

**EXPLANATORY MEMORANDUM TO THE
REPORTING OF PRICES OF MILK PRODUCTS (ENGLAND) REGULATIONS 2005**

2005 No 1441

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

2. Description

2.1 These Regulations require a sample of milk processors to provide information on the prices at which they sell milk products after processing, to Defra, for onward transmission to the European Commission. Failure to provide this information on request is an offence. This will assist England in fulfilling its obligations under Commission Regulation (EC) No 562/2005 of 5 April 2005.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Background

4.1 Article 6 of Commission Regulation (EC) No 562/2005 of 5 April 2005 laying down rules for the implementation of Council Regulation (EC) No 1255/1999 as regards communications between Member States and the Commission in the milk and milk products sector requires Member States to take steps to ensure that dairy processors provide them with information on prices in the time scales required. These Regulations introduce penalties for processors who fail to do so.

5. Extent

5.1 This instrument applies to England.

6. European Convention on Human Rights

6.1 Not applicable

7. Policy Background

7.1 Commission Regulation (EC) No 562/2005 of 5 April 2005 lays down requirements for Member States to communicate to the European Commission certain information about the milk and milk products sector. Article 6 requires Member States to communicate certain price information to the Commission on a weekly basis. The price information is used by the Commission when calculating refund and aid amounts which form part of the common organisation of the market in dairy products.

7.2 Member States are required to provide the Commission with "ex-factory" prices for certain milk products except cheese where national production represents 2% or more of Community production. Member States must also provide price information for cheese which represents 8% or more of total annual national cheese production. Member States are also required to take steps to

ensure the dairy processors provide them with this information. The price information must be provided to the Commission by 10am (UK time) each Wednesday. "Ex-factory price" is defined as "the price at which the product is purchased from the enterprise, excluding taxes (VAT) and any other cost (transport, loading, handling, storage, pallets, insurance, etc). Price information is regarded by processors as extremely commercially sensitive, and previously, there was some resistance to provide this type of information.

7.3 This instrument has been made to ensure that the Department can meet these requirements. It is to come into force on 1 July 2005. It is intended that similar Regulations will be made in Wales, Scotland and Northern Ireland.

7.4 With the agreement of Lord Whitty, former Parliamentary Under Secretary of State (Lords) for the Department for Environment, Food and Rural Affairs, a formal consultation on the proposal for a Statutory Instrument was not carried out because the matter was considered to be highly specialised and there were a limited number of stakeholders all of whom had been directly involved in the policy development process, and that the Department is required to comply with EU Regulations by the deadline set. Dairy processors accept the need for collection of this data, but have concerns about the confidentiality of the commercially sensitive information. The Department will make clear in notices issued that the information will be treated as confidential and will be issuing internal guidance on the use of this data.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

9. Contact

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REGULATORY IMPACT ASSESSMENT

1. Title

1.1 The Reporting of Prices of Milk Products (England) Regulations 2005

2. Purpose and Intended effect of the measure

(i) Objective

2.1 To enable Government to collect representative, accurate and complete weekly price information from dairy processors for the weekly returns to the European Commission required under Article 6 of Commission Regulation (EC) No 562/2005.

Separate SIs will be made for Scotland, Wales and Northern Ireland.

(ii) The Issue

2.2 The common organisation of the market in milk and milk products includes a number of measures designed to manage the markets in order to fulfil the objectives set out in Article 39 of the Treaty of Rome. These measures include payment of export refunds and subsidies to help dispose of surplus milk and milk products. The Commission use price information to analyse the market situation and determine what measures are required to manage the market (particularly the setting of subsidy and refund levels).

2.3 Commission Regulation (EC) No 1498/1999, required Member States to return price information on a range of milk products to the Commission. Member States were given the option to report ex-factory, wholesale or retail prices.

2.4 The UK was the only Member State unable to obtain ex-factory price information from their operators, who felt that providing this price information compromised market confidentiality. The UK therefore provided wholesale prices which could not be compared with ex-factory prices as they included additional variable costs such as transport and loading. All other Member States reported ex-factory prices.

2.5 Several years ago, the Commission asked the UK to provide ex-factory prices in line with other Member States to enable the Commission to compare prices throughout the Community. Defra approached market operators through their representative trade associations who suggested that the Department should approach a market research company to obtain information on prices: their members were not prepared to provide the information directly because of concerns about confidentiality.

2.6 The Department did not consider this approach to be a feasible or cost effective option. It was unclear how a market research company would have been able to collect ex-factory prices without contacting dairy processors (which would have given rise to the same confidentiality issues), and the costs to the Department in using one would have been considerable. As the Regulation did not require the reporting of ex-factory prices at that time,

the UK continued to report wholesale prices to the Commission. However, even though dairy processors argued that wholesale prices were less commercially sensitive than ex-factory prices, Defra has struggled to gather prices which are representative of national production.

2.7 In May 2004, the Commission presented proposals to repeal and replace Regulation (EC) No 1498/1999. One of the elements was a change to the price reporting system. The Commission considered it essential to be able to compare price quotations. Commission Regulation (EC) No 562/2005 repeals Regulation (EC) No 1498/1999 and comes into force on 1 July 2005.

2.8 Article 6(1) of Regulation (EC) No 562/2005 requires Member States to provide the Commission with ex-factory prices for certain milk products except cheese where national production represents 2% or more of Community production. Member States must also provide price information for cheese which represents 8% or more of total national cheese production. The price information must be provided to the Commission by 11 am Brussels time each Wednesday. Article 6(5) defines ex-factory price as "the price at which the product is purchased from the enterprise, excluding taxes (VAT) and any other costs (transport, loading, handling, storage, pallets, insurance, etc). Article 6(3) requires Member States to "take the necessary steps" to ensure the information they provide is "representative, accurate and complete".

2.9 During the early stages of negotiations of Commission Regulation (EC) No 562/2005, there was reluctance from the trade to the proposals (mainly because of the switch to reporting ex-factory prices, concerns about deadlines for providing the information and about confidentiality). For this reason, the UK Government supported the inclusion of a paragraph in the text of the Regulation which states:

"The Member States shall take the measures necessary to ensure that the economic operators concerned provide them with the information required within the relevant time limits."

(iii) Risk Assessment

2.10 There is a risk that without legislation, the UK dairy industry will fail to provide Government with ex-factory prices as required. This would result in the UK being unable to provide the returns required under Commission Regulation (EC) No 562/2005.

2.11 Failure by the UK to provide timely domestic information on ex-factory prices as required under Commission Regulation (EC) No 562/2005 would affect the influence that the UK has on the market management tools employed by the Commission to balance the market. Commission proposals on market management would not take into account the market situation in the UK.

2.12 Failure to comply with Commission Regulation 562/2005 could result in infraction proceedings against the UK.

3. Consultation

3.1 Those affected by the new requirements are dairy processors and cheese-makers. Defra policy officials fully consulted their representative bodies, Dairy UK and the Provision Trade Federation (PTF) (as well as wider dairy interests including the National Farmers' Union, the Food and Drink Federation, and the Biscuit, Cake, Chocolate and Confectionary Association) during the negotiations of the draft Commission Regulation (including on the requirement for processors to provide price information). All those affected by the changes responded. The Commission also consulted the European trade associations.

3.2 On the basis that the subject matter was highly specialised and there were only a limited number of stakeholders all of whom had been directly involved in the policy development process, and that the Department is required to comply with EU Regulation by the deadline set, Lord Whitty, former Parliamentary Under Secretary of State (Lords) agreed that a formal written consultation on the need for a SI was not required in this case.

3.3 Since negotiations at EU level concluded, further consultation has taken place with Dairy UK about the implementation of the requirements.

4. Options

(i) Do nothing

4.1 This would result in the UK being unable to obtain the regular, reliable and complete information required to make a return under Commission Regulation (EC) No 562/2005. This might lead the Commission to launch infraction proceedings.

4.2 Failure to make returns or comply with the Regulation would also compromise the UK's position and influence in Management Committee negotiations. This could also adversely affect the domestic dairy market as any fluctuations in UK prices would not be taken into account by the Commission when formulating market management strategies.

4.3 Failure to collect representative, accurate and complete information and make the returns required under the Regulation would mean that the policy objective for this work area could not be met.

(ii) Introduce Domestic Legislation

4.4 Domestic legislation in this case is driven by the existing EU legislation which comes into force on 1 July 2005.

4.5 Introducing domestic legislation would reduce the risk of the UK providing inaccurate or non-compliant information to the Commission under Commission Regulation (EC) No 562/2005.

4.6 As part of the reporting provisions required of Member States under Commission Regulation (EC) No 562/2005, the UK is required to provide to the Commission details of how it intends to collect and weight the prices, and how it intends to ensure that the prices are representative, accurate and complete. Domestic legislation would lay a robust framework to

assure the Commission that we will be able to comply with the requirements of the Regulation.

(iii) Sector Provision of information on a voluntary basis.

4.7 UK processors could be asked to submit this information on a voluntary basis.

4.8 This option would reduce the regulatory burden on operators and Government.

4.9 As is the case with the current reporting system under Commission Regulation EC No 1498/1999, there is a risk that the prices reported would not be representative of UK production (as required by the Commission Regulation).

4.10 There is a risk that the Commission will not consider a voluntary requirement for the UK dairy processors to submit information to be a robust enough system.

4.11 Given past reluctance to provide the information required, there is also a risk that the industry would not stick to the voluntary agreement and that the UK would therefore be unable to make the returns required under the Regulation.

4.12 The UK wishes to avoid a situation arising in the future where it cannot comply with the requirements of the Regulation due to failure of operators to submit price information.

5. Costs and Benefits

(i) Sectors and groups affected

5.1 A small number of dairy processors will be affected by the legislation. These price returns must be made for milk products other than cheese, where national production represents 2% or more of the Community production, or where production is considered as representative at national level. Member States are also required to communicate prices for cheese which represent 8% or more of the total national cheese production. The Regulation further states that Member States should gather the price information through representative surveys. In order to ensure the Commission is provided with prices that are easy and meaningful to compare, prices will be collected from dairy processors who are large-scale manufacturers of bulk commodity products. Small businesses will therefore be excluded from the price reporting system.

5.2 It is envisaged that returns will be collated by the trade organisation, Dairy UK. Dairy processors have indicated that this would be their preference as it would give them greater confidentiality (Dairy UK would pass aggregated, not individual price quotations to Defra). It has been estimated by Dairy UK that at most, the provision of price information by dairy processors would require one person in an administrative grade spending one hour per week collating and forwarding the information. Based on the average salary for a member of administrative staff, this would amount to a cost of between £728 - £832 per annum per participating processor. The participating processors are likely to be seven of the largest UK dairy processors. Since the price reporting requirements draw on information already held by processors and will require the transmission of the same either directly to Defra or via a trade

association, the Regulation is not likely to lead to new costs or have significant economic impact on existing processors.

5.3 None of the three proposed options will have any Race Equality Impacts.

(ii) Benefits

Economic

5.4 Operators benefit from participating in the EU price reporting mechanisms as the Commission uses these price reports to adjust and implement market management measures (from which many dairy processors benefit). It is essential that the Commission takes UK price data into account when planning market measures as the UK is subject to currency fluctuations outside the Euro. Operators will also benefit from legislation setting out clearly their obligations for reporting prices and giving clear legal bases for the collection of those prices.

Social Impacts

5.5 It is not likely that any of the policy options will have significant social impact.

Environmental Impacts

5.6 It is not likely that any of the policy options will have significant environmental impact.

6. Small Firms Impact Test

6.1 We have consulted the dairy industry through the trade association, Dairy UK, who have confirmed that those likely to be affected under the proposals are seven of the largest major UK dairy processors and that the policy proposals will have no significant or disproportionate impact on small businesses.

7. Competition Assessment

7.1 The dairy industry is dominated by three large dairy processing plcs, and three large and increasingly 'vertically-integrated' co-ops. The five largest processors in the UK control more than two thirds of UK milk processing. 47% of the raw milk produced in the UK is used to produce liquid milk, with cheese production being the next largest use, accounting for 26% of milk utilisation.

7.2 We do not expect market share to be distorted by any of the policy options, nor do we expect market structure to be affected. The policy will not lead to higher set-up or ongoing costs for new businesses that existing business would not be expected to meet. We have applied the Competition Filter Test where applicable to each option as follows:

7.3 Option (i) - This is the "do nothing" option and no legislation is proposed under this option.

7.4 Option (ii) - The proposed legislation would affect the largest firms in the dairy processing sector. See Paragraph 5.1 for details.

7.5 Option (iii) - This option would rely on voluntary provision of information by the sector and therefore no legislation is proposed under this option.

8. Enforcement, Sanctions and Monitoring

Enforcement and Sanctions

8.1 Policy Option (i) would maintain the status quo. Under the current price reporting system laid down in Commission Regulation (EC) No 1498/1999, levels of compliance are low and unrepresentative. If this option were retained no enforcement mechanisms or penalties for non-compliance would be proposed.

8.2 For policy option (ii) it is proposed that a new offence be introduced for non-compliance with the requirements set out in the legislation. The offence would be for failure to comply with

a notice from the Secretary of State requiring the information laid down in Article 6 of Commission Regulation (EC) No 562/2005. The Home Office were consulted on the creation of a new offence and have agreed that a suitable penalty for non-compliance would be set at level 5 on the standard scale.

8.3 Policy option (iii) would be a voluntary measure and no enforcement mechanisms or penalties for non-compliance would be proposed.

Monitoring and Review

8.4 Price information from operators would need to be submitted to Defra weekly for onward transmission to the Commission. Therefore Defra policy officials will monitor the effectiveness of the chosen policy option on a weekly basis and will be aware of compliance levels and of details of how well the policy is meeting the objective.

8.5 Member States are also required to complete an annual return to the Commission indicating how they intend to collect the price information. Therefore, an annual review will be undertaken.

9. Implementation and delivery plan

Success Criteria

9.1 The success criteria for the policy will be that the UK is able to comply with the requirements of Commission Regulation (EC) No 562/2005.

Communication Strategy

9.2 Defra will set out clear lines of communication between stakeholders and policy officials throughout implementation and delivery. Defra plans to work collaboratively with Dairy UK and the dairy processors using existing lines of communication to inform and engage stakeholders on the issue.

10. Post-implementation Review

10.1 Notwithstanding the annual review by the Commission, it is our intention to review this policy after a period of three years to assess the effectiveness of the policy in delivering the objective. However, this does not preclude earlier review if circumstances call for it, for example, if the chosen policy option has any unforeseen and/or unintended consequences, if Government intervention is still required, or if penalties for non-compliance require review.

11. Summary and Recommendation

11.1 The changes in the proposed new Regulations - which are mandatory - do not impose an excessive new burden on the milk processing sector.

'I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs'.

Signed: Bach

Date: 26th May 2005

Lord Bach

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