EXPLANATORY MEMORANDUM TO

THE FAIR DEALING OBLIGATIONS (MILK) REGULATIONS 2024

2024 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

2.1 These regulations impose obligations on business purchasers in relation to the contracts they make for the purchase of cow's milk, to improve fairness and transparency in the UK dairy sector.

2.2 Industry preference for such intervention was highlighted in the response to a public consultation regarding the need for legislation in the sector, held in 2020, which demonstrated cross-industry desire for regulations to introduce a minimum contractual standard in the market.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England, Wales, Scotland, and Northern Ireland.

4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England, Wales, Scotland, and Northern Ireland.

5. European Convention on Human Rights

5.1 The Rt Hon Mark Spencer MP, Minister of State (Minister for Food, Farming and Fisheries) at the Department for Environment, Food and Rural Affairs, has made the following statement regarding Human Rights:

"In my view the provisions of the Fair Dealing Obligations (Milk) Regulations 2024 are compatible with the Convention rights."

6. Legislative Context

6.1 This Statutory Instrument is the first to be made using powers in section 29 of the Agriculture Act 2020 (the "Act"). Section 29(1)(a) enables the Secretary of State to impose obligations on business purchasers of agricultural products in relation to contracts they make for the purchase of agricultural products from qualifying sellers. These powers are exercisable for the purpose of promoting fair contractual dealing by business purchasers of agricultural products from qualifying sellers.

6.2 These regulations apply where the agricultural product being purchased is cow's milk, although the intention is to develop subsequent regulations to cover any other agricultural sectors where there are issues regarding fairness in business relationships. As the issues faced by different farming sectors vary considerably, this sector-specific approach is considered the most appropriate.

6.3 Section 29(1)(b) of the Act enables the Secretary of State to make regulations providing for the enforcement of obligations imposed under section 29(1)(a). Section 29(9) provides that the powers under subsection (1)(b) include power to confer functions on any person. These regulations confer enforcement functions on the Secretary of State in order to ensure compliance with the regulations made under section 29. It is our intention to establish an office within the Department of Environment, Food and Rural Affairs which will exercise the Secretary of State's enforcement functions.

6.4 Section 29(3) of the Act defines a 'business purchaser' and a 'qualifying seller'. We have adopted the definition of 'business purchaser' in these regulations however these regulations will only apply to 'qualifying sellers' within the meaning of s.29(3)(b)(i) of the Act. Under the definition listed in section 29(3)(b), a 'qualifying seller' encompasses producers, producer organisations, association of producer organisations and produce aggregators. These regulations apply only when a business purchaser is purchasing milk from a person within the meaning of s.29(3)(b)(i) in the Act, which is defined in these regulations as a 'producer'. This is because in the dairy market, it is these persons who business purchasers are purchasing milk from and who are therefore the contracting party in contracts to purchase milk.

7. Policy background

What is being done and why?

7.1 Primary agricultural producers in the UK tend to be small, individual businesses operating independently. By contrast, operators further up the supply chain – with whom farmers do business – tend to be highly consolidated businesses that can command substantial shares of the relevant market.

7.2 This disparity makes primary producers vulnerable to unfair trading practices and can lead to contracts which impose commercially harmful terms and provide little legal protection.

7.3 Poor contractual relations, and unfair or unclear terms and conditions between producers and processors, can limit the ability of farmers to budget effectively, manage price volatility, invest and innovate, and run profitable businesses. Ultimately, this could reduce choice, value and/or increase prices for consumers. In the context of broader changes to UK agriculture (including the transition to different forms of financial support on offer to the sector) it is important farmers receive a fair return from the marketplace and the objective of these regulations is to require fair contractual dealing and promote transparency in contracts for the purchase of milk.

7.4 Regulations exist elsewhere to address the problems which can arise from imbalanced commercial relationships. In 2013, the Groceries Code Adjudicator ("GCA") was appointed to oversee the relationships between the largest UK retailers and their direct suppliers. It is widely recognised that the GCA has improved the relationship between large grocery retailers and their direct suppliers.

7.5 However, most farmers do not supply supermarkets directly and so they are not covered by the GCA. In response to concerns raised from primary producers, the Government ran a Call for Evidence at the end of 2016 to explore the case to extend the GCA's remit. The UK Government's response to the Call for Evidence concluded that there was insufficient evidence to justify extending its remit to cover the whole supply chain. Instead, the Government made a range of commitments to address the specific issues which were raised by primary producers in the Call for Evidence. These included introducing mandatory written contracts in the dairy sector and exploring the benefits of statutory codes of conduct. Powers were subsequently provided by the Act (section 29) to achieve this.

7.6 These regulations, made under section 29, introduce new obligations on business purchasers of cows' milk in relation to contracts for the purchase of cows' milk. These regulations require that all contracts are made in writing and contain all relevant terms pertaining to the purchase of milk. The regulations mandate that all contracts contain clear pricing terms through either a fixed or variable price, setting out how the price to be paid is generated and establishing a means for producers to challenge variable price calculations.

7.7 A number of other provisions are also introduced, including prohibitions on unilateral changes to contract terms, prohibitions on contractual exclusivity in certain circumstances, mandating the inclusion of clear force majeure terms and requiring dispute resolution mechanisms to be established in milk purchase contracts.

7.8 The regulations also introduce requirements around termination clauses in contracts which must be incorporated into milk purchase contracts. Flexibility on mandatory notice periods is afforded where the parties mutually agree to end the contract at a different time or where the other party is in material breach of contract. A 'material breach' of contract is a breach which is more than just trivial but is not necessarily always so serious as to give rise to the common law right to terminate for a repudiatory breach of contract. It will, however, be for a court to decide in each case whether a breach is 'material' according to the particular circumstances of the case.

7.9 The regulations will come into force on the day after the expiry of 12 weeks beginning with the day on which the regulations are made (the "Commencement Date"). However, for purchases where the possession of milk is taken by a business purchaser in accordance with a contract that was made before the Commencement Date, the regulations will apply in relation to these contracts 12 months after the Commencement Date. This is to ensure that businesses have sufficient time to transition any existing contracts so that they are brought into compliance with the regulations.

7.10 The instrument also creates a new enforcement regime to oversee compliance with the regulations. The regulations designate the Secretary of State as the person responsible for enforcement of the obligations placed on business purchasers. Under these regulations, the Secretary of State has the power to fine business purchasers up to 1% of their turnover in the UK if they are found to be non-compliant with the regulations. The Secretary of State is also able to order that business purchasers pay compensation to producers where they are in breach of the regulations. Under the regulations, parties are able to appeal decisions taken by the Secretary of State to the First Tier Tribunal (General Regulatory Chamber).

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act 2018.

9. Consolidation

9.1 There are no plans to consolidate these regulations.

10. Consultation outcome

10.1 Between June and September 2020, the Department for Environment Food and Rural Affairs, with input from the Devolved Administrations, conducted a public consultation exploring contractual relationships in the UK dairy sector.

10.2 A summary of responses was published in February 2021, which outlined the 839 responses to the consultation. There was significant demand for legislation; 72% of respondents agreed that contract reform legislation was needed. 47% of respondents stated that they had directly experienced contractual issues, with references to a range of issues including contract changes implemented with little notice, difficulties with payments and retrospective alterations to contract terms. Responses routinely highlighted the challenge of building a profitable business without greater long-term security.

10.3 The dairy industry introduced its own Voluntary Code of Practice in 2012 which was an attempt to improve the fairness of contracts on offer. The consultation revealed that this had largely failed to address the issues, with piecemeal application and many processors not complying in relation to clauses such as the length of a notice period, supply periods, pricing mechanisms and dispute resolution processes. Legislative intervention is therefore deemed necessary for addressing the power imbalances within the sector in order to promote fair contractual dealing. Several processors also shared the view that, as not all processors currently follow the Voluntary Code of Practice, an imbalance across the sector has arisen.

10.4 The consultation Summary of Responses can be found here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/976159/summary-responses-contractual-practice-uk-dairy-sector.pdf

11. Guidance

11.1 Regulation 22 requires the Secretary of State to publish guidance relating to the imposition on a business purchaser of a monetary penalty or a requirement to pay compensation. The Secretary of State must have regard to this guidance when making decisions relating to the imposition of monetary penalties or the ordering of compensation to be paid by the business purchaser to the producer. This guidance will be published prior to the Commencement Date.

12. Impact

12.1 There is a small anticipated negative cost impact to processing businesses, primarily to meet the needs of familiarisation to the new regulations and the reissuing and renegotiation of existing contracts. However, there are significant, positive impacts anticipated for producer businesses. There is no impact on charities or voluntary bodies.

12.2 There is a small anticipated negative financial impact on the public sector, for the set up and maintenance of the new enforcement agency.

12.3 A full Impact Assessment has not been prepared for this instrument because it was projected that the direct costs to business fall below the required threshold for this assessment. A more general assessment, the De Minims Assessment (DMA), is available from the Department for Environment, Food and Rural Affairs, 2 Marsham Street, London, SW1P 4DF.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses.

14. Monitoring & review

14.1 As established in regulation 27, a review of the regulations will be undertaken within five years of the Commencement Date. Subsequent reviews must be carried out from time to time, at intervals no greater than every five years.

15. Contact

15.1 Andrew Powley at the Department for Environment, Food and Rural Affairs Telephone: 020 82258214 or email: andrew.powley@defra.gov.uk can be contacted with any queries regarding the instrument.

15.2 Tim Mordan, Deputy Director for Innovation, Productivity and Science, at the Department for Environment, Food and Rural Affairs can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Rt Hon Mark Spencer MP, Minister of State (Minister for Food, Farming and Fisheries) at the Department for Environment, Food and Rural Affairs, can confirm that this Explanatory Memorandum meets the required standard.