.

Q362 Neil Parish: I turn to milk quotas. We are not hitting quota at the moment in this country, so ending quotas probably will not make that much difference to us. But what will the difference be across Europe if other member states—Holland perhaps—increase their production and that production finds its way here? Do you think that would then drive down our prices further?

Mr Paice: It certainly could do. Because of the point I made earlier about the costs of transporting liquid milk, it would almost certainly be processed products that penetrated our market. That is why I feel so strongly that we have to fight back against this import penetration by developing our own products and investing in processing so that we can compete at price.

Q363 Neil Parish: In New Zealand, for example, although there is not actually a quota, they always have to make sure that Fonterra and other co-operatives have the processing capacity to deal with the amount of milk produced. There is almost a quota through that system. Do you think that we will move to that type of system here? You would always have a buyer anyway, but in a way the buyer would dictate the amount of milk produced.

Mr Paice: I am not sure that it is really any different. I assume that nobody will suddenly put up a big dairy and produce a lot of milk without having a buyer already in hand, and that buyer will exist only if there is a market for your milk as liquid or a processed product. I think, in that respect, that it is no different from New Zealand. In New Zealand we have seen a dramatic increase in dairy production, so I do not think you can argue that there is any form of quota. The only issue is whether Fonterra—as it is 95% Fonterra—has the processing capacity to dry your milk to export it. I read recently that it is talking about putting up yet another new drying plant, so it does not sound as if it is up to any sort of notional quota. I do not see that particular read-across.

Q364 Neil Parish: Summing up with the quota, we have got four years to get the processing sector right in order to get a decent price for our milk so we can resist that when it comes.

Mr Paice: That presumes other countries will suddenly dramatically increase production when quotas disappear, which may be a rash presumption. Frankly, no dairy farmer in Europe is making a fortune. They are all complaining about their prices, even though they may be better than ours.

Q365 Thomas Docherty: I am sorry to be late, Minister. Very briefly, your written evidence to the Select Committee said that you were looking separately from the European Union’s work at a range of measures, one of which included the voluntary principles on country of origin labelling, which might include the dairy industry. Could you briefly outline for the Committee what benefit you think country-of-origin labelling would bring to the dairy industry in the UK?

Mr Paice: It provides the opportunity for effective marketing, because it is the foundation of it. Whether it is a dairy or any other product, it is pointless marketing “British is best”, if I may use that sort of cliché, to advocate British quality milk products or anything else if the consumer goes into a shop and thinks they are buying British as a result of that marketing campaign only to be buying, perhaps...
unwittingly, something else masquerading as British. That was why in opposition we always used—we still do—the phrase “honest labelling” so that people are not misled into thinking they are buying a product from one country when it is from another. I think that if you have got that right, you can justify upping your marketing. Again, it is not for the Government directly to do it, but there are ways in which we can stimulate it and encourage the industry to market its products very effectively. I think that that is important. We all know that the majority of consumers buy largely on price, but some—increasingly more—are influenced by the provenance of what they are buying. That is my answer to why I believe the dairy industry could benefit from it.

Q366 Thomas Docherty: Obviously there has been some exchange on this issue before. Do you expect the forthcoming Government buying standards to increase the procurement of British dairy products and, if so, by how much in your estimation?

Mr Paice: I am afraid that I do not have an estimate, but the answer to whether or not they will increase it is yes. When we publish them, we have made clear that they will be mandatory on all of central Government, subject to there being no increase in cost. I think there is now ample evidence from case studies that there is no reason why the cost should increase. As far as the rest of the public sector is concerned, we propose that it should be a matter of exhortation, encouragement and local pressure to encourage our schools and hospitals, many of which are already doing it, to follow suit. I think that there will be an increase; obviously not in liquid milk, because it is all British, but in some cheeses and other dairy products.

Q367 Thomas Docherty: Would you expect your Department to lead by example?

Mr Paice: I sincerely hope so.

Q368 Thomas Docherty: Was that a yes?

Mr Paice: I can assure you Ministers are already pretty hot on that subject.

Q369 Chair: Finally, how do you think the voluntary approach to labelling is working at the moment?

Mr Paice: The honest answer is that it is too early to say. The voluntary agreement was signed in the late autumn. We commissioned a benchmarking survey, which was done in April, to take the baseline so, frankly, it is far too soon to be able to measure. Mr Docherty mentioned forgetting what’s going on in Europe. I do not think that we can do that entirely because the food information regulations that are being negotiated in Europe hold out the prospect—indeed the probability—of the mandatory country-of-origin labelling of a number of products.

Q370 Chair: Minister and Mr Robinson, you have been very generous with your time. We are very grateful to you for participating in our inquiry. There were a couple of questions on research and development. Perhaps we may write to you on those and other issues.

Mr Paice: Of course.

Chair: Thank you.
Wednesday 8 June 2011

Members present:
Miss Anne McIntosh (Chair)
Richard Drax
George Eustice
Mrs Mary Glindon
Neil Parish
Amber Rudd

Examination of Witnesses

Witnesses: Peter Nicholson, Milk Procurement Director, Robert Wiseman Dairies, and Graeme Jack, Communications Director, Robert Wiseman Dairies, gave evidence.

Q371 Chair: Good afternoon, gentlemen. Welcome. Are you sitting in the right places? Good, you are very welcome. We will begin. Thank you very much indeed for joining us here for our inquiry into the dairy industry. Introduce yourselves and give your positions for the record, if you would.

Graeme Jack: I am Graeme Jack, and I am Communications Director of Robert Wiseman Dairies.


Q372 Chair: We are very grateful to you for participating, because we wanted to look at every aspect of the dairy industry. We have had interesting evidence, some of it a little conflicting. Do you believe that there is a systemic problem in the dairy industry?

Graeme Jack: No, we are very conscious that, at the moment, the market is volatile but it has not failed. Demonstrably, there is ample competition for milk supply. If you look at the south-west of England, for example, there are a number of buyers competing for milk supply. There is competition between retailers and between processors. There is volatility, but there is no systemic failure, in our opinion.

Q373 Chair: Are you concerned by, and how would you account for, the decline in the number of milk producers? Does that concern you?

Peter Nicholson: In this context, it is not so much the number of milk producers that is of relevance; it is the amount of milk that is produced in the country. The number of milk producers has declined year on year for as long as I have been in the dairy industry, which is over 30 years. It is the total amount of milk that is produced in the country that is of relevance to the market, as opposed to the number of milk producers, although I appreciate that it might be an issue in certain regions—particularly the east, where a lot of milk producers have gone out and moved to the west. As far as we are concerned in the supply of milk, while being conscious of the reduced number of milk producers, it is the amount of milk that is produced in the country that is the relevant factor.

Q374 Chair: Has that gone down to a level that worries you?

Peter Nicholson: Milk production over the last five years has fallen slightly and recovered last year, but it is still well in excess of the requirements of the liquid market, and that goes to prove the point that no company making milk or dairy products is actually short of milk. Although we are very aware of the point you are making and are not complacent about it, the fact of the matter is that no customer has gone short of milk.

Q375 Chair: If you had a wish list, what do you think Defra, the Department, could or should be doing to promote the dairy industry?

Graeme Jack: As far as Defra’s role, Government’s role, is concerned as it relates to our industry, we would be looking for regulation that is appropriate, that allows a market to function freely, that is not gold-plated. We would be looking for support from Defra in order to promote and stimulate innovation and to help educate the wider public around the benefits of that innovation. The work that has been done in the Dairy Roadmap around the sustainability of the dairy industry, and Defra’s input in that respect, has been valuable and we would look for Defra’s commitment to that to be maintained.

Peter Nicholson: To support that, through the Dairy Supply Chain Forum, which is chaired by the Minister, the growth of a project called Dairy 2020, which is looking at the sustainability of the industry for the future, actually supports that. Defra is behind that particular project, as indeed is the whole industry.

Q376 Chair: Should we as consumers be concerned that there are only three major processors that bottle milk for the supermarkets?

Graeme Jack: On the contrary, the industry has consolidated to the extent that there are three processors in the fresh milk sector, but demonstrably there is strong competition between these three processors. I do not see why that competition would cease going forward. I think there is a healthy competitive aspect to the processing sector.

Q377 Chair: Are there any particular regulatory changes that you would like to see?

Graeme Jack: Sorry, in respect of what?

Chair: Just the way that Defra or the Commission, in terms of the contract, regulates.

Peter Nicholson: The industry is operating as a free market at the moment and, from our point of view, from Wiseman’s point of view, we see no necessity for intervention in the way in which it is operating. Undoubtedly there are challenges across the whole of the industry and the supply chain that we recognise, and that is the case in any free market. We are under...
pressure in terms of competitiveness and shrinking margins, again across the supply chain, and that is all a part of the supply chain really seeking to provide value to the consumer. Consequently, coming back to your original point, I do not think the consumer should actually be nervous about the fact of the three majors. There are a lot of other minor players that are just as competitive and keen as the likes of us and our major competitors.

Q378 Richard Drax: Innovation, Mr Jack? What innovation?
Graeme Jack: Innovation in respect of developments on farm and within the processing sector. We do believe that there is a role to be played by Government in promoting innovation in the round. We have seen some developments in the sector that have been helpful and useful, and some that have floundered due to lack of understanding by the public.

Q379 Neil Parish: Do you mean size of farm? What do you mean? Are you referring to Nocton?
Graeme Jack: Yes, certainly Nocton was a development that floundered for its own reasons, but I think it is important not to confuse size with excellent animal husbandry and so on. There was some confusion that large-scale enterprise equals an enterprise that perhaps does not offer that aspect.

Chair: We are going to come on to Nocton a little later, if we may.

Q380 Neil Parish: Good afternoon. I will be quite direct in my questioning, because basically the dedicated supply chain for liquid milk is heralded greatly, and you have Tesco, which heralds it very much so. Of course, they guarantee a reasonably high price to the farmer. But do you not end up between a rock and a hard place because, when Tesco has a bit of a war on its prices, which it is doing at the moment, and reduces them, surely they squeeze you? I know it much so. Of course, they guarantee a reasonably high price to the farmer. But do you not end up between a rock and a hard place because, when Tesco has a bit of a war on its prices, which it is doing at the moment, and reduces them, surely they squeeze you? I know it very difficult for you to comment when they are one of your biggest customers, but is this a worry for you?
Graeme Jack: You are referring to the profit warning that we confirmed last September.

Q381 Neil Parish: Yes, I have that here as well. I am asking the question quite directly, because we are looking at a grocery adjudicator. Is it fair that Tesco sets a price to the farmer, then has a price war in their supermarket and somebody has to pay for it—hopefully not Tesco, from their perspective?
Graeme Jack: Let us address the circumstances surrounding the profit warning. Our profit warning in September resulted from a period of intense competition across all of the markets that we service—competition to supply. In situations like this, businesses like ours are faced with a choice: we can walk away from that competition and consequently give up volumes of milk to our competitors, or we can defend these volumes, albeit at a lower margin. We are an efficient company; we have a strong balance sheet, and we chose to defend our volumes and accept that that would come at a price, which was reduced margins.

What is important is what we are doing now about this, and what we are doing is looking to recover our margins by focusing on our own efficiencies and eliminating cost. We are behaving, in our view, as any business would faced with intense competition. Our calculation is that, if we are an efficient business, we will weather this. We are optimistic going forward. We have some short-term margin pressures that we will address, but we are an optimistic and confident bunch.

Q382 Neil Parish: If you were processing and then selling on again, you would then, as a processor, be setting quite a lot of the price that you paid for that milk. As far as I can see with this sort of dedicated system you have with the supermarkets, you have been taken out of that equation. Is that not dangerous for you in the end if you get squeezed and squeezed and squeezed?
Graeme Jack: Our stance, as far as dedicated and segregated arrangements are concerned, is that we believe that they have been good news for the dairy industry. The supermarkets have effectively moved to secure their supply of milk, and we have no issues with that and we support that. Pete mentioned earlier that production off farm has benefited as a result of confidence pushing through the system. As far as we are concerned, we have no issue with that. We are prepared to compete as an efficient business, and that is what we will do. If this is a free-flowing market, we have confidence that we will emerge out the other end in good shape.

Peter Nicholson: The competitiveness that you refer to stretches across the whole of the sector, whether it be Tesco or any of the majors or minors. There has been tremendous competition in that particular sector over the last two years in a battle against food inflation. Whether these customers have aligned arrangements or whether they do not, what they do with regard to the wholesale price or retail price is completely separate from the mechanisms that determine the farm-gate price. While, as you said, over the last 12 months our margins have been squeezed tight, the value of raw milk has gone up by 10%. That shows quite clearly the dissociation between the trends determining the value of raw milk and what happens in the retail sector, which has fallen by 12% in the same period of time. There is a difference in the mechanics within those particular sectors.

The aligned groups, backing up what Graeme said, are a very good initiative, and have helped farmers progress as far as production is concerned and, indeed, as far as milk price is concerned. The underlying market value of raw milk remains. It might not be evident in the Tesco arrangement but, if I take one of our other customers, Sainsbury’s, they have a similar aligned supply and premium, but that premium is not a stand-alone premium; it is a premium that sits on top of the market value of milk. Consequently, those benefiting from the aligned supply arrangements with Sainsbury’s are also directly affected by those particular mechanics associated with the raw milk market.
Q383 Neil Parish: My final point is that you in a way deal mainly or almost entirely in the liquid milk market, and so you have these very big contracts with the supermarkets. Do you have any scope for developing your market, albeit in liquid, into, for argument's sake, milkshakes or whatever? Are you able to go down that route or are you proposing to do so? One of the arguments is the industry has to take more advantage of different products and things. Are you just keen to be the most efficient deliverers of bottled milk?

Graeme Jack: Over the years, we have been innovative, albeit within the fresh milk sector. We introduced our 1% fat milk just over five years ago. We were the first in Britain to introduce that and that is now a very significant part of the fresh milk portfolio. There is innovation and potential for innovation within our sector. We have proved that and we continue to look at ways in which we can innovate. It is not just about efficiency for us; it is about helping our customers develop the fresh milk category, although efficiency is certainly very important.

Q384 Neil Parish: Of course, if you are taking 3% of butter fat out, you can also use that. Do you manufacture any form of butter or anything like that?

Graeme Jack: No.

Q385 Neil Parish: You would pass that fat on, would you, through the industry?

Peter Nicholson: We are one of the biggest sellers of bulk cream. We do pot cream; it is not a lead product, but with our major customers we do pot cream. But by far the majority of cream that is surplus to the liquid milk process is sold as a very valuable by-product and indeed has been very helpful in our ability to cover increasing costs, for fuel and resin in particular, over the course of the last 12 to 18 months.

Q386 Neil Parish: That goes out through the supermarket chain, does it?

Graeme Jack: Yes. Just to clarify, of all of the cream produced as a by-product of producing fresh milk, 25% would then be sold back into the retail channel as pot cream. There are two or three spikes during the year where that is considerably higher. The first is Wimbledon, just coming up, and secondly Christmas. Apart from that, the vast majority of cream is sold, and most of that for export.

Q387 Amber Rudd: Dairy UK’s evidence to us said that there was a risk that the Commission’s Milk Package would “impede, or may even distort, the operation of the market to the long-term detriment of the industry”. Which elements of the proposals do you think potentially create that risk?

Peter Nicholson: To start with, we would be cautious about the proposals, not only because they are not all confirmed and written down yet, but also because, as I mentioned earlier, our experience is that this particular sector does not need any intervention. That taken as read, the area we would be most concerned about is the imposition of any restrictions within contracts. Our contracts, and I speak for Robert Wiseman Dairies, have been going for a long time; there are over 1,000 producers that have joined us, thinking that our contract is transparent and very acceptable to them. Very few producers, over the 17 years that we have had that contract, have decided to move away from Wiseman because they are dissatisfied with it. We see that the relationship that we have with our producers through that contract is a strong long-term relationship.

Again I re-emphasise that I accept that not all the detail is confirmed here, but the concern we have is that if there is some restriction within contracts on linking terms and conditions with price, the long-term nature of the direct-supply arrangement might well be compromised, in that to link directly the length of contract with the length of a price will bring the industry back to very short-term relationships. I do say that; unfortunately, the industry does work on short-term strategies and, as a consequence, we need to try to ride those strategies through relationships. If we are forced to comply with short-term strategies, contracts will become shorter and the industry will become much less of a long-term arrangement. That is where our concern is with regard to an element of the EU proposals.

Q388 George Eustice: I just wanted to build on that point and ask whether the contracts you have at the moment contain all four of the criteria that the EU Milk Package sets down—price, volume, seasonality and the length of the contract.

Peter Nicholson: It all depends on what you refer to as volume. It certainly relates to prices, termination and seasonality. There is not a volume in there. Basically, our commitment within that contract is to market all the milk produced by that farm. There is not a ceiling. There is a floor, on the basis that if they do not produce enough to pick up, we cannot pick it up, but there is not a ceiling. It all depends on how you interpret the volume element.

Q389 George Eustice: Is it not the case that you are already satisfying the Milk Package in a way, and it should not be a problem for you if it was introduced?

Peter Nicholson: That is our view. The discussions are high-level group discussions. Prior to that, the NFU launched contract templates. We discussed those with our producer representatives, and examined our contract against that template. We have examined our contract against what we know of the EU proposals, and we believe that our contract ticks all the major boxes. The one box that it perhaps does not address is the selling of milk to two purchasers, but it ticks all the other boxes.
Q390 George Eustice: Just going backwards, you explained just now in the previous question why you have concerns about the Milk Package—that it might lead to more short-term contracts. That has clearly not happened. You cover price within your contract, but it has not led to more short-term contracts, has it? What is it that you think will change with the EU?

Peter Nicholson: Again, I preface the comments by saying that we do not know all the detail, but the concern is that the introduction of a milk price change, whichever way, has to be within the resignation period of the contract. Our resignation period is three months. If you tie those two things together, it means that you would not be able to change a milk price situation for three months. In the market in which we operate, that would just not be practical. That is our concern. We are not tied in within the rental period. We have a period of three months, and we have to have a clause on termination and length of contract, and the two are not linked, that concern is nullified to a certain extent.

Q391 George Eustice: Do you think that, on one level, to get farmers in an adequate negotiating position, the two do need to be linked? That is the whole point. A farmer needs to be able to say, “Unless you are going to pay me a fair price, I am out of here.” If they cannot say that, it is not going to strengthen the supply chain and bring proper market forces into the supply chain.

Peter Nicholson: Again, this comes down to the long-term relationship. I would answer that on the basis of the relationship we have had with our producers over the last 17 years. In our written submission we outlined in detail an independent comparison as to how our milk price had benefited those producers, who have been with us during that period of time, and that was up to about £260,000 over the 17 years. Our belief is that is how we operate. It is the trust that our producers put in us and the transparency of the contract that give it its strength. We do not want to be in a volatile situation where we have to move milk prices every month, and consider resignations and terminations of contract on a monthly basis. It is a volatile marketplace and we, as an industry, have to roll with that and try to reduce the peaks and increase the troughs to try to make it a more stable environment on a long-term basis. We do not believe that shortening contracts and linking in resignation periods directly with price changes aids that.

Graeme Jack: If I could just add to that, the core of our proposition is unchanged over the 17-year period that Pete referred to. The core of the proposition is that, if you wanted to supply Robert Wiseman Dairies, we will return to you a market, a competitive price and a business strategy that you can scrutinise. If, as a farmer, you believe that we are not meeting our own promises, you can give us three months’ notice to move. Demonstrably, that strategy has been appropriate for our business, because we have not seen a significant level of resignation—in fact, we have healthy lists of farmers who wish to supply us. We feel we have a best-of-class contract in our sector, and we know how important it is to meet our promises, because we have a vulnerability if we do not meet our promises.

Q392 George Eustice: I take on board your point that you have shorter break period than a lot of other contracts, which clearly does help. Just on the point of price, I know you have your partnership board that discusses the price. One of the points the NFU is making is that it need not necessarily define what the price is in pence per litre, but it should at least define a consistent basis on which the price is arrived at or calculated.

Graeme Jack: We stand by our record on price.

Q393 George Eustice: What factors does the partnership board take into account? Is it basically just the market price? Is there a set yardstick?

Peter Nicholson: Yes, it is. Again, we are as transparent as we can be about the state of the market with those people involved in that discussion. It is very clearly an influencing body rather than a negotiating body, so consequently we outline all the reasons for any price alteration, whether it is up or down, taking the market conditions into account, the value of cream, where our competitors are in the marketplace as well as the commodity market in general. We would look at those particular trends and advise what changes should be made against those trends, and justify it on that basis. Obviously they will put counter-arguments; we would listen to that particular argument and, in some instances, their arguments influence what the final decision is.

Q394 George Eustice: Do you factor in production costs on the price—a bit like, for instance, the Tesco Sustainable Dairy Group does?

Peter Nicholson: No, we do not. As I said earlier, the actual mechanics associated with the value of raw milk are different from the mechanics associated with the value of wholesale milk or, indeed, retail milk. Consequently, the trends that determine the value of raw milk are very much external or outside of Wiseman’s control. Obviously, our competitiveness with our major competitors is key, and we cannot afford to be too far away from where their particular price is, so that is closer to home, but our own efficiency, as far as our operation is concerned, is not an element that is taken in to any great extent.

Graeme Jack: If I could just add to that, the market value of farm-gate milk is not the cost of production of that milk. Sometimes the market value exceeds the cost of production; sometimes it is behind the cost of production. We are a market-oriented company. We actually pay a premium on the market value of commodity milk in order to secure that milk. That is what we pay. The other point that is important to make is that, on farm, there is a wide variation in the costs of production; some analysts have suggested it could be as much as 10 pence. At any one time there will be farmers who are well above and farmers who are below, but we pay the market value.
Q395 Chair: I am anxious to make progress. Could I ask whether your 24-month notice is normal in the industry?

Peter Nicholson: The 24-month notice is for us, because we give that to producers. Normal? It is normal for there to be a longer notice period to be given by the processor than the producer gives the processor, but the periods of time are variable. I would not say that two years is normal.

Q396 Chair: In reply to a question, you said there was no ceiling on volume. If that is the case, how could you communicate to farmers that there was an oversupply?

Peter Nicholson: We are moving towards 70% of our total requirement coming from our direct supply. On that basis, on average 30% of the milk that we require actually comes from sources other than our direct supply. Our ability to manage and accommodate increases in volume from our direct supply is actually greater. We require our direct supply to give forecast volumes—both 12 months in advance and revised quarterly. We encourage them to work hard on getting those accurate, and so consequently we manage the balancing situation in that respect.

Q397 Richard Drax: To what extent does the price of liquid milk to the consumer affect the farm-gate price?

Graeme Jack: There is an annual exercise undertaken by DairyCo, the levy-funded organisation funded by farmers, which looks what they call supply chain margins—who gets what share of the cake. In our view, it is quite a simplistic analysis. The reality is that retail prices are a function of competition between retailers. Selling prices, as far as processors are concerned, are a function of competition between processors, and farm-gate milk prices are determined by factors like supply and demand, and commodities. We think that the whole share-of-the-cake argument is somewhat simplistic and is not really rooted in the reality of how the market works. That is our view.

Q398 Richard Drax: Will the Commission’s Milk Package proposals affect the share of the retail price of milk that is received by farmers and processors?

Peter Nicholson: We do not believe that it will. I have answered the question with regard to the contracts. The other element of the EU Package is the introduction of producer organisations. The whole purpose of producer organisations is to give the farming base a stronger negotiating position. We recognise that and we recognise the democracy of giving people the opportunity, which is why we have the representatives of the Wiseman Milk Group. All we would say in that particular situation is it is important that, if we are going to introduce that principle into the dairy industry, it should be governed by the same Competition Commission regulations as those that govern us as processors and retailers as well. Providing that is the case, we are quite happy to work with producer organisations in being able to determine the value of the raw material.

Q399 Richard Drax: You have touched on this in your first answer, but do you consider the distribution of value through the supply chain to be fair or sustainable?

Graeme Jack: To illustrate the point that I was making earlier about how the supply chain works, we do feel it is simplistic to talk about who gets what within the supply chain. A good illustration of that is that the farm-gate milk price that we pay has increased by 10% over the last year, but the average retail price has decreased by 12%. Hopefully, that illustrates the point that I am making: the retail price is a function of competition between retailers, whereas the market for farm-gate milk behaves in a different way completely. It is hard to answer your question, because to answer your question we would have to accept there is a logic to the share-of-the-cake argument, but we think the markets are essentially quite different.

Richard Drax: The sustainable point is whether the dairy producers, the actual farmers, can go on receiving what many would claim is an unfair price—i.e. they go out of business because they are not getting a big enough share of the cake.

Q400 Chair: The point is—and if you keep your answers just a little bit shorter—that farm costs have gone up hugely and they are not covering their costs. You might say they have gone up by 10%, but they are not covering their costs.

Peter Nicholson: Tesco is the exception to the rule as far as basing the price they pay for milk on the cost of production. That is the answer. As Graeme referred to in an earlier question, the value of raw milk is not based on the cost of production. Sometimes the commodity market will give a cost, a value of raw milk, that is higher than the cost of production, and sometimes it is the other way round. At the moment, there is a lot of upward pressure on costs and, consequently, it is difficult, even though the milk prices are rising, to match one with the other. However, it is not based on cost of production and that is the fundamental point. However, I would say that, just as there are processors whose margins are in the positive sector now and there are farmers whose margins are in the negative sector, there are also processors with margins in the positive and farmers with margins in the positive. It is dangerous to quote generalities, even though I do appreciate the point that is being made.

Q401 Amber Rudd: Dairy UK emphasised to us the volatility in the milk price. How do you manage volatility in the liquid milk sector?

Peter Nicholson: It is something that we are concerned about. As we said earlier, when we look at the value of raw milk, we look at the commodity markets and we try to take the peaks and troughs out. Sometimes the peaks are too high and the troughs are too low, and so, as an example, throughout 2008 and 2009 our milk price held higher than the majority of the commodity markets and consequently softened that blow and made it more level. At some stage, if that cycle gets too long, you have to give into the pressure of price and adjust prices accordingly. The
same happens when milk prices go up. There is a lag between movement in commodity and movement in the liquid sector, basically because there is a long negotiation period with customers in amending milk prices, and so you get a lag in that particular sector. We try to smooth out the troughs and peaks but, depending on the cycle, you cannot always satisfy everyone.

**George Eustice:** I want to ask you about producer organisations, another element of the Commission’s proposals, and raising the threshold of the size of these producer organisations. What impact do you think that would have on the competitiveness within the UK dairy sector and what impact would it have on processors like yourself?

**Peter Nicholson:** I mentioned earlier that we recognise that producer organisations are a means of gaining a stronger negotiating position. On the proviso that those producer organisations have to operate within the same competition rules that we ourselves have to operate within, we see no concern with regard to that. Does it strengthen their hand? We believe that we are reflecting the raw value of milk against the commodity value now. To say that the new producer organisations will give producers a better value for the product undermines the fact that we believe the current system is working. It would prove in our mind that the current system was working.

**George Eustice:** For instance, the Government itself has expressed some concern that allowing a single producer organisation or a cluster of producer organisations to have effectively 33% of national production might give them too strong a position. Is that a view you would share?

**Graeme Jack:** We would be concerned with any vehicle if it compromised competition. We are instinctively free market operators. We would be concerned with anything that compromised that.

**George Eustice:** Do you think that would be too far? We said in an earlier question that there are three big players as processors in this.

**Graeme Jack:** Yes, and three players that compete very strongly. For us, it is really down to the competition authorities to judge what is appropriate; we are not experts in that respect. All we are saying is that it is important that there is a vibrant competitive sector and that the market is not bucked.

**Q406 Neil Parish:** I want to talk a little bit about consolidation in the processing industry. I see from the figures that, in 2002, you were taking 600 million litres of milk; now you are taking 1.2 billion litres of milk. I reckon that is roughly 10% of milk production; if my memory serves me correctly, our milk production is something like 13 billion litres, isn’t it? What is fascinating is that the milk production is capped or has been by quota, albeit it is below the quota now. You have doubled your size in the market. What further consolidation do you believe you can make? Further to George’s question, how much further can you go? You must have a pretty big percentage of the liquid milk market at the moment. What is your percentage of the liquid milk market?

**Peter Nicholson:** Yes, we do and we realise that our organisation’s current system is working. It would prove in our mind that those producer organisations have to operate within the same competition rules that we ourselves go forward, just as there is and has been in the production sector.

**Q407 Neil Parish:** What is roughly your percentage of the liquid milk market?

**Graeme Jack:** We reckon it is around the 31%, 32% mark.

**Q408 Neil Parish:** It is interesting. When we had the Minister here—this is talking about overall milk being processed, not just the liquid milk market, which is only about half the market—he was saying that if anything gets to 33%, then it is or could be considered a monopoly, which is interesting. Could I just question you a little bit further?

**Chair:** Could you do it briefly?

**Neil Parish:** Yes, very quickly. The liquid milk market is what you are in. There are very tight margins. At the moment, the equivalent is 32 pence a litre for milk powder. People can pay for raw milk 32 pence, so is there any argument for you as a company to go into producing milk powder?

**Peter Nicholson:** We have looked at other areas of the dairy industry to work in and we have dismissed them to date, believing that we really want to be specialists, rather than generalists. There are far more companies better than us in respect of the cheese and powder markets. We can work with them in partnership, rather than compete with them.

**Q409 Neil Parish:** There is the argument that it would drive the raw milk price up for farmers if there was greater competition. It is unusual for milk powder to be worth more than liquid milk.

**Graeme Jack:** Certainly. Pete’s point is worth re-emphasising. We believe that our success over the years has been in large part because of the focus in
our business. We believe we are Britain’s fresh milk professionals, and that is what we are trying to achieve. We do not really want to close the door to doing anything else within the dairy sector, but we still have some headroom to grow. We still have capacity within our business. We have invested £475 million to create that modern capacity, and we believe that will drive our business forward.

Q410 George Eustice: You talked quite a bit earlier about adding value to your products, even in liquid milk, and you have a business model that is based solely on the liquid milk sector. What are the advantages to you of having that degree of specialism and not being in any other processing techniques?

Graeme Jack: We believe the advantages of focus are that we can drive innovation and efficiency. We are not distracted by trying to focus on a whole portfolio or range of products. We are just focused on the one product grouping, and that focus has allowed us to identify and drive efficiencies within our business, which in turn has given us competitiveness in our sector. It is a business model that has worked, and we hope continues to work, for us.

Q411 George Eustice: Is there anything that Government could do to remove some of the barriers that stop you investing in plant and improved processes?

Graeme Jack: We have not been shy of investing. We have just completed a dairy in Bridgwater in Somerset, which we built at a cost of £100 million. We believe it is the most environmentally advanced dairy in the world. A lot of the technology within that dairy has been successful for us, and we are now introducing it back through the rest of our network of dairies. If there have been barriers, we have managed to cross them and we think there is work to do to continue.

Q412 Mrs Glindon: One possible development in the dairy industry is the creation of super-dairies. Are you in favour of larger production units and, if so, do you think the Government should be doing more to explain these developments to the public?

Peter Nicholson: We are obviously well aware of the development at Nocton, and we have not been critical of that development, although how it was handled was unfortunate. The pressure on efficiency within the dairy industry means that dairy farmers, just as dairy processors, have to take advantage of whatever technology and whatever efficiency they can to be able to contain costs. To encourage producers to embrace these technologies, actually address efficiencies and address carbon-footprint improvement, you have to allow them to expand beyond where they are at the moment.

We believe that as a business, and we believe that there is work to do with consumers, in knowledge transfer and education, to be able to put across the point that Graeme made earlier very distinctly—that the size of the enterprise is irrelevant. It is the management of the health and welfare of the animals that is key. I could take you to 100-cow herds where that management is poor and I could take you to 500-cow herds where that management is good. It is the management that we need to impress upon the consumer that will give them the comfort that production is being handled professionally. That is something we do have to get over to the consumers. As an industry, we need to address that; we recognise that. Nocton is a harsh lesson that we need to take learnings from.

Q413 Mrs Glindon: Is there anything that the Government could do specifically to help you with that?

Graeme Jack: As we said earlier, Government certainly has a role in promoting the best innovation and advancements within the dairy industry, and helping the industry to educate the wider public about why these advancements are beneficial. Nocton Dairy’s example was nothing short of disastrous in terms of polarising public opinion. There is now a great deal of work to be done, in our opinion, not just by the industry but by the industry and Government, to make the point that Peter just made—that it is not about size, but about excellence in animal husbandry.

Q414 Chair: You will be aware of the issue—last August, I think it was—about the milk products from cloned animals. The Food Standards Agency has issued very clear advice. Do you have a view on products and milk from cloned cows?

Peter Nicholson: We would concur with the advice issued by the FSA, which relates to progeny of clones as opposed to cloned animals. Our belief is that the consumer concern, which comes back to welfare again, is about how the cloned animal is treated. The progeny of clone really is a normal animal and, as such, product from that animal should be marketed in a normal way. To do anything other than that is an impossible traceability exercise and so, consequently, the FSA has come out with a balanced view, after much deliberation.

Q415 Chair: To pursue Mary Glindon’s point on trying to educate and inform the public on both cloning products and also these large-scale enterprises, I do not see how we are going to compete and fend off imported milk and milk products if we do not. Do you agree?

Graeme Jack: We absolutely concur with that. We cannot do anything other than encourage farmers to make progress with their businesses to help them achieve the efficiencies required to compete on a UK and European level. As a business, we have been allowed to make progress by investing. We have been allowed to upscale processing to the extent that our dairy at Droitwich is now producing 10% of the nation’s milk. That would not have happened anywhere 20 years ago. No one can criticise farmers for trying to achieve similar efficiencies.

Q416 Neil Parish: What do you consider is going to be the effect of establishing a grocery code adjudicator on, first, your relationship with your supermarkets—the supermarkets you are supplying—and, second, with the dairy producers, or perhaps with both?
Mr Nicholson and Mr Jack, we are very grateful to you for participating in this inquiry and being so generous with your time. Thank you.
Introduction

1. There is an overwhelming amount of evidence available to suggest that the dairy supply chain is currently not functioning correctly (Annex 2). Throughout 2010, for example the industry experienced dairy companies announcing record profits and months later announcing profit warnings and share price drops; the price of dairy commodities on world, EU and UK dairy markets soared (and even achieved record levels in some cases), yet milk prices to dairy farmers stagnated throughout the year and retail gross margins on dairy increased, while margins to the rest of the supply chain fell.

2. It was against this backdrop of supply chain chaos that the EU Commission established a High Level Expert Group to examine the long-term future of the EU dairy sector. From the outset, the HLG recognised that contractual relationships between milk producers and purchasers are fundamental to ensuring fairness in the dairy supply chain, particularly with quotas being phased out by 2015.

3. The Commissioner for Agriculture and Rural Development, Dacian Cioloş, has come forward with a package of formal legal proposals to amend the single CMO regulation as part of its response to the HLG on milk’s recommendations. In its proposals the Commission has identified a significant imbalance in bargaining power between farmers and dairies and a lack of certainly and control about the price farmers will receive for their milk. The package seeks to address bargaining power and create a harmonised approach across the EU in four different areas:
   - Providing a legal instrument for member states to put in place supply contracts with specific terms between farmers and milk processors.
   - Allowing farmers to negotiate contractual terms collectively through producer organisations (POs).
   - Extending the exemptions that apply for inter-branch organisations (IBOs) in the fruit and vegetables sector to the dairy sector.
   - Requiring milk processors to declare information on milk deliveries.

4. The NFU believes that the proposals in respect of contracts and producer organisations are of most direct relevance to British dairy farmers. In particular, the NFU believes that the Commission proposals on contracts provide a basis for addressing the significant flaws that exist in current contractual arrangements that force dairy farmers to supply all of the milk they produce to dairies, exclusively, for a duration not less than 12 months with very little, if any, predictability about the price he or she will be paid for the milk.

5. Regulation is always a last resort, yet the dairy supply chain provides a strong example of where regulation can have a legitimate role to play in ensuring fair dealings, reducing risks and raising the benchmark for all.

The Commission’s Proposals

Milk contracts

(a) Member states can make the use of formal written contracts compulsory. Although, contracts will remain voluntary at EU level. Co-operatives will be exempt from any requirement for compulsory contracts at a member state level.

6. The Commission proposes that member states can choose to make formal written milk contracts a compulsory requirement. However, we are concerned that this could undermine the desire to see a harmonised approach across the EU and could allow member states to opt out of measures that could address the serious problems in milk contracts. There is no compulsory requirement for milk contracts in the UK currently, yet the vast majority of milk deliveries in the UK are already covered by written contracts. However, we believe that milk contracts as they exist in the UK are unbalanced and unfair, transferring all the risk of market competition and fluctuations onto farmers.

7. Dairy farmers are locked into contracts that compel them to send all of their milk to one buyer, for a normal minimum notice period of 12 months with absolutely no certainty about the price they will be paid from month to month, let alone a year. Contracts such as this exist in no other industry. Milk is a perishable product, that has to be collected every day, and dairy farmers have no choice but to agree to these contracts,
thus there is no “freedom” to contract from a farmer perspective. As such, the NFU believes that the UK government should follow the lead of the Commission in making written contracts compulsory to ensure that British dairy farmers are able to benefit from these proposals.

(b) Where a member state decides that every delivery of raw milk between a farmer and processor shall be covered by a written contract, that contract will fulfill the following conditions:

- The price payable, which will be static and set out in the contract or vary only on factors that are set out in the contract (i.e., a formula or linked to specified market indicators).
- Volume which may, or shall be delivered and timing of deliveries.
- Duration of the contract, with termination clauses.

8. While the Commission’s requirements for milk contracts are elements that the NFU would consider to be necessary to have in any milk contract (as set out in the NFU’s template raw milk agreement and guidance notes for farmers) the NFU has also expressed the need to consider exclusivity alongside any volume specification so that producers are not tied in to one milk buyer. This will become particularly important once quotas are removed in 2015.

9. There is a risk that volume clauses in milk contracts could become a replacement form of quota, managed and regulated by milk buyers. The ability for dairy farmers to supply agreed volumes to one or more buyers would improve competition for milk and strengthen producer bargaining power. The NFU would like to see the Commission consider exclusivity alongside its contract requirements.

10. Importantly and, we would say most significantly, the Commission will require that the price is written into the contract. By definition therefore a means of varying the price must also be agreed between the parties. This will represent a major step-change in milk contracts and go a large way towards addressing the current lack of certainty and clarity on price that are offered to dairy farmers in milk contracts currently. However, a means of varying the price must also be agreed between the parties. The requirement to have an agreed method of price variation written into the milk contract would strengthen the Commission’s proposals. Furthermore, we suggest that price variation and termination clauses be linked, and that any price variation that occurs outside an agreed formula must be agreed freely between dairies and farmer representatives, or Producer Organisations.

(c) A contract will not be required if the farmer supplies a co-op—but only if the co-op statutes contain provisions with the same objective as the Commission’s “contract requirements”.

11. As the current statutes for UK co-operatives do not meet the requirements set out under the Commission’s proposals these measures will be equally applicable to dairy farmers supplying co-operatives as it will be to dairy farmers supplying private dairy companies. The NFU certainly believes that farmers supplying co-operative businesses would also benefit from more balanced, professional, business-like contracts, which are tailored to the supply requirement of milk buyers and also bring greater certainty to the way milk prices are determined. At the same time milk contracts offered by co-operatives and private dairies should allow dairy farmers to capitalise on other selling opportunities, manage risk, grow their business, and prepare the ground for the end of milk quotas in 2015.

**Producer Organisations**

(d) The Commission proposes to allow producer organisations to negotiate contract terms, including price jointly, or on some of its members’ production to a dairy:

- POs will be subject to quantitative limits at EU and member state level.
- The PO must notify the competent authority of the member state to register as a legal entity.
- Strict clauses are set out in the regulation that will restrict the activity of the PO so as to prevent price fixing, and other distortions of competition.

12. Producer organisations can play a role in increasing bargaining power provided that they have sufficient scale, capital and are professionally run. These proposed amendments could become applicable to UK farmers if the current direct selling groups (Dairy Crest Direct, Wiseman Milk Partnership etc) seek formal PO status. However, there needs to be much greater clarity provided at a member state level on what the requirements are, and what responsibility this would provide to farmer representatives.

13. The NFU suggests that the following measures could be complementary to those proposed in the dairy package with regard to Producer Organisations:

- The appointment of independent facilitators by producer organisations could be seen as a useful first step in seeking to resolve contractual disputes between farmers and dairies.
- The NFU believes that there is a strong case for improving the professionalism of producer organisations. This could be achieved by employing the services of professional negotiators to assist POs / representative groups in negotiations and price discussions with dairy companies.
Greater uptake of formal training by farmer representatives could be encouraged through the Rural Development Programme and is going to become more important as the level of responsibility and influence farmer representatives have increases.

Adding value and innovation provides some opportunities for farmers and farmer co-operatives to increase their bargaining power with dairies and retailers. Rural Development programmes continue to offer a means by which innovation and value-adding can be encouraged although there should be some examination as to the flexibility of programmes to ensure that funds are accessible.

What can Government do?

14. The measures proposed by the Commission are certainly promising, and have the potential to be beneficial for UK dairy farmers, providing Defra gives them its full backing. The proposals mean that the UK Government now has a unique and powerful opportunity to help address the dysfunctions in the dairy supply chain by acting on the EU Commission’s proposals for changes to milk contracts and producer bargaining power.

15. Specifically we would urge UK Government to:

- Introduce legislation to make the use of written contracts between farmers and dairy companies compulsory; to eliminate unreasonable contractual practices especially with regard to milk pricing and create fair and balanced contractual terms prior to the removal of quotas.
- Draw up a contractual code of practice that highlights best and worst practice in relation to raw milk contracts, backed up, if necessary, by regulation to ensure fair 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.
- Prepare standard template contracts as an example of best practice. The NFU’s template contract would provide an excellent basis for this.
- Examine whether the operation of Rural Development programmes can be improved to assist farmers and producer organisations in adding value and by enabling the employment of professional support for negotiation.
- Investigate the possibility for producing more transparent information on the distribution of margins in the supply.

March 2011

Supplementary written evidence submitted by National Farmers’ Union (NFU)

Follow-up Questions to the Oral Evidence Session on Wednesday 27 April 2011

1. Please confirm if the NFU’s view is that milk contracts should specify a fixed price or pricing formula, rather than allowing for price to be negotiated between the buyer and supplier during the period of the contract? Is this a unanimous view among members of the NFU? What are the disadvantages to a pricing formula, from the producer’s perspective?

The NFU believes that contracts should contain either a clear price or mechanism for determining the price to be paid to producers. This should be agreed mutually by both parties. In practice, we believe it is right for farmer representatives and dairy processors to agree on an appropriate price determination mechanisms for their respective supply chain/market.

Many existing milk supply contracts do not contain any mechanism for the determination of price, other than stating that the buyer will notify the seller of change to price from time to time, sometimes with a limited degree of notice, sometimes retrospectively. This one-sided approach to setting prices throughout the spectrum of British dairy contracts renders farmers with little bargaining power, creates uncertainty and thus undermines fundamental investment that is needed on farms. This is not only iniquitous, but is almost unique as a contractual arrangement.

With a price mechanism as a compulsory term in contracts, price adjustment by the buyer that was not in accordance with the mechanism could constitute a breach of contract on behalf of the buyer, which could subsequently trigger release of the seller from part of or their entire notice obligation.

To put the ‘status quo’ into context; farmers supplying Dairy Farmers of Britain in the months before its collapse farmers had no choice but to continue to supply, despite many having the opportunity to sign contracts with other buyers willing to pay a competitive market price.

2. Do the Commission’s proposals for contracts need to be compulsory in order to ensure that they are adopted widely, or would a voluntary approach work?

During the discussions of the Dairy Supply Chain Forum it has become clear that transparent price determination in contracts is not uniformly supported by dairy processors. This of course is no surprise, as the
ability to reduce producer prices at will, is a luxury that gives processors the freedom to maximise their margins. Together with long notice periods it means that processors have limited fear of losing raw milk supply. The NFU has encouraged a comprehensive debate on contracts across the industry for the last four years. This has led to some changes. However, processors are unwilling largely to relinquish the control that they have over raw milk prices meaning that few contracts, if any, stipulate clearly the price that farmers will be paid or the means by which prices will be adjusted. Although the NFU would like to believe that the necessary changes could occur voluntarily, we are increasingly frustrated and believe that the compulsory is necessary to ensure that changes occur.

3. The Committee requested additional evidence on the number of dairy producers historically (10 to 15 years ago)

In 1995 Dairy Farmer numbers in England and Wales stood at 28,093, in 2000 this figure was 21,772, in 2006 this was 13,778 and in May this year it was 10,896. A full breakdown of producer numbers can be found on the DairyCo website in the Datum section.

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4. Your evidence stated that the price that dairy farmers are currently receiving and perceiving is significantly less than market indicators would dictate. For how long has this situation persisted and is this time-lag longer than is usual for other sectors?

The following graph, illustrates this point, by comparing farm gate price average to a combination of MCVE and AMPE, the manufacturing derived milk values used as a bench mark in the dairy industry. Alternative permutations of MCVE and AMPE show a similar pattern, with regard to time lags.
5. You stated that the “Commission’s proposals do not provide anything near the totality of the answer; they at least provide a partial solution to one of the biggest problems”. What is missing from the Commission’s proposals that would provide a more complete answer?

The Commission’s package cannot answer all the problems in the British dairy sector since many of the problems are commercial in nature. There are a number of supply chain issues that can only be addressed by the supply chain. For instance, inefficiencies in the processing sector can only be addressed through investment and consolidation in manufacturing. However the dairy package does present a possible solution to some of the recurring and stubborn issues around price determination in contracts and also the competition law barriers to farmer collaboration and collective negotiation.

6. Dairy UK told us that farmers had to get involved in milk processing to get a greater share of the value added. How can farmers do this, and how feasible is it?

It is natural that a trade association representing the interests of dairy processing companies will in some respects differ in view from the NFU which represents farmers. We would agree with Dairy UK that investment downstream in processing is one way in which farmers can add value to raw milk and has certainly proved successful (albeit over a long period of time) in some other EU member states where vertical integration via co-ops is the norm. However, the history of farmer investment in processing in the UK is not always a happy one, with a number of ventures having failed or not entirely meeting their initial aspirations. Examples such as Amelca, United Milk (Westbury) and Dairy Farmers of Britain spring to mind. This is not to undermine the progress that UK co-ops such as Milk Link and First Milk have made but it is important to appreciate the confidence dent that dairy farmers have received in the past as a result of investments in processing that have not proven to be successful and led to significant losses of investment to farmers.

What is more, farmers have huge amounts of capital tied up in the infrastructure necessary to produce milk. For instance a cow with a value of between £1,500–2,000, requires at least an acre of land worth £6,000–10,000 and capital infrastructure investments of at least £5,000 on top of this. Where farmers have made investments downstream through co-ops or other forms of farmer controlled business, they should certainly expect a fair return on this investment, in addition to a raw milk price that reflects its value in the market place or reflects costs of production.

The NFU encourages and aims to support any member who has the appetite to invest in processing to add value to their milk. However we do not believe such activities should be relied upon to cross subsidise their core business activity of farming. What is more, the value of all milk produced should, to some extent, reflect its contribution to end use. The NFU has consistently argued that there is absolutely no reason why raw milk produced for the liquid market should track commodity market variables as its ultimate use is divorced from these markets.

7. Would you agree with Dairy UK’s claim that “dairy companies pay premiums for security of supply. If they are faced with mandatory contracts that link price and duration of the contract, you reduce the security of supply and you reduce the incentive for dairy companies to pay premiums”?

We do not agree with Dairy UK’s assertion and we can see nothing in the Commission’s proposals that would prevent processors from paying premia in order to secure milk. We understand that the package would simply require contracts to specify either the price, or price formula to be paid (this could take the form of a minimum guarantee) and for this to be agreed by both parties in advance. What is more, the benefits of the dairy package in terms of driving certainty and predictability into pricing arrangements in contracts cannot be under-estimated. At the moment, premia are paid over prices that are not clearly set out in contractual terms (the level of premium may be fixed, but the base price is not). If adherence to a determination mechanism became a contractual clause, which if broken can lead to a notice period break, the best way for a dairy processor to maintain security of supply would be to adhere to the terms of such a price clause.

A farmer who breaks contractual terms such as milk quality, risks his security, likewise a processors who fails to operate within certain price parameters, agreed between parties, should also be exposed to such risk. Can you expand on your comment that the Government should reconsider fiscal incentives to help deal with the cost of cross-compliance?

Our comment was made in relation to capital investment in infrastructure that helps dairy farmers deal with regulatory burdens such as Nitrate Vulnerable Zone requirements on manure/ slurry storage capacity. There are in essence two parts to this. The first of these is the withdrawal of Agricultural Buildings Allowances that allowed farmers to write off a proportion of investment in new buildings, including slurry stores, against tax. This offered an affordable fiscal incentive to induce investment and defray the costs of essential infrastructure needed to meet regulatory requirements (which is normally a depreciating asset). The ABAs are being phased out and being replaced by a considerably less generous Annual Investment Allowance.

The second issue relates to capital grants. Funding for projects relating to NVZs in Wales and Scotland attract a degree of capital support from the Welsh and Scottish governments. This support is not available in England. Furthermore, rural development funds could be targeted to help farmers with cross compliance requirements, through investment and assistance with grant applications for projects relating to environmental improvement (manure management/NVZs) and animal welfare improvements on farm (cattle handling). In
addition there is still scope to improve the environmental credentials and profitability of dairy farming through targeted help with energy efficiency audits and capital improvements as a consequence of these.

8. The implementation of the Fruit and Vegetable Producer Organisation regime by the RPA resulted in the UK incurring substantial disallowance for misinterpreting the regulations. Are the Commission's proposals for Dairy POs sufficiently clear to negate this risk?

It is important to understand the distinction between POs under the Fruit and Vegetables regime and the arrangements proposed in the dairy sector. Under the former, POs are created and recognised as a vehicle for drawing Community funds under the CAP to support the activities set out under a PO's Operational Programme. These activities include enabling growers to become more efficient, improve the quality of their products and respond to environmental demands. In the dairy package, no financial support is made available to POs. Instead, the “incentive” is to allow the body to collectively negotiate contracts on behalf of the individual producer suppliers. As we understand it, the issues in relation to disallowance under the FVP regime relate to the payment of community funds to PO’s that had been incorrectly “recognised” by the RPA. Despite these problems, grower members of PO’s in the UK continue to express considerable support for the fruit and vegetable PO regime and the way in which it has helped them to respond to the demands of the market.

The Commission’s proposals are not entirely clear as to their scope: it is not clear how PO’s would be formed, how they will operate and how they can be organised. These are details we would expect to emerge through more detailed implementing regulations. However, there may well be potential for the formation of POs in the UK dairy sector and we would hope Defra is proactive in its engagement with the Commission in the interim.

Dairy farmers are limited in their ability to work collaboratively to collectively negotiate terms and conditions of trade which are favourable. Barriers include competition law, the nature of the industry and farmers businesses and also the scars of attempts to work collaboratively in the past, in Milk Marque. The commission’s proposals could be the catalyst and facilitator for collective negotiation, through which price determination and other conditions are effectively negotiated in a free manner between dairy processors and farmers. As with all such undertaking the devil is in the detail and the detail is still clouded by the legislative and democratic processes of the European institutions.

June 2011

Written evidence submitted by Dairy UK

POSITION OF DAIRY UK

1. The future of the UK dairy sector is strongly positive. From the restrictive legacy of the Milk Marketing Boards, the sector has taken on the challenges of a de-regulated market and is transforming its competitiveness. The industry is now driven by the needs of the consumer, supported by product and process innovation; it has led the European Union by creating close supply chain relationships between farmers and processors in a sophisticated system of supply chain producer groups; and is undertaking sustained capital investment in factories and farms. The economic outlook for the sector is for rising global demand driven by income and population growth. The UK industry will benefit from this, and our growing competitiveness will allow us to thrive in this environment.

2. In assessing the Dairy Package, Dairy UK’s priority is to secure a profitable future for British dairy farmers whose prosperity is clearly fundamental to the future of the whole dairy supply chain. We have taken a long term perspective. We recognise that there are serious short term pressures on the industry, primarily as a result of volatile input costs. We also recognise that volatility will be a permanent feature of dairy markets, and we have assessed the Dairy Package on whether it will help the industry to improve its competitiveness to accommodate this dynamic.

THE DAIRY PACKAGE

3. In summary, our views on the Dairy Package are:

Contracts

3.1 Dairy UK supports the establishment of arrangements which would see the requirement for contractual arrangements between dairy farmers and processors throughout the European Union. This situation has prevailed in the UK for many years, but it is not universal practice in mainland Europe. However, within this, it is imperative that the content of contracts is established on a voluntary basis, allowing clear market signals to be communicated, trust to develop and, through close understanding, ensure returns from the market place are maximised.

3.2 We believe that the imposition of regulation into these arrangements would work against these objectives. We anticipate that it would lead to increased instability and, in a situation where regulation did not extend across the whole market, the farmer would experience less, and not more, certainty about future earnings.
Producer Organisations

3.3 Dairy UK fully acknowledges the natural right of farmers to organise collectively to market their produce. Producer Organisations are a model for this and they may instil greater confidence amongst farmers that they are legitimately maximising their bargaining power.

3.4 At the same time it is imperative that such organisations remain subject to the normal laws of competition, and that national authorities have discretion to intervene on a case by case basis. The European Commission has recognised this requirement in its proposals and we support its inclusion. If this does not apply, we would anticipate a significant reduction in forward investment by British dairy companies, and this would be detrimental to the future of the British industry.

Inter-Professional Organisations and Transparency

3.5 Given the existence of bodies such as Dairy UK and DairyCo it is not clear to us what the IPO model can contribute to the sector. We have no difficulty with the requirement for purchasers to continue to provide data on milk collection. At the same time, we submit that disclosure of commercially sensitive information would be to the industry’s disadvantage.

Summary

4. We are disappointed that the Dairy Package will do nothing to increase the wealth of the British dairy industry. More fundamentally it does not address the issue of improving competitiveness. Addressing the challenge of the market is the primary mechanism by which the industry improves its competitiveness. There is a risk that the package will simply impede, or may even distort, the operation of the market to the long term detriment of the industry.

Operation of the UK Dairy Market

5. In line with the clear policy direction of both the European Council and the UK Government, the British dairy industry has been preparing to operate in a deregulated market. We anticipate that the removal of the milk quota regime in 2015 will be the final substantive step in the process of market deregulation. We consider that the potential re-introduction of regulation into contract determination would represent a major change in policy direction that would only be valid if there was clear evidence that the UK market was not working.

6. In our view, the dairy market in the UK is fiercely competitive and is working despite the effects of the recession. There is ample competition for milk supply amongst a large number of milk buyers, none of which is in a dominant position. Over the past six years the volume of milk on direct supply to the top six milk buyers in Great Britain fell from 7.6 billion litres to 7.2 billion. There is also ample competition between a large number of retailers and industry customers.

7. We believe that the underlying process of price formation continues to function. Market returns for commodity products determine the underlying trend in farm gate prices. This relationship has not broken down, as evidenced by the following graph which shows the relationship between the UK farm gate price, and the base value for milk (the Actual Milk Price Equivalent adjusted for transport costs).

8. The graph shows a strong relationship over the long term. It is also clear that, as with any market, there are lags but over time these average out. In the latter part of 2010, the market has been affected by new
commercial factors which have served to accentuate these lags. These include a surge in milk production in the UK (milk production over May to January 2011 was 4.5% higher than 2010); and a move by retailers to place greater emphasis on delivering value to consumers as a result of pressure on incomes.

9. This has led to a particularly tough negotiating environment with retailers as they seek to meet consumer demands. But the market is still responding to underlying fundamentals. There has been a flurry of upward movement in farm gate milk prices in January and February this year in response to the strength in commodity markets.

10. Farmers are suffering a major squeeze on margins. Regrettably, as prices are determined by commodity markets, there is no automatic recovery of input costs in dairy. We submit that this situation does not demonstrate a non functioning market. It is in fact a characteristic of the market.

DEVELOPMENT OF CONTRACTS

11. Key to the industry’s development in the UK has been the continuous and rapid development and differentiation of contractual relationships. To facilitate product innovation and the development of greater value added, milk buyers in the UK differentiate their supplying farmers into separate pools to meet the requirements of individual plants, products and customers. Amongst the UK’s major dairy companies, the number of different contracts offered to their suppliers ranges from three up to 13.

12. Investment by buyers in developing relationships with farmers requires stable contractual relationships. Dairy farmers benefit through greater price stability and the payment of premiums. These premiums are not paid at the expense of other dairy farmers.

13. We submit that the regulation of contracts would be fundamentally at odds with the dynamism and innovation shown by the UK dairy industry in this area. At the very least, it could also undermine the stability of contractual relationships to the detriment of both milk buyers and dairy farmers.

PRIVATE DAIRIES AND PRODUCER RELATIONSHIPS

14. The Commission’s stated intention is that Producer Organisations would only effectively deal with private dairies. This suggests the introduction of discrimination in the market place. We can detect no grounds for doing this, either in terms of milk prices paid, investment commitments, or financial performance. We remain concerned about this aspect of the Commission’s proposals pending further clarification.

15. It is not clear how Producer Organisations can work in the UK’s current commercial environment with the existence of Processor Supply Groups and multiple contract types offered by individual buyers.

16. Granting an exemption from EU competition law to permit one segment of the supply chain to create a dominant monopoly is flatly at odds with the concept of a market led industry striving for competitiveness. It would only retard industry development, reduce investment and create inefficiency.

March 2011

Supplementary written evidence submitted by Dairy UK

FOLLOW UP QUESTIONS TO THE ORAL EVIDENCE SESSION ON WEDNESDAY 27 APRIL 2011

1. Please find below our responses to your supplementary questions. Having looked at the questions directed to the Minister we would like to take this opportunity to address the Committee’s concerns over the current operation of dairy industry contracts.

2. The normal practice is for contracts between dairy farmers and milk purchasers, whether co-operatives or private dairy companies, to be:

   — open ended;
   — have long notice periods;
   — commit the milk purchaser buy all the milk produced by the farmer;
   — exclude the farmer from supplying any other purchaser; and
   — leave the price at the discretion of the purchaser.

3. Whilst these type of arrangements may not accord with notions of ‘fairness’, they are unquestionably appropriate to the dairy industry, as it is largely the model adopted throughout Europe and the rest of the world.

4. The reason why contracts have evolved in this way is because dairy producers need to sell their milk on a daily basis. Raw milk cannot be stored for long and it has to be moved off the farm as quickly as possible. Likewise processors need to buy milk on a daily basis. They need to keep their factories full and to continuously serve their customers, especially if they are in fresh product markets.

5. Both parties therefore equally need a secure commercial relationship. For purchasers, the longer the relationship, the more they can invest in it. This can range from maximising transport efficiencies to developing
and marketing products based on that relationships, eg; selling products on the basis of provenance. For co-ops in particular the length of the commitment by the producer also reflects the producer’s commitment to their fellow farmers in the co-op.

6. The product made from the raw milk is sold onto volatile markets. Purchasers simply do not know with any great certainty what they are going to be paid for the product and consequently what they can pay the producer. Price certainty is therefore not available to any party in the dairy industry supply chain in volatile markets. As a result, the focus of the producer/purchaser contract is to give security to both parties. Price is left to the determination of the market.

7. It is inherent in this model that purchasers have to continue to pay a competitive price to producers. If they do not, the producer will resign and the purchaser will lose their supply of milk. As purchasers seek security of supply, then they are under a commercial imperative to prevent this from happening.

8. All the evidence from the market indicates that purchasers continually adjust their prices to ensure that they are in line with market developments and that they are competitive, and that the market is operating effectively to protect producers.

9. As with all other markets the trend in UK farm gate prices is driven by the trend in commodity markets. As requested we attach our analysis of price formation in Europe and the USA.

10. It has been argued that these arrangements leave farmers in a state of excessive and unnecessary uncertainty. Uncertainty is inherent in a volatile market. However, purchasers have moved to create supply group organisations that represent the farmers contracted to them. Purchasers use these organisations to maintain a constant dialogue with their farmers. Separately farmers are also well served by the market information made available by DairyCo. As a result there is high degree of knowledge throughout the industry on market developments.

11. Producers are hypothetically exposed to the risk of retrospective price changes under this model. It is a practice that Dairy UK is strongly opposed to. However, instances of retrospective price changes are extremely rare. In the most recent instance when this did happen, it accelerated the collapse of the purchaser as a business because of the resulting resignation of producers.

12. If regulation of contracts results in the duration of contracts being linked to changes in price, (ie; the contract would have to be re-negotiated if the price was to be changed) then market volatility would mean that purchasers could only address the commercial risk of potentially uncompetitive raw material costs by cutting the duration of contracts. This would result in a long term loss of income to farmers. This is because purchasers pay premiums for security of supply. Those premiums would no longer be available.

13. It has been contended that mandatory contracts that link contract duration to price changes would somehow place purchasers in a better negotiating position with their retail customers. The idea is that customers would be less likely to press for price cuts if they felt that purchasers would lose their milk supply. This idea fails to take account of the competitiveness of wholesale markets. Industry customers have a range of competing dairy companies, both UK and international, to choose from. Restricting the ability of UK dairies to respond to market movements would only undermine their competitiveness to the advantage of importers.

14. The reason why contracts normally require exclusivity is a matter of practicality. The vast majority of farmers are still relatively small. It is simply not cost effective for a purchaser to collect only a portion of a producers output. It would also contradict the need for security of supply if a producer could switch from one purchaser to the next on a daily basis depending on short term price changes.

15. Non-exclusive contracts may become more practical as producers grow larger and contractual arrangements are developed that give purchasers predictability in the volumes of milk collected. There are already examples of non-exclusive contracts in operation. This is particularly the case where the producer is also a small processor and they want an outlet for their surplus milk.

Responses to Questions

1. Your evidence states that “The key driver is increasing the pie. The disappointing aspect for us of the dairy package is that it does not do that”. What could the Commission or the Government be doing to help increase the pie?

Routes to achieving greater value added include:

- Improving industry cost efficiency.
- Increasing product differentiation.

Greater efficiency requires research & development, innovation and knowledge transfer. The Commission and the Government could contribute by giving greater emphasis to these issues in the forthcoming reform of the CAP.
There are an enormous variety of routes available to the industry to achieve product differentiation but the contribution by the Government and the Commission could include:

- Providing a secure legal foundation for country of origin labelling. This would help the industry to market product on the basis of provenance.
- Reconsider the requirements of the Nutrition and Health Claims regulation which is putting severe restraints on the ability of the industry to market products on the basis of established nutritional science.

2. Does the situation regarding competition law need to be clarified to encourage co-operation and collaboration in the dairy industry?

Maintaining the integrity of competition law is a prerequisite to investment in the industry. Our objection to the Dairy Package is that it proposes to grant certain segments of the supply chain an exemption from competition law. Aspects of competition law dealing with producer co-operation could usefully be clarified.

Effective implementation of existing competition law provides assurance to all parties in the supply chain that they will not be subject to monopolies exploiting their market power. This is a necessary pre-requisite to attracting investment into the industry. Without it investors cannot have confidence in the value of their investment. Consequently it is important that the Dairy Package does not curtail the application of competition law, or grant exemptions to particular segments of the supply chain.

The operation of competition law in respect of co-operation between producers is not clear. In examining the Dairy Package, Defra identified a range of opportunities that already existing for co-operation between dairy producers in the marketing of their product. Most of these were not widely known or understood.

The legal status of producer organisations in the dairy sector also needs to be regularised. The model is available in the fruit and vegetable sector and there is no reason in principle why it should not be extended to the dairy sector.

3. The NFU’s written evidence to us advocated the use of facilitators to help in negotiations between buyers and producers. What is your view of their proposal?

We need to see the NFU’s proposal before we can comment in full but if our interpretation is correct then we would have some reservations.

We have not had sight of the NFU’s written evidence and we do not know the details of their proposal. We would need to see it before we can comment on it in detail.

If negotiations are undertaken by buyers and groups of producers, then commercial good sense should ensure that producers will access the negotiating expertise that they require to function as a credible selling group. Most dairy farmers are capable businessman and skilled negotiators. This is especially the case given the number of inputs required to run a dairy farm.

If our understanding of the concept of a facilitator is correct then it implies that a party would, at minimum, sequentially represent a number of producer groups in negotiations with a range of milk buyers. This implies that the facilitator would be privy to the commercial intentions of the various groups they represent and the outcome of the negotiations they participate in. This could contradict competition law and prejudice the interests of milk buyers.

At most a facilitator would negotiate on behalf of a number of producer groups simultaneously with a number of milk buyers. Depending on the scale of producer groups involved this could effectively result in the creation of a scale monopoly. Consequently, whatever the extent of the facilitators role, appropriate safeguards would have to be put in place to ensure continued competition in the supply chain.

4. Your evidence refers to volatility being the main problem facing the Dairy industry at the moment. Could the Commission or Defra be doing more to help producers and processors manage volatility?

The Commission needs to play a continuing roll in minimising extreme downward price volatility through the provision of a safety net.

This issue is being considered as part of the CAP Reform debate. During the last price slump in 2008–09 the existence of intervention purchasing helped to stabilise markets and protect producer income.

The EU needs to continue to play this role as dairy markets are inherently unstable. This is because like all agricultural commodities, demand for dairy products is relatively inelastic. Consumption does not rapidly respond to changes in price. This means that small variations in global supply can result in large changes in price.

The industry will benefit from a functioning futures market for dairy commodities. Futures contracts have been launched in a number of exchanges but they have yet to achieve liquidity.
The most effective means available to the industry to minimise the effect of volatility is to invest in value added products. These products are less exposed to the price volatility of commodity markets.

5. You stated that "So dairy companies pay premiums for security of supply. If they are faced with mandatory contracts that link price and duration of the contract, you reduce the security of supply and you reduce the incentive for dairy companies to pay premiums. It is as simple as that". Please could you explain exactly how the Commission's proposal for a mandatory contract specifying volume, duration etc. would reduce security of supply, and for whom?

The Commission's proposal could be interpreted to link the duration of contracts to changes in price. If this is the case then the industry would end up operating with shorter contracts. As these would not provide security of supply the premiums paid by purchasers for security would be lost.

There is still some uncertainty over how the Commission's proposal is to be interpreted. Initially the Commission indicated that it was their intention to link contract duration to changes in price. More recently they have moved away from this position and indicated that existing industry practice of purchasers setting prices would be entirely compatible with the regulation.

However, the regulation is still subject to debate in the European Parliament. Further amendments to the regulation could substantially alter its meaning. Whatever falls out of the legislative process will also have to be interpreted in the UK.

The view has been put forward that regulation should be used to achieve greater certainty for producers over price and that farmers should be able to resign from contracts if they are subject to a price change that they did not agree with. These views could significantly affect the implementation of the regulation in the UK and the devolved regions. There is therefore a distinct possibility that the implementation of the regulation in the UK will result in contract duration being linked to price.

Given the uncertainty of the volatile markets served by the industry, as stated above, milk purchasers could only respond by shortening contracts. This would drive out industry premiums and increase price instability for farmers.

6. Your evidence opposed mandatory contracts. Is it the fact that having a contract would be mandatory that you disagree with, or do you think that contracts should not have to contain the four elements suggested by the Commission (volume, duration, price, seasonality)?

We have no difficulty with a requirement for contracts. Likewise we have no difficulty with the idea that they should cover the four elements proposed by the Commission. However, we are opposed to anything that would prescribe precisely how those elements are met. It should be left to the negotiating parties to determine.

7. Do share the NFU's concern that the 'critical mass' is being lost in the UK dairy industry that will hamper its ability to respond to future opportunities?

There may be issues in certain regions but we believe there should be good grounds for confidence that the UK industry as a whole is sustainable.

Dairy UK's objective is for a sustainable future for all segments of the dairy industry supply chain. The industry’s long term prospects are strongly positive. The UK dairy industry is the third largest in Europe and milk production is expanding. Output grew by 4% last year.

Dairy farming is however concentrating into certain regions in the UK. The two maps below show the difference in the distribution of dairy farmers in England between 1980 and 2006. Clearly dairy farming will be losing critical mass in certain areas, but hopefully it will be gaining in others.
8. Has the introduction of dedicated supply groups benefited the UK dairy industry as a whole?

The industry has generally benefited from these arrangements.

We presume that this question is about the integrated supply arrangements put in place by retailers for the supply of liquid milk.

Benefits include:

— Price premiums to the farmers involved.
— Closer supply chain relationships.
— Reduction in confrontational industry politics.
— Investment by retailers in farmers.
— Better on farm production standards.
— Closer alignment between industry practices and consumer expectations.
— Quicker exploitation of market opportunities.

However, they are not an unqualified benefit. The disadvantages include:

— Creation of have and have nots amongst farmers.
— Costs of milk segregation.
— Loss of opportunity to develop brands under the ownership of the industry.
— Evolution to direct producer/retailer contract could expose processors to loss of milk volume if producers were transferred by a retailer to a new processor.

Because of these qualifications it is a matter of commercial judgement for individual processors and their supplying producers whether they would wish to facilitate the development of integrated supply chain arrangements for raw milk for the manufacture of cheese.

The term ‘supply groups’ can also refer to those organisations established to represent the interests of farmers supplying an individual processor. These organisations are of unquestionable benefit to the industry.
9. Your evidence referred to the role for Government in determining labelling (Q 97). Are the food industry’s voluntary principles sufficient to protect British products, or do you believe additional regulations on country of origin labelling for dairy products are needed?

Yes. Dairy UK’s preference is for country of origin labelling to be made mandatory.

The voluntary code of practice helps to move commercial practice in the desirable direction and we appreciate the Government’s role in facilitating the development of the voluntary code.

The important point is that the objective is to distinguish between product produced in the UK and product imported from outside the UK. There should be no obligation to distinguish between country of origin within the UK.

10. Your evidence suggested that transparent sharing of information on pricing is already happening (Q 62). However, do you accept the Commission’s assessment that price transparency across the whole industry is needed, not just between processor and producer within individual supply groups?

Our understanding of the Dairy Package is that the Commission is not proposing greater price transparency across the whole industry.

As drafted the regulation only provides the legal basis for the continued collection of information on deliveries of milk to dairies after the cessation of the quota regime.

We fully support the greater sharing of information within supply chains. This was the substance of our reply to the Committee’s question. We do not support full transparency between supply chains. Full disclosure of commercially sensitive information would act to the detriment of the industry. It would allow the industry’s customers to exert greater commercial pressure on the sector.

11. According to media reports, you recently told farmers in Queensland that UK farmers were facing an unsustainable cost price squeeze from the major supermarkets. If this is the case, could you clarify your evidence to the Committee that:

In our view, the process of price formation in the dairy industry is fundamentally from the bottom up. It starts in the commodity markets, goes to the raw milk market, goes to the wholesale market and then is left up to the retailer to decide how they want to take a position in the marketplace with consumer. As such, what happens in the retail market is almost completely independent of what happens in the raw milk market and the income to the dairy farmer. So it is not a question of trying to appropriate additional margin from the retailer and distributing it back to the dairy farmer. In a properly functioning marketplace, that is simply not going to happen. The dynamic is in the other direction, and it is a problem of the industry addressing volatile commodity markets and the effect it has on farmers that we have to address, and there is not a ready-made solution to try to appropriate margin from the retailer. In terms of the functioning of the market, it is not there. (Q 89)

The statement made in Australia is fully consistent with the evidence given to the Committee.

The quote referred to in the question was erroneously attributed to Jim Begg. However, in the context of the Australian market it accurately described the dilemma facing certain Australian farmers. This does not however contradict our view of market dynamics in the UK. The apparent inconsistency is due to the differences in geography of the UK and Australian raw milk markets.

The raw milk market in Great Britain is effectively a single entity and most dairy farmers have a range of buyers to choose from. In Australia things are very different. The size of the country means that the raw milk market is fragmented and dairy farmers supplying raw milk to the liquid market do not have an alternative outlet. This means that some farmers do not benefit from the support to the market given by commodity prices. Consequently price discounting by Australian retailers may affect milk prices to these farmers.

June 2011

Further supplementary written evidence submitted by Dairy UK

PRICE TRANSMISSION IN FARMGATE MILK AND DAIRY COMMODITY PRICES: A COMPARATIVE STUDY OF US, UK AND EUROPEAN MARKETS

Dairy UK is the trade association that represents the interests of producers, producer co-ops and dairy companies in the UK. Members of Dairy UK process around 85% of the milk produced in the UK. Further information on Dairy UK can be found at www.dairyuk.org

1. INTRODUCTION

The issue of price transmission in the dairy industry has been the subject of significant interest and research in recent years. Of particular interest, both in the US and Europe, has been the relationship between farmgate,
commodity\textsuperscript{1} prices and retail prices for milk and dairy products. A key question in the debate surrounding milk price relationships concerns whether or not farmgate prices respond to changes in commodity prices, and crucially if responses are proportional and maintained over time. Answering this question can go a significant way to ascertaining whether markets are “functional” and operating efficiently.

The focus of this paper will be to examine the relationship between farmgate and commodity prices within UK, US and European markets. The aim will be to ascertain whether or not these prices operate in a broadly systematic manner in the UK and how this compares to the relationship that exists in the US and European markets.

2. Methodology

The starting point of the research presented here is a model of European milk pricing outlined by staff at the dairy industry trade body CNIEL (Centre National Interprofessionnel de l’Economie Laitière)

2.1 Price Transmission Model

The model assumes that farm gate prices follow commodity prices, the precise mixture of which being particular to the circumstances prevailing in the national market.

For selected EU countries the model assumes that:

— Continental farm gate prices are driven by the German commodity market where farm gate prices follow commodity prices (weighted 70% for Cheese and 30% for butter/powder) with a lag of one month. Cheese prices in this context consist of; 48% fat Gouda, 40% fat Edam and 10kg Emmental blocks with the Kempen quotations for each of these equally weighted to create a single “German Cheese Price”.

— The Belgium, Dutch and Danish markets follow German commodity prices in broadly the same fashion.

— The French use a national milk pricing system consisting of an index based on:
  — 20% butter and SMP quotations;
  — 20% German cheese prices (again using a mean of 48% fat Gouda and 40% Fat Edam and 10kg Emmental blocks);
  — 60% fixed to represent domestic sales of fresh products; the resulting price is then adjusted in order to keep it in line with German Prices;

— Spanish farmgate prices follow French prices with a premium of 3 cents to match the transportation costs of condensed milk from western France to Spain.

— Polish farmgate prices are linked to domestic commodity prices for butter and powder.

— Irish farmgate prices are linked to domestic commodity prices for butter and powder.

This paper will not look at the French and Spanish markets since prices are driven by France’s national milk pricing formula and as such do operate in a manner that is easily comparable to other European Markets.

To see how US and UK prices compares with this model it was assumed that:

— UK farm gate prices follow butter/powder and mild cheddar markets. A weighted average of 80% mild cheddar and 20% butter/powder was chosen as the best fit,

— US farmgate prices follow US butter/powder returns.

2.2 Commodity and Farmgate Price Index

A single “commodity price” was created for each country by combining the combining monthly average whole sale prices with the following weightings.

<table>
<thead>
<tr>
<th>Country</th>
<th>Cheese</th>
<th>SMP/Butter\textsuperscript{2}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>70%</td>
<td>30%</td>
</tr>
<tr>
<td>Ireland</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Poland</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>US</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>UK</td>
<td>80%</td>
<td>20%</td>
</tr>
</tbody>
</table>

The resulting prices were then indexed to the average commodity price in 2003 to allow comparison with corresponding farmgate prices which were also indexed in the same manner. As such when the each index

\textsuperscript{1} For the purpose of this paper “commodity” shall refer to the drivers of farm gate prices in respective markets, be they SMP, Butter or Cheese.

\textsuperscript{2} SMP/Butter price is weighted as 60% SMP and 40% Butter
price falls below 1.00 this indicates a fall in price relative to 2003 levels and an increase above 1.00 indicates an increase in price relative to 2003 levels.³

The objective of this analysis is to determine the extent to which farm gate prices reflect the trend in commodity markets.

3. COMPARISON OF MARKETS

The resulting indexed prices have been plotted and are presented on the graphs below. Figs 1 to 3 show the indexed data for the UK, German and US commodity and farmgate prices.

**Fig 1**
UK BUTTER/SMP (20%) MILD CHEDDAR PRICES (80%) AND FARMGATE MILK PRICES 2003 TO 2011

![Graph showing UK butter/SMP and milk prices 2003 to 2011]

**Fig 2**
GERMAN BUTTER/SMP (30%) AND CHEESE (70%) AND FARMGATE MILK PRICES 2003 TO 2010

![Graph showing German butter/SMP and milk prices 2003 to 2010]

³ Polish prices are indexed to the average price of May 2004 to May 2005. USA Data is indexed to the average price for 2004 as data is not available prior to this.
As the graphs above demonstrate, UK, German and US markets all function in the same manner with farmgate prices following their respective basket of commodity prices very closely. UK markets have tended to be less volatile than their German and US counterparts and saw a much smaller fall in prices in 2009 than either Germany or the US. This was not due to the effect of sterling as all data is in domestic currency.

3.1 Data Plotted as Rolling Annual Average

Figs 4 to 10 show a rolling annual average of the indexed commodity and farmgate prices of all countries in the study which allows us to see general trends more easily with the effect of seasonal payments evident in Figs 1 and 2 below eliminated.
Fig 5
GERMAN BUTTER/SMP (30%) AND CHEESE (70%) AND FARMGATE MILK PRICES 2003 TO 2010—MOVING ANNUAL AVERAGE

Butter/SMP/Cheese
Milk Prices

Fig 6
US BUTTER/SMP AND FARMGATE MILK PRICES 2004 TO 2010—MOVING ANNUAL MEAN

Butter/SMP
Milk

Fig 7
GERMAN BUTTER/SMP (30%) CHEESE PRICES (70%) AND DUTCH FARMGATE MILK PRICES 2003 TO 2010—MOVING ANNUAL AVERAGE

Butter/SMP/Cheese
Milk Prices
**Fig 8**
GERMAN BUTTER/SMP (30%) CHEESE (70%) AND DANISH FARMGATE MILK PRICES 2003 TO 2010—MOVING ANNUAL MEAN

**Fig 9**
GERMAN BUTTER/SMP (30%) CHEESE (70%) AND BELGIAN FARMGATE MILK PRICES 2003 TO 2010—MOVING ANNUAL MEAN
4. Findings

Whilst the analysis used above uses a broad brush approach and a more detailed analysis would be required to fully understand the relationship between commodity and farmgate prices in the countries examined we are able to see a clear linear correlation between the data sets. The UK, German and US markets demonstrate the closest correlation between commodity and farmgate prices, indicating the most functional and predictable relationship.

The three scatter graphs below demonstrate the level of statistical correlation between commodity and farmgate prices measured, using Pearson’s Correlation Coefficient as a means of analysis which is a fairly standard technique for statistical analysis.

Pearson’s Correlation Coefficient is a measure of the correlation (linear dependence) between two variables X and Y, giving a value between +1 and −1 inclusive. A figure of 1 indicates a very strong positive correlation; in this instance a figure of 1 would see farmgate prices fluctuating in line with commodity prices in a predictable and linear fashion.⁴

⁴ Please note; farmgate prices used for correlation analysis have been adjusted to remove the effect of seasonal payments where these exist.
The table below displays the correlation coefficient for each of the countries examined. All the countries show a very high level of correlation.

<table>
<thead>
<tr>
<th>Country</th>
<th>Coefficient Correlation</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>0.96</td>
</tr>
<tr>
<td>Germany</td>
<td>0.93</td>
</tr>
<tr>
<td>USA</td>
<td>0.89</td>
</tr>
<tr>
<td>Belgium</td>
<td>0.88</td>
</tr>
<tr>
<td>Holland</td>
<td>0.85</td>
</tr>
<tr>
<td>Denmark</td>
<td>0.73</td>
</tr>
<tr>
<td>Ireland</td>
<td>0.69</td>
</tr>
<tr>
<td>Poland</td>
<td>0.66</td>
</tr>
</tbody>
</table>

![Graph](chart1.png)

R = 0.96

![Graph](chart2.png)

R = 0.93

![Graph](chart3.png)

R = 0.89
The data used for the analysis above has not been adjusted for time lag that exists between commodity and farmgate fluctuations, if the time lag is taken into account it is likely we would see an increased level of correlation across the board with a marked increase seen for Danish and Irish Markets.

5. CONCLUSIONS
This paper supports the assertions advanced by Dairy UK that:

— Globally, farm gate prices follow trends in commodity markets.
— UK farm gate prices follow trends in butter/SMP and mild cheddar.
— That the UK market is not dysfunctional compared to its global counterparts.

May 2011

Written evidence submitted by The Co-operative Group

1. INTRODUCTION

1.1 The Co-operative Group is the UK’s largest mutual retailer, with some six million customer members. It is a family of businesses, most of which are consumer-facing, and range from food retailing to financial services, and from pharmacy to farms. By far the largest business is The Co-operative Food which, following the acquisition of Somerfield in March 2009, now operates around 3,000 stores in communities throughout the UK with over 20 million customer transactions each week.

1.2 The Co-operative Group fulfils a federal role for all other consumer-owned co-operative societies through the Co-operative Retail Trading Group (CRTG). CRTG manages the buying and promotional function on behalf of those societies, including the supply of liquid milk and other own-brand dairy products.

1.3 The Co-operative Group welcomes the opportunity to provide evidence to the Environment, Food and Rural Affairs Committee as part of its inquiry into the implications for the UK dairy sector of the European Commission’s package of Milk Proposals.

2. THE CO-OPERATIVE GROUP AND THE UK’S DAIRY SECTOR

2.1 Over recent years, The Co-operative Group has undergone a process of significant change with revitalisation of the Co-operative brand and significant capital investment in its businesses. As part of this process, The Co-operative Group has renewed its focus on its direct offer to customers and members through a strategic review of the sectors in which it competes.

2.2 Less than 10 years ago, The Co-operative Group was unique amongst retail organisations because three of its then businesses had a direct stake in the dairy supply chain; namely, through its farming business, its liquid milk processing business and its retail outlets.

2.3 In November 2003, The Co-operative Group announced that its farming business, The Co-operative Farms, was to withdraw from dairy farming. The Co-operative Farms remains, to this day, a leading farming business but until 2003 it also operated a sizeable dairy operation in England, producing over 20 million litres of milk a year.

2.4 The withdrawal from dairy farming was an integral part of restoring long term viability to the commercial farming business which had not been immune to the impact of the down-turn in farm incomes in the late 1990s. Essential to The Co-operative Farms’ journey on the road to recovery has been a determination to be significantly more customer-focused, adding value to the primary production process, reducing dependency on commodity products and developing a new Grown by us range of own-brand products for The Co-operative Foods which now includes crops that range from soft fruits to top fruits (including heritage apples) and from potatoes to honey. The decision to withdraw from the dairy sector was, therefore, made in order to concentrate resource—both in terms of potential capital expenditure and employee expertise—on sectors where The Co-operative Farms was confident in its ability to add significant value as part of its customer-focused strategy.

2.5 In the dairy sector, however, the outlook for The Co-operative Farms was bleak. The fluctuating variances between cost of production, farm-gate price and prices at other points in the supply chain have been well-documented elsewhere. The Co-operative Farms in the run-up to its decision in November 2003 was not immune to this variance. In addition, The Co-operative Farms faced labour costs that were significantly higher than many individual, family-led dairy farmers with a package of benefits that are market-leading in the primary agricultural sector and yet are fully in line with The Co-operative’s corporate remuneration scheme. The globalised dairy sector also presented challenges for the UK dairy sector as a whole, with a number of countries producing dairy commodities for export at costs well below those that were sustainable in the UK.

2.6 The Co-operative Farms, therefore, faced a situation where, despite high levels of technical performance at its dairy sites, its “input” costs were at a comparatively high-level which were not commensurate then, or in the longer term, with income levels. Various structural factors therefore drove the decision to withdraw from dairy farming, and instead to concentrate on other sectors of UK agricultural output. It is recognised that this
strategic opportunity to divest in one sector and, meanwhile, to consolidate in others is an option that would not have been open to the vast majority of the UK’s dairy farmers.

2.7 Similarly in the summer of 2004, The Co-operative Group announced the sale of its Associated Co-operative Creameries milk processing business to Dairy Farmers of Britain (DFB). The subsequent collapse of DFB has formed the basis of a previous inquiry by the Committee. But the decision by The Co-operative Group to withdraw from dairy processing was part of a strategic review, led by its Board, with a determination to focus on those commercial sectors where there was clear potential to add value to its consumer-members.

3. The Co-operative Group and the UK Dairy Market Today

3.1 Today, through the CRTG network of co-operative food stores, we sell some 1.7 million pints of milk each day.

3.2 The Co-operative Group announced in November 2010 that it would move to a dedicated milk supply scheme, and in March 2011 announced that the contract for the supply of some 363m litres of milk a year had been awarded to Robert Wiseman Dairies under a new two-year agreement commencing in August 2011.

3.3 Within the UK’s retail sector, The Co-operative Group has followed the trend of moving towards dedicated milk supply rather than leading the way. Discussions were initiated in 2007 with our then suppliers, Dairy Farmers of Britain, about moving towards a new form of dedicated supply chain. However, these exploratory talks were rejected by DFB which claimed to have in principle objections to any differentiated contract structure within its membership base. DFB appears to have been the only large dairy processor that objected to the option of the “farmer pool” model. Following a clear and transparent tender process in 2009, it was announced later that April that DFB had not been successful in securing any contracts to supply fresh milk to CRTG.

3.4 The new contract with Robert Wiseman Dairies will, however, create a new supply model that, in partnership with the processor, will herald the development of long-term, transparent, relationships with the circa 350 British dairy farmers that will be recruited to the pool.

3.5 Central to this new agreement will be a partnership approach that seeks to enhance the sustainability of the UK’s dairy sector by driving up environmental standards while fostering improved supplier (ie farmer) and customer (ie retailer) dialogue and understanding. Farmers who are selected to form the pool supplying milk to The Co-operative through Robert Wiseman Dairies will receive a premium and wider benefits in return for a number of pre-requisites.

3.6 Several of the elements that will form the basis of the three-way partnership will take forward the work of the Dairy Supply Chain Forum’s Sustainable Consumption and Production Taskforce, on which a number of retailers—but not The Co-operative Group—participated. The Milk Roadmap, launched in May 2008, set a number of targets designed to reduce the environmental impact of the dairy industry. The Co-operative Group’s focus on a number of these environmental impacts will contribute to the sector’s progress in achieving the targets. Likely prerequisites, for instance, will be Energy and Carbon annual assessments which include, greater nutrient planning, measures to reduce water use and improve water harvesting that should contribute to measured and improved reductions in carbon footprint. In addition, all farms that form part of the pool will be expected to conform to an approved agri-environment scheme such as the Entry Level Environmental Stewardship Scheme (and their equivalent in Scotland and Wales).

3.7 Given The Co-operative’s long-established commitment to animal welfare and the importance attached to the issue by Co-operative members as part of The Co-operative Food Ethical Policy, the health of the dairy herds that may form part of the pool will also be a prerequisite. A healthy dairy herd is clearly an efficient herd, and so evidence of proactive herd health plans that are informed by data input to a national milk recording service and locomotion scoring (to assess mobility) will be part of the agreement.

3.8 Both the package of environmental impact and animal welfare measures have been championed within the Dairy Supply Chain Forum because, crucially, they can be proved to drive up standards while simultaneously delivering cost savings and greater efficiencies to farmers themselves.

3.9 Greater mutual dialogue will be established with the farmers who form the pool through the establishment of “business groups” with around fifteen farms in each group, annual farmer meetings and a Co-operative suppliers committee which is envisaged will meet four times a year alongside representatives from the processor and the dairy team from within The Co-operative Food.

3.10 Early thought is also being given to whether it will be possible for farmer members of the dedicated supply chain to access synergy benefits that may exist with other businesses within The Co-operative Group, not least the procurement strength and technical expertise of The Co-operative Farms.

4. The European Commission’s Proposals

4.1 Clearly now that The Co-operative Group’s engagement in the dairy sector is primarily driven by consumer-facing retail interests, the work of the High Level Group and subsequent Commission proposal’s on contractual relations have been monitored from afar rather than integral to developing business strategy.
4.2 The Co-operative Group already comes within the scope of the Groceries Supply Code of Practice (GSCOP) and it is too early to predict what impact the Groceries Code Adjudicator may have on supplier relationships. However, The Co-operative Group would not favour any move towards a prescriptive, EU-wide approach to contract negotiation, and considers that it could bring with it rigidity that would risk stifling innovation and efficiency.

4.3 Similarly, our experience of producer organisations in other agricultural sectors through The Co-operative Farms (strawberries, peas, apples) has brought limited benefit. UK growers have rushed to join the relevant organisations in order to feel part of a competitive level playing field with continental growers who are already participating. But the uncertainty around the administration of the scheme has been coupled with little evidence of net benefit. The advantages for producers are, therefore, less-than-proven. Although not yet in implementation phase, The Co-operative Group is keen to work closely with the farmers that will form part of the Wiseman Milk Partnership.

4.4 One area where progress remains slow in comparison to some of the UK’s global competitors lies within the area of Research and Development. The Co-operative Group believes that the future of the UK’s dairy sector will rest on continuous technological progress with a strategic programme of research and development and that this is an area where Commission focus should be prioritised.

5. General Observations

5.1 As the UK’s largest co-operative business, The Co-operative Group is proud of its co-operative ownership, structure and identity. We believe passionately that co-operative enterprises are both a viable and credible alternative to the proprietary business model. The Co-operative Farms has also long been a protagonist for significantly enhanced collaboration amongst farmers, who sometimes may regard their local farming neighbour as the main competitive rival, while neglecting the competitive challenges that exist on a global level. But it is important that the same commercial disciplines apply to co-operatives as to any other type of business. Increased, and necessary, collaboration amongst farmers and growers is, in our view, possible within the framework of existing competition law.

April 2011

Written evidence submitted by the European Commission

FOLLOW UP QUESTIONS TO THE ORAL EVIDENCE SESSION ON TUESDAY 3 MAY 2011

1. Please could you clarify why the Commission’s proposals for Producer Organisations in Dairy do not include the grants for adding value that were available to those in Fruit and Vegetable Producer Organisations? What grants will be available to Dairy Producer Organisations?

As regards the aid for producer organisations (PO) in the fruit and vegetable sector, please see Regulation (EC) No 1234/2007, Title I, Chapter IV, Section IVa, on aids in the fruit and vegetable sector.

Contrary to milk, where ± 95% of the production is delivered to dairies for adding value by processing into dairy products fit for consumption, most of the fruits and vegetables are fit for direct consumption after having been harvested, cleaned, possibly cut and packaged. Therefore value can be added at farmer level especially where they are organised in producer organisations, which allows also to concentrate the offer.

To start a public aid scheme to finance investments in processing milk by PO would create distortion of competition between such PO’s and existing industry. However, nothing prevents producer organisations to develop into a processing co-operative on the basis of investments paid by the members.

A proposal is made to grant starting up aids (no investments) for setting up producer groups that can develop into producer organisations (see COM (2010) 537 final, point 7).

2. You referred to Mr Paice, the Minister for Agriculture's involvement in a forum on the functioning of the food chain. Please could you provide the Committee with additional information on the workings and output of this forum?

Please see Commission Decision establishing the High Level Forum for a better functioning Food Supply Chain (Official Journal C 210 of 3.8.2010, page 4).

3. Under current EU competition law, what is the limit on the proportion of national or EU-wide milk production that can be produced by a single co-operative or private company?

There is no such limit. Article 102 TFEU only prohibits abuse of a dominant position; it does not prohibit the existence of a dominant position itself. Under the Merger Control Regulation, however, as administered by DG COMP, however, mergers of undertakings may be prohibited if the size of the resulting entity would give rise to competition concerns. No such rules would apply to the normal growth of an entity (eg by more members joining a co-operative).
4. Can you explain what ability National Competition Authorities will have to investigate cases of unfair competition under the current European Commission Milk Package proposals?

First, it is worth noting that currently EU competition law applies to the dairy sector, pursuant to Article 175 sCMO, subject to the limited exceptions of Article 176. Therefore both NCAs and the Commission (DG COMP) may apply the general rules on cartels and monopolies (EU and/or national) in the dairy sector in the same way as in other sectors of the economy under general competition law.

The only changes made to this situation by the dairy proposal are a limited anti-trust exemption for certain activities of dairy inter-branch organisations, and in particular a provision permitting collective negotiations by producer organisations on behalf of their members with dairy processors (subject to certain limits) as set out in the milk package proposal point 4, adding a new Article 126a to the sCMO.

To apply this Article, the competent national authorities first have to recognise the producer organisation. They should also ensure that the provisions of Article 126a are respected. In case that competition is excluded or to avoid serious prejudice to SME processors, National Competition Authorities may intervene in situations covering their national territory (see paragraph 5 of the same proposed Article).

May 2011

Written evidence submitted by Tesco Stores PLC

1. EU Proposals

1.1 The European Union proposals are intended to help balance the supply and demand for milk, stabilise income for farmers and improve transparency throughout the dairy supply chain.

1.2 A key component of these proposals is formal contracts, forming written agreements between the farmer and the processor. For liquid milk, Tesco has direct relationships and contracts with over 700 dedicated dairy farmers who form the Tesco Sustainable Dairy Group (TSDG).

2. Tesco Sustainable Dairy Group

2.1 The TSDG provides us with quality assurance and stability of supply as we know the source of all our fresh milk. For farmers, it provides a guaranteed market for all the milk they can produce, as well as access to shared expertise and learning from other farmers and the Tesco Dairy Centre at the University of Liverpool.

2.2 We provide TSDG members with a guaranteed price for milk which is independently reviewed twice a year taking into account farm input costs and market prices. The price we pay is based on an accurate cost of production and is not simply led by market forces. From 1 April, Tesco dairy farmers who take part in the independent cost tracker review will receive a new price of up to 29.78ppl. This is an increase of 1.60ppl, since the previous six-month review last September.

2.3 The new payment follows an independent check of Tesco farmer production costs by Promar, the research consultancy specialising in agriculture and agri-food sectors. The increase is mainly a result of higher feed costs. This new price is significantly higher than the average processor’s price currently paid to dairy farmers, at 26.74ppl.

2.4 However, the Group is about more than just price. It is about establishing collaborative relationships within our milk supply chain and working together to improve quality, animal welfare and environmental impacts. In practice this means regular communications through regional meetings, workshops and conferences; high standards through for example mobility scoring and milk recording; reducing environmental impacts through our carbon footprinting and labelling exercise and nutrient management plans and research and best-practice through our dairy Centre of Excellence at Liverpool University.

3. Research and Development

3.1 We invest in research and development for a number of reasons:
   — It helps our suppliers to improve productivity and address issues such as environmental degradation and animal welfare.
   — It helps us to reduce our carbon footprint and to chart the route to a low carbon economy.
   — It improves our efficiencies and lowers costs.
   — It encourages innovation.
   — It ultimately improves the quality of products and services for customers.

3.2 Dairy Centre of Excellence—We are collaborating with the University of Liverpool on the Tesco Dairy Centre of Excellence, which aims to bring together the whole of the industry to look at issues from animal welfare to consumer trends.
3.3 The centre has undertaken a number of research trials into areas such as lameness, fertility and nutrition. With conditions such as lameness costing British dairy farmers thousands of pounds a year, this research will make a real difference to the welfare of herds and the competitiveness of the dairy industry.

3.4 In this coming year, research will focus on reducing the environmental impact of milk production—an increasingly important area and one where we are already making good progress. In 2009 we were the first retailer to label the carbon footprint of a pint of milk and, in line with the dairy industry’s Milk Roadmap, 10 per cent of our milk containers are now made from recycled material.

3.5 The University of Liverpool has been trialling on-farm measurement devices to determine if management system or feed type has any impact on methane emissions. It has also been looking at heat recovery and rainwater harvesting systems to be used on the farm.

3.6 We opened the new visitor centre in January 2010 which aims to be a national resource for schools, farmers and dairy industry experts. It will enable groups to engage with the work of the centre by hosting education and industry workshops.

April 2011

Supplementary written evidence submitted by Tesco PLC

FOLLOW UP QUESTIONS TO THE ORAL EVIDENCE SESSION ON TUESDAY 10 MAY 2011

1. What proportion of the processed milk products sold in Tesco stores are from UK-produced milk (not including regional or speciality products)? What other countries do you mainly source from?

All our liquid milk is sourced from the UK, and we aim to source as many processed milk products from UK producers as possible.

All our Tesco standard cheddar and the majority of our Value range cheddar is sourced from British producers, with the remainder sourced from Ireland. Over 90% of our butter is British, with the remainder from Denmark. Over two thirds of our yoghurt is British, with the rest coming from France and Germany.

2. Have you assessed whether the country of origin of processed dairy products is important to consumers?

We have long supported clear country of origin labelling in order to allow consumers to make an informed choice. In November last year we signed up to the set of Principles on Country of Origin Information developed by the food industry in collaboration with Defra. We are committed to labelling our main dairy products with country of origin, and have already labelled milk and cream.

We have conducted research on customer attitudes to country of origin labelling on dairy products. Our findings showed that while customers care about country of origin labelling, it is not the critical factor in purchasing decisions. Quality, taste and freshness are the most important factors for customers when buying dairy products. Only a quarter of customers frequently look for country of origin labels on dairy products.

3. Have the food industry’s voluntary proposals on country of origin labelling affected your buying decisions for dairy products?

No, the food industry’s proposals on country of origin labelling have not affected our buying decisions for dairy products. We are committed to supporting the UK farming industry and are proud to be British agriculture’s biggest customer.

4. Your evidence refers to the need to address the trade deficit in dairy. What proactive steps could Government take to address this?

This should be a common objective across the supply chain. Collectively, we could look at how to re-balance exports of mainly cheap commodity products and imports of high added-value speciality products. The industry is increasingly market-oriented and efficient; however, there is more that can be done to ensure opportunities for value added products are fully exploited. Other steps might include looking at how we might reduce costs and increase incentives to encourage more high-value manufacturers of dairy products to locate in the UK; championing product innovation by British retailers and manufacturers; and encouraging more supply-chain collaboration such as that achieved by the Tesco Sustainable Dairy Group.

5. You referred to ensuring security of supply through your dedicated supply groups. Is future security of your milk supply a concern?

By guaranteeing to pay Tesco Sustainable Dairy Group farmers above the cost of production, we are giving them the confidence and ability to invest in a way that should ensure their long-term sustainability and our security of supply. Our work with the Dairy Centre of Excellence at Liverpool University to improve dairy productivity and sustainability is also helping us to ensure the security of our supply chain.
6. Could you confirm how often the milk price paid to producers in the TSDG is reviewed? What scope is there for producers in the TSDG to request interim reviews of the milk price?

The milk price paid to TSDG producers is set every April for the following year, and is based on a forecast of farmers’ costs. It is reviewed after six months, and in exceptional circumstances may be reviewed more often. For example, we had an extraordinary price review in January 2011 due to rapidly rising commodity costs. The farmers in the TSDG consider price stability to be one of the major benefits of the scheme. They have therefore requested only one major price review per year.

7. Can you provide the Committee with further information on the geographical distribution of producers in the TSDG, their size, and their range of production costs?

The TSDG scheme is country-wide; the producers supplying us are distributed across England (464 farms), Scotland (65 farms) and Wales (81 farms). The herd size ranges from 34 to 545 cows.

We do not have access to individual farmer production costs. These are reviewed and collated by Promar, a research consultancy specialising in agriculture and agri-food sectors. We have access to a pooled average, which includes factors such as unpaid family labour and depreciation.

May 2011

Written evidence submitted by the Department for Environment, Food and Rural Affairs (Defra)

EXECUTIVE SUMMARY

1. The Government recognises concerns in the UK dairy industry, but is optimistic about its future. It aims for a profitable, thriving, and competitive sector that protects natural resources and safeguards animal welfare. It has reinvigorated the Dairy Supply Chain Forum, and is introducing a Groceries Code Adjudicator. The UK is actively engaged in negotiations on the Commission Milk Package. These would enable dairy producers to enhance their bargaining power through the formation of producer organisations. However the Government considers that the proposed exemptions from competition law are not the best way to strengthen the European dairy industry. The UK agrees that Member States should be free to make contracts compulsory or not, but the detail of contracts must be freely negotiated. The Commission in its report on the dairy market notes positive market developments and states the soft-landing is “on track” in most member states. The Government is sceptical about introducing compensation for reducing production.

OVERVIEW OF THE UK DAIRY INDUSTRY

2. The UK has a strong dairying tradition and natural farming advantages. In 2009–10, 16,400 farmers produced 12.83 billion litres from 1.9 million cows. There are six major processors in the UK dairy industry. Three are UK co-operatives (First Milk, Milk Link and United Dairy Farmers) each processing some and selling on some of their members’ milk; and three are private companies (Dairy Crest, Robert Wiseman Dairies, and Arla Foods which is owned by the Scandinavian co-op) each supplied by their own pools of contracted producers and supplemented as necessary by milk purchased from others, in particular the co-operatives. There are many other smaller processing companies, some with their own dedicated producers.

3. Of UK production in 2009–10, around 53% went into liquid milk, while the rest went into cheese (27%), milk powders (7%), condensed milk (3%), yoghurt (2%), cream (2%), and butter (2%). Other dairy products accounted for 2% of production. Wastage also accounted for 2%. Exports amounted to about 16% of production with the industry in Northern Ireland particularly reliant on export markets. Imports represent about 25% of total goods consumed in the UK. Overall the net trade balance in 2009 amounted to a net import of products worth about £1.27 billion. UK production has been constrained by quotas.

4. Over the last decade, producer numbers have declined by a half but milk production has fallen, in the same period, by only 9%. This is due to increases in both the average herd size (currently 113) and annual yields per cow (around 7,000 litres). This trend is replicated across industrialised countries. After a number of years of decline production increased about 5% in 2010. Farmgate prices vary between purchaser and the use of the milk. The highest prices (about 28ppl) are currently paid for major retailers’ drinking milk, with the lowest (around 23ppl) for milk for general cheese manufacture.

5. UK farmgate prices in 2010 averaged 24.66ppl. Average prices in EU Member States ranged from 45.34ppl (Cyprus—a long way above the second highest average of 32.99ppl in Greece) to 21.18ppl (Romania). The EU average was 27.10ppl.\(^5\)

6. Prices are not the only factor determining the viability of the industry. Costs are also relevant. Production costs and farmgate prices vary substantially. The average farm business income from agriculture for dairy farms in England in 2009–10 was over £24,000, not including income from agri-environment and agri-food schemes.\(^5\)
diversification schemes, or the single payment. However, the least efficient will struggle if input costs are high and returns are poor. During 2010, input costs, especially feed, increased notably.

7. The UK market has a range of formal contracts in place. They may contain aspects such as production parameters including quality and other milk characteristics, collection arrangements and how prices may be varied, for example, according to standard of milk delivered. Bonuses may be paid in addition.

8. Other than established cooperatives (which have around 3,500 members) there are no groups recognisable as producer organisations or equivalent. There are dedicated supply chain arrangements, mainly for drinking milk, linking approximately 1,500 producers (around 10%) directly to retailers whilst each of the major processors has producer groups. Each of these groups can enhance knowledge exchange and have some influence on contractual conditions.

**DEFRA APPROACH AND ACTIVITY**

9. The Government aims to support and develop British farming and sustainable food production. A dairy sector that produces for the market, is profitable, thriving, and competitive is an integral part of this. Its future lies in meeting consumer needs while protecting and enhancing natural resources and safeguarding high standards of animal welfare. Because of its strong natural dairying advantages, the UK is well placed to exploit domestic (particularly added value), and export markets to the benefit of all parts of the industry. Investment is required to succeed in these markets. The potential in export markets is set to increase with growing world incomes, and an expanding world population.

10. However the Government recognises that parts of the industry are currently struggling and that there could be a better balance of bargaining power between producers and processors. It is aiming to address the issues both domestically and in the EU. It cannot however intervene directly on prices or discuss prices collectively with the industry.

**DOMESTIC ACTION**

11. The Government is taking a number of steps domestically:

   — The Government is carrying out an evaluation to monitor labelling of meat, meat products and some dairy products both for existing legislative requirements and voluntary labelling. The food industry developed a set of voluntary principles, which were launched on 24 November. These have been agreed by trade associations representing manufacturers, retailers and the food service sector (British Retail Consortium, Food and Drink Federation, British Hospitality Association, British Services Association, Dairy UK, British Meat Processors Association). All the major supermarkets have signed up to the approach.

   — The Government is committed to ensuring that food and drink procured by Government Departments meet British or equivalent standards of production where this does not lead to an overall increase in costs. We want Government to lead by example and to see top quality British produce on public sector plates, which provides value for money, meets customers’ requirements and delivers on sustainability. Government Buying Standards, which will be mandatory for central Government, are to be introduced in March 2011.

   — We have reinvigorated the Dairy Supply Chain Forum, challenging key representatives to discuss issues and opportunities, the health and future of the dairy sector, and how the industry might address the trade balance and secure its own sustainability and long-term British milk supply. The first meeting in this more productive format was 20 January 2011. The focus of the next Forum this summer will be how individual businesses and groups of suppliers and customers through the chain need to establish clear strategies to secure the long-term sustainability of British milk supply and the industry as a whole.

   — We are establishing a Groceries Code Adjudicator (GCA) to monitor and enforce the Groceries Supply Code of Practice (GSCOP). The GSCOP was introduced so that major retailers with buyer power would be prevented from passing excessive risks or unexpected costs onto suppliers. The GCA will investigate complaints from anyone in the supply chain that is directly or indirectly affected by a breach of the Code and can deal with them anonymously. A Bill is currently being drafted.

   — Under the Rural Development Programme for England and the dairy-specific funding agreed under the European Economic Recovery Programme, Regional Development Agencies have since 2008 been delivering projects concerned with boosting the competitiveness of dairy producers in the areas of modernisation of holdings, higher standards of animal health and welfare, improved nutrient management, and diversification into such activities as ice cream manufacture. The Welsh Assembly Government is investing £3.3 million into the Welsh dairy industry over three years through the Dairy Supply Chain Efficiency project. The project is funded by the Supply Chain Efficiencies scheme (SCE) through the Rural Development Plan for Wales 2007–13.

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*Farm Business Survey 2009–10. With other elements included, the farm business income increases to £56,100.*
EU DEVELOPMENTS—HIGH LEVEL GROUP AND COMMISSION DAIRY PACKAGE

12. The Commission’s proposals on contractual relations follow the establishment of a High Level Group (HLG) after European farmgate prices tracked the global dairy market boom and bust during 2007–09 with the EU industry then over-producing against significantly reduced demand. Although the UK was somewhat insulated from this by exchange rate and its geographically isolated market, we actively engaged in all HLG discussions. The Commission’s dairy proposals address four of the HLG recommendations—on producer bargaining power, written contracts, inter-branch organisations and transparency.

13. Since the HLG began we have had continuous engagement with industry and devolved administrations to establish and adapt the UK position and we are actively and constructively engaged in the Council discussion of the Commission proposals.

14. The Commission proposals provide an opportunity for producers to enhance their bargaining power by banding together to negotiate contracts with milk processors. However the Government does not consider that the proposed exemptions from normal competition law, allowing contract negotiations to cover up to 33% of member state production are the best way to strengthen European dairy industries and may lead to distortions of competition, particularly in sub-national markets for raw milk. This might harm UK exports of dairy products. Clarifying that it is already possible for producers to collaborate within existing competition law would be a quicker and less risky way of achieving balance. We want producers to have the opportunity to get a fair share of value that is added in the supply chain without distorting competition.

15. We have requested that the legislation enables national competition authorities to continue to act to protect balanced competition within their respective territories.

16. With regard to contracts, the Government agrees with the Commission that Member States should be free to make contracts compulsory or not and the detail of contracts must be freely negotiated. Prescriptive approaches risk damaging the ability of the industry to innovate and operate efficiently. Regional flexibility in the application of this proposal is essential for the UK. However, we take the firm view that this can be achieved without explicit reference.

17. The Government is content with the proposals on inter-branch organisations, transparency and the voluntary establishment of producer organisations as long as these do not increase burdens or have negative impacts on intra-community trade.

18. We remain concerned that the Commission has not conducted an impact assessment. We are pressing for a full analysis.

THE COMMISSION’S “SOFT-LANDING” REPORT

19. The UK is about 8% below production quota and quota value is close to zero. In its report the Commission notes positive market developments across the EU. After a significant fall in prices and producers’ incomes in 2008–09 that followed the price spike of 2007, the dairy market situation recovered in the second half of 2009 and continuously improved in the first half of 2010. Overall the milk sector is gradually heading towards market orientation.

20. The Commission conclude that overall the “soft-landing” as quotas are ended is “on track in an overwhelming majority of Member States” and that there is no reason to revisit the quota phase-out agreed in the Health Check, despite not guaranteeing the soft landing in three over-quota Member States.

21. The Commission’s proposed meetings between Management Committee experts and the industry Milk Advisory Group should help the speed and transparency of market developments, situation and prospects. We have no objection to such improved liaison but it must not allow individual commercial interests to undermine proper procedures.

22. However the Government is sceptical about the Commission’s other suggestion of introducing, in exceptional circumstances, compensation for reducing production by 1% to 2%. This might work against our goal of a competitive EU dairy industry. Such schemes may be very costly, distortionary, open to fraud, and easily defeated by farmers who expand production. The Commission has not tabled any formal proposals or discussions on this measure.

March 2011
Follow up Questions to the Oral Evidence Session on Wednesday 18 May 2011

1. The Minister agreed that there were systemic problems in the dairy sector. Do these problems arise mainly between processors and retailers, or processors and producers?

   The Minister noted that “systemic problem” can mean different things. In his evidence, he explained that he sees a problem with the level of market penetration by the UK industry of value-added processed goods. There is an unusually significant focus on liquid milk in the UK market. He noted that only 47% of our milk goes into processed products, a small percentage relative to other European states.

   This focus is a problem at the processing (and also retail) stages in the chain. The Minister felt that there has been insufficient investment and innovation in processing these high-value products, and has noted that many products sold on retailers’ shelves are imported. There is also very little focus (other than in Northern Ireland) on commodities exports markets.

   UK market-demand outstrips UK processing capacity. That capacity is balanced to UK production on-farm. Thus, there is little spare raw milk in the UK market place and no significant demand for any spare raw milk (there are no alternative markets).

   There are clear opportunities for the expansion of UK manufacturing, to: substitute UK products in place of imports; and export particularly commodity products onto growing world markets. However, this would require processors to take a commercial risk in developing the necessary capacity.

   The Minister also noted that, in some cases, there may be problems to do with bargaining power in the supply chain, between producers and processors and between processors and retailers.

   In his evidence, the Minister explained the nature of the market, with processors competing for the very substantial retail contracts and to maintain their own market share (and thereby factory efficiency) for all liquid milk. This includes some selling to the highly competitive “middle ground” market of the “discounting retailers”, where margins will be low and where significant sales growth has occurred. Major retailers reacted to that growth last year with price drops and at the same time were renegotiating contracts with major processors who were bidding to secure delivery contracts.

   While the Minister noted that there may be some imbalance between processors and retailers, the Groceries Code Adjudicator seeks to prevent abuses in this stage of the supply chain by retailers, and the most notable imbalance appears to be between processors and producers.

   There are indications of asymmetry in price transmission, where prices paid to farmers by processors don’t rise as fast as processor income, or processors do not pass on a reasonable share of that income back to farmers, while processors drop prices as quickly as their own income drops.

   Arguably this is processors managing (mitigating) price volatility in the market to protect producers. While such protection from volatility may be welcomed by some farmers, others may in fact prefer to receive farm gate prices that track market prices and commodities income realised by processors so they benefit from gains when commodities markets are strong. Farmers would need to accept they might suffer when markets are weak.

   These imbalances in the stage of the supply chain between processors and producers may have a solution. Dairy farmers have a perishable product with expensive transport costs. The Minister has previously recognised the benefits of producer organisations which have become a key focus of discussion on the Commission’s Milk Package. These may help redress this balance and Ministers have given their strong encouragement to farmers to consider forming these groups.

2. What is the Government doing to increase exports of dairy produce?

   Defra has a commitment in our Business Plan to “work with the food and drink industry, and other government departments, to take full advantage of the potential for growth through overseas trade (including by identifying global market opportunities and barriers to exports)

   The new UK Trade & Investment strategy, “Britain open for business”, sets out how the Government will provide practical support to exporters and inward investors over the next five years. Global shifts in diet across the world, from grain-based to more sophisticated and varied diets, offer large opportunities for UK food companies. UKTI and Defra will work in partnership with industry to ensure the food and drink sector is able to take full advantage of the potential for growth through overseas trade and use the overseas diplomatic network to identify global market opportunities for firms of all sizes.

   Defra leads on a number of initiatives to support British dairy (and other food) exports, such as working with industry to develop export certification schemes for non-EU markets. A recent success in dairy has been certifying of products to export to India.

   The latest cheese and butter export statistics are encouraging. They can be viewed at:
   www.dairyco.net/datum/dairy-processing—trade/imports—exports/uk-dairy-exports.aspx
However, as observed in answer 1, in order for the UK to take advantage of clear opportunities for the 
expansion of UK export manufacturing into growing world markets, at least one processor will need to take 
the necessary risk involved in developing new processing capacity.

3. The Milk Package aims to increase transparency by encouraging the publication by IBOs of data on the 
prices, volumes and durations of contracts for the delivery of raw milk. Is this data already collected and 
published in England? What scope is there to extend this concept of transparency of price and volume data 
to agreements between processors and retailers?

The Milk Package proposal on transparency continues the requirement for purchasers of raw milk to report 
the volumes they buy each month. IBOs may also have a role in increasing transparency and engaging in 
knowledge transfer. However, the establishment of IBOs would be discretionary and it would be for industry 
to make proposals to establish one or more.

At present, data on the prices paid by milk contracts are publically available, most easily through the Dairy 
Co website (www.dairyco.net). Dairy Co also publishes data on liquid milk margins, which can be found on 
their website (http://www.dairyco.net/datum/dairy-processing—trade/dairy-supply-chain-margins/liquid-milk-
margins.aspx). Volume and duration information for individual contracts is not published in this way, although 
data are available for aggregate volumes collected and recent research on milk selling arrangements provides 
information on contracts gained from a telephone survey of 252 dairy farms (http://www.defra.gov.uk/statistics/
files/defra-stats-fbs-milk-selling-report-1005.pdf). Until 2015, farmers must have quota to cover their milk 
production.

The scope to extend transparency of prices further has limitations. As the Minister noted in his evidence, 
transparency can be an excellent tool (for example, for farmers to benchmark their costs or other elements 
such as carbon emissions), but there will always be commercial constraints on its prevalence. The Minister 
wrote to the NFU on 16 April asking what new data would be useful and how the industry could obtain and 
publish those data in a way that protects individual sensitivities but also ensures the most reliable picture 
is provided.

Separately from the Milk Package, the European Commission is currently exploring the potential for 
collecting (and then publishing) a limited amount of additional statistical data which may help provide 
improved clarity on some market information. These new statistics may include data on private stocks, 
quantities of milk sold at spot prices, and information on milk powder prices differentiated by human and 
animal feed quality. We have informed the Commission that we welcome transparency, but that we would have 
to be sure that these statistics were useful and that their collection did not impose disproportionate burden on 
the industry.

4. Referring to the “Information note for Central Government on procuring food to UK or equivalent 
production standards”, please could you provide examples of dairy products where it has been demonstrated 
that UK standards of production for this product are higher than in other countries resulting in an improved 
quality of product? If this data is available by 19 June, please could you append the report on departmental 
progress against the commitment to procure food meeting British or equivalent standards of production

The commitment for the public sector to procure food meeting British or equivalent standards of production 
is a Coalition Commitment that predates the recently launched Government Buying Standards. Departments 
have until the end of June to report on this commitment. Government Buying Standards (which incorporate 
wider concerns such as the nutritional value of foods and sustainability of catering operations) were launched 
on 16 June this year and Departments have a three-month lead-in time to begin incorporating GBS criteria into 
their catering contracts.

As such, at present there are no examples of departments replacing their purchases of dairy products with 
alternative supplies produced to a higher standard of production as a result of the Standards.

In the UK we have some of the best food production standards in the world but many producers from 
elsewhere in the EU are capable of producing food to the same high standards as we do in the UK. It is a 
matter of quality, not origin, and is intended to ensure that all producers, including SMEs and local producers, 
would be given a fair opportunity to bid for these contracts. Defra has made clear throughout that our policy 
on UK or equivalent standards, subject to not increasing overall costs, is not a “buy British” campaign and 
should not be interpreted by Departments as such.

5. Please could you provide further information on the membership, aims and work programme of the Dairy 
Supply Chain Forum?

The Dairy Supply Chain Forum meets twice a year and includes representatives from all parts of the dairy 
supply chain. Under the chairmanship of the Minister of State, the Forum is being reinvigorated. The Minister 
is paring-down representation per organisation to a senior level which will ensure debate is translated into 
actions. The Minister has produced new terms of reference of the Forum (attached) to ensure the meetings 
achieve real debate that is sharply focussed on assuring the long term sustainability of the industry and the 
future of British milk supply.
The Minister continues to consider the best way in which to run the Forum. The first meeting in this new format (20 January) was attended by the following organisations:


The Forum discussed the health and future of the dairy sector, the trade balance, the progress of the Commission's dairy proposals and industry sustainability. The next meeting (5 July) will focus on industry sustainability. The agenda is attached, as are copies of letters sent to Forum members by the Minister of State in February and May.

6. The food industry’s voluntary standards on country-of-origin labelling for dairy specify that processed dairy products should be labelled with either the country of origin of the milk or the place of manufacture. The same standards advise that meat products must be labelled with the country of origin of the meat, not the place of manufacture. Does this exception for dairy provide adequate protection to British dairy producers?

Raw milk is very rarely traded across the UK’s borders (or GB to NI) in either direction due to the high costs of sea transportation, except for relatively small amounts crossing the Ireland-NI border. As such, the place of manufacture of the processed product is highly likely to be the UK if the country of origin of the milk is the UK and vice versa. For UK milk, therefore, due to our geographical situation, the exception for dairy in the food industry’s voluntary standards should not harm UK dairy producers.

7. Your written evidence (on contracts) states “Regional flexibility in the application of this proposal is essential for the UK. However, we take the firm view that this can be achieved without explicit reference”. Could you expand on what is meant by regional flexibility?

Potentially, one or more of England and the Devolved Administrations could take a different decision on whether to make contracts compulsory in its area from the decision taken by the others. The UK takes the firm view that the potential for such regional flexibility in the application of the Milk Package is achieved without the Milk Package explicitly stating that this is possible.

8. The Committee asked the NFU why it could not get its members to all use a standard contract. The NFU told the Committee that:

"The challenge for us as a trade association is that we are bound by competition law not to bring individual undertakings—ie individual farming businesses—together to do something of that kind of nature. I think it would be a serious breach of UK and EU competition law for us to do that".

Please could you clarify for the Committee the Government's position on the ability of trade associations to encourage their members to demand a particular contract (assuming that the contract specified a price formula rather than a fixed price)?

The Minister committed to providing an answer to this point at the oral evidence session:

The law should not prevent the NFU from setting up non-binding and freely accessible standard terms for dairy contracts; indeed it is recognised that that is one of the legitimate functions of a trade association. An industry code of practice could also set-out unacceptable or preferred practices and elements of contracts.

Any template agreements that strayed into exchanges of sensitive commercial information, setting of prices, or division of markets, would be more problematic. Specifically, exchanges of information on future, and in some circumstances, current, prices, volumes and capacity or future commercial intentions, and other very sensitive commercial information would be likely to contravene competition law.

The NFU’s standard contract does not specify prices, volumes and so on. Its promotion is unlikely to breach competition law. On the other hand, if the NFU were to attempt to coerce farmers or processors to adopt its standard contract, this could risk being viewed as anti-competitive behaviour.

9. The Minister stated that the draft Groceries Code Adjudicator Bill might include provisions to enable the Adjudicator to investigate situations where there had been retrospective changes to contracts between dairy producers and processors. Is it your understanding that the draft GCA Bill contains these provisions?

The Minister explained that “the role of the adjudicator and the grocery supply code of practice is between retailers and their suppliers, so strictly it does not affect the dairy industry”. This is in line with the bill as drafted. However, he expressed his view that, although the Adjudicator will not have a direct influence on contracts between dairy producers and processors, "it is reasonable to say that there will hopefully be a spin-off or spill-over—however you want to describe it—of the principles that are being adopted at that level".
The Minister stated that the Competition Commission accepted that retrospective price changes between retailers and their suppliers (in the case of dairy, the processors) are wrong. He noted that it is possible to read-across from this to the relationship between producers and processors, explaining his view that retrospective price changes in this relationship “should equally be wrong”.

10. What tools are available to Government to assist large scale agricultural holdings to gain planning permission, assuming there are no intrinsic welfare or sustainability objections to large holdings?

There are a number of tools local planning authorities can use to assist the establishment of large scale agricultural holdings. For example, pre-application discussions can establish clearly information required and timescales involved in determining planning applications, and Local Development Orders can grant a blanket planning permission for development in an area specified by the local planning authority. However, such tools are for local planning authorities to use rather than central Government.

The report of the Farming Regulation Task Force stated that: “Planning is a substantial barrier for development. It is vital that current regulations are changed to allow farm businesses to adapt, innovate and grow. The forthcoming National Planning Policy Framework must explicitly support sustainable and productive farming and must promote sustainable intensification.” The Government will look closely at this recommendation along with others from the Task Force and publish an initial response this autumn with a full and final response early in 2012.

11. What level of funding will be allocated to spending on research in the dairy sector over the rest of this parliament? What are Defra’s future priorities for research in the dairy sector?

The Defra research programmes are cross cutting with budgets allocated to themed programmes rather than specific farming sectors, such as dairy. However, Defra funds a significant amount of research on dairy through research programmes on Sustainable Farm Management, Agriculture and Climate Change, Resource Efficient and Resilient Food Chain, Sustainable Water Management and Animal Health and Welfare. In total, for 2009–10, research programmes representing a combined spend of about £16 million were of relevance to the dairy sector.

Defra plans to continue supporting the competitiveness and sustainability of the dairy sector through these programmes with research in areas including animal nutrition, genetics to underpin breeding, animal husbandry, manure management, water use and quantification, development of options for reducing emissions of pollutants to air and water, and animal health and welfare, including TB. In addition, Defra is contributing to the Technology Strategy Board Sustainable Agriculture and Food Platform, which will provide up to £90 million over five years for industry led research on farming and food, including dairy—a current call on sustainable protein production is of relevance to dairy.

Defra’s Evidence Plans for 2011–12 can be found through the following link:


The Evidence Plans are separated by policy area. However, the research programmes that deliver the evidence to policy are organised into the research/science themes noted above.

The Government supported the recommendation made by the High Level Group on Milk to improve innovation and research across the EU (coordination and better use of funding). Discussion of this has been left to CAP negotiations rather than the Commission’s Dairy Package.

12. The Minister told us that “so much of what we are doing aims at those areas that the Government can influence: trying to help them to drive costs out of the business and to become ever more efficient”. What specific actions is Defra pursuing at the moment to achieve this?

The Minister explained that much of what we are doing is aiming to limit the costs on farmers that harm their efficiency in order to “get the industry back in a position where an efficient producer of any size can make a profit in the marketplace”.

Defra is pursuing several specific actions to achieve this:

(1) The Farming Regulation Task Force published its report on better regulation in farming and food on 17 May 2011. Work is already underway to respond to the report’s recommendations. The Minister has accepted a number of recommendations in full or in principle, covering areas such as the Nitrates Regulations and livestock movements.

(2) Funding under the Rural Development Programme for England can aid farmers seeking to drive out costs and become more efficient. Examples specific to reducing costs in the dairy sector include projects concerned with modernisation of holdings and improved nutrient management.

(3) In our negotiations on the Commission’s Milk Package, we have been very keen to ensure that the proposals do not create additional burdens on dairy farmers. We have resisted calls for excessive conditions for the creation of producer organisations, recognising that the aim of these proposals is to help dairy farmers, not to add further costs to their businesses.
Defra wants to see the CAP encourage the achievement of improvements in competitiveness and environmental outcomes in tandem. The CAP should provide increased incentives through Pillar 2 for farmers to co-operate and share best practice, to collaborate on light processing or by sharing plant and resources, and to take advantage of the latest techniques and innovations.

Defra is continuing to support the industry-led Agri-Skills Strategy. This is designed to support professionalism, business skills, and continuing professional development across the agricultural sector, helping farmers increase their efficiency.

Management is crucial for farming success. The Farm Business Survey has shown that farmers who do not benchmark are twice as likely to be low performers as those who do. There are a number of free schemes available to farmers including MilkBench+. Defra is looking at ways to encourage more farmers to take up benchmarking as part of our Business Plan commitment to support a more competitive farming sector.

May 2011

Written evidence submitted by Robert Wiseman Dairies

1. COMPANY BACKGROUND

1.1 Robert Wiseman Dairies was founded in 1947 by Robert Wiseman Senior and now provides almost a third of the fresh milk consumed in Britain every day.

1.2 Wiseman procures milk from over 1,000 contracted dairy farmer members of the Wiseman Milk Group, with the balance of the Company’s requirement for milk provided by farmer owned co-operatives including First Milk, Milk Link and the organic milk producers co-operative, OMSCO.

1.3 The Company employs more than 4,700 staff, operates six major processing dairies in Aberdeen, East Kilbride, Glasgow, Manchester, Droitwich Spa and Bridgwater, and fourteen distribution centres around the country.

1.4 Wiseman has the capability to distribute milk to customers in every postcode in Great Britain and supplies retailers including Tesco, Sainsbury’s and The Co-operative Group, as well as more than 12,000 convenience and independent stores.

1.5 The Company has invested more than £480 million in its network of dairies and depots since its listing on the London Stock Exchange in 1994, more than any other fresh milk processor in the UK.

2. RESPONSE TO THE EU PROPOSALS FOR THE DAIRY INDUSTRY

2.1 As a member of Dairy UK we confirm that the Dairy UK written submission presented to the Environment, Food and Rural Affairs Committee is reflective of our views on the EU Proposals for the Dairy Industry.

3. HOW WE WORK WITH FARMERS

3.1 The contractual and working arrangements we have in place with dairy farmer suppliers continue to evolve, and over time have proved successful in delivering a secure, stable milk supply that meets the needs of our business and our customers, whilst delivering an above market average farm-gate milk price for dairy farmers who choose to supply us.

3.2 Farmer Representation:

3.2.1 Dairy farmers supplying the Company are represented in discussions with the Company by a Wiseman Milk Partnership Board, which consists of six democratically elected Wiseman Milk Group representatives.

3.2.2 The Board meets at least quarterly with at least two Company Directors to discuss both price and contract changes. On contract issues, there is full involvement of the Board in any changes that are proposed. Discussion will result in compromise and changes, which are made in return for an acceptance that there is a business need to any proposal. On price the debate is more geared at influencing change rather than negotiating—the business needs to keep competitive and prices need to be market related.

3.2.3 The system has worked well historically and has evolved as the Wiseman Milk Group has changed in both size and structure. Fundamental contractual reviews have taken place over the years, as have minor changes and alterations. Some milk price reviews, which have led to market related reductions, have not always been welcome, but thorough debate and explanation has always taken place.

3.2.4 Wiseman has committed to providing appropriate notice of major changes or alterations in its contract with Wiseman Milk Group members and the Company will not impose retrospective price adjustments.
3.3 The Wiseman Contract:

3.3.1 A criticism often levelled at milk buyers is that dairy farmers who are unhappy with price, conditions, business performance or strategy are restricted from moving to an alternative buyer by notice periods that they consider to be onerous.

3.3.2 By far the majority of industry notice periods are typically 12 months.

3.3.3 The standard contract offered by Wiseman incorporates a three month notice, with the exception that no resignations occur during the period September to November (trough period of milk production)—this means in effect that there is a five month notice period for July resigners and four months for August resigners. Should we wish to serve notice on a dairy farmer supplier, we are contractually bound to give 24 months notice.

3.3.4 The underlying principle is that our dairy farmer suppliers’ commitment to us is dependent on Wiseman continuing to deliver the appropriate market orientated farm gate milk price and future business strategy. Whilst members of the Wiseman Milk Group can move by giving no more than three months notice, the Company’s approach to milk procurement has resulted in very low levels of resignations.

3.4 Standard Farm Gate Milk Price:

3.4.1 Independent analysis carried out by analysts at milkprice.com in 2009 to mark the fifteenth anniversary of deregulation in 1994, highlighted the extent to which Wiseman has delivered on this commitment to its dairy farmer suppliers.

3.4.2 The table below uses milkprice.com standard litre comparisons (1 million litres per annum producer, 4.0% butterfat and 3.3% protein). Over the period since deregulation, it illustrates returns for an average UK dairy producer, average farm gate milk price and a comparison between income received by farmers supplying Wiseman and other major milk buyers over that period.

<table>
<thead>
<tr>
<th></th>
<th>RWD</th>
<th>First Milk</th>
<th>Milk Link</th>
<th>Arla</th>
<th>Dairy Crest</th>
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</thead>
<tbody>
<tr>
<td>14 year total</td>
<td>£2,977,800</td>
<td>£2,762,500</td>
<td>£2,718,800</td>
<td>£2,922,000</td>
<td>£2,899,900</td>
</tr>
<tr>
<td>Ave per year</td>
<td>£212,700</td>
<td>£197,321</td>
<td>£194,200</td>
<td>£208,714</td>
<td>£207,135</td>
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<td>Ave ppl over 14 years</td>
<td>21.27</td>
<td>19.73</td>
<td>19.42</td>
<td>20.87</td>
<td>20.71</td>
</tr>
<tr>
<td>Comparison vs RWD</td>
<td>(215,300)</td>
<td>(259,000)</td>
<td>(55,800)</td>
<td>(77,900)</td>
<td></td>
</tr>
</tbody>
</table>

3.5 Growth of the Wiseman Milk Group:

3.5.1 We believe that the growth of the Wiseman Milk Group can be attributed to a number of factors:

   — The Company’s increase in its requirement for milk volumes over time to satisfy the requirements of its customers;

   — Dairy farmers willingness to join the Wiseman Milk Group; and

   — Increased production from the Wiseman Milk Group farms as a consequence of the confidence and stability that selling to RWD provides.

3.5.2 The more recent development within the fresh milk sector of the creation of producer supply groups aligned to major retail customers has enhanced the RWD proposition. Many producers who...
supply Wiseman have had the opportunity to benefit from participation in groups created by Tesco, Sainsbury’s and Marks & Spencer.

3.5.3 More recently, The Co-operative Group has confirmed that it is to set up a supply group of around 350 Wiseman producers, who will benefit from a premium over and above the Wiseman standard price from August 2011.

3.5.4 Each of these groups has different structures, characteristics and priorities. However, they are all returning a premium farm gate milk price for those Wiseman producers who are participating.

3.5.5 These initiatives by major retail customers are having a marked effect on confidence and willingness by producers to invest and expand. Many producers who are involved in “aligned” supply groups are showing significant increases in production volumes over and above average milk production increases across GB as a whole.

3.5.6 We welcome and support these retailer initiatives.

3.6 Summary:

3.6.1 Wiseman has demonstrated that an appropriate contractual relationship with dairy farmers supplying the Company delivers benefits to both parties over the long-term. The Company’s approach has resulted in very low levels of resignations.

3.6.2 With the exception of two periods each year, Wiseman Milk Group members can exercise their right to move to an alternative buyer after completion of a three month notice period.

3.6.3 The underlying principle is that ultimately our dairy farmer suppliers’ commitment to us is dependent on Wiseman continuing to deliver the appropriate market orientated farm gate milk price and future business strategy.

3.6.4 We welcome initiatives by our retail customers to build producer supply groups. These in turn have had a positive impact on dairy farmers, increasing confidence, willingness to invest in the future and production levels.

April 2011