APPENDIX 3

Independent legal advice to the committee on the revised National Foods contract with suppliers

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Mr Cleaver Elliott
Clerk Assistant (Committees)
Department of the Senate
Australian Senate
Parliament House, Canberra ACT

Dear Mr Elliott

Independent Advice to the Senate Select Committee on Agriculture on the fairness of a revised National Foods contract

I refer to our correspondence this week in the above matter. I attach my advice to the Committee for its consideration. I hope it is of assistance. Thank you for asking me to provide this advice. Please let me know if you have any questions in that regard.

Yours sincerely,

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Independent Advice to the Senate Select Committee on Agriculture
on the fairness of a revised National Foods contract

I have been asked to advise on revisions that have been made to the National Foods Australia Pty Ltd Tasmanian Farmgate Milk Supply Agreement a copy of which has been provided to me. Specifically, I have been asked to advise:

- whether the revised contract is fair;
- whether the revisions meet the concerns expressed in submission 129;
- what revisions would be required to make the contract fair if the revisions do not meet the concerns expressed in submission 129.

1. Is the revised contract fair

I have interpreted the term 'fair' to mean:

- reflecting a reasonably balanced negotiating power between the parties to the contract;
- that both parties are able to protect their interests and assess, with a reasonable degree of certainty, what their rights and obligations are under this contract; and
- that neither party is able to exert undue pressure to the detriment of the other party.

The revised contract is, in this sense, fairer than the original version. As the following comments indicate, there is still room for further adjustment. I do not have expertise in the dairy industry. I am therefore unable to comment on the fairness of, for example, the specifications producers must meet when supplying milk or the price National Foods is offering.

2. Concerns expressed in submission 129 regarding the contract

I address below both whether the concerns in submission 129 have been met by the revisions and if not, what revisions would be required to do so.

a) The submission raises concerns about instances in which National Foods reserve the right to make or change the rules and contract processes. In clause 1.1, the **Quality Assurance Program** is defined as one 'reasonably approved' by National Foods. Similarly, the **Milk Supplier Audit Procedure** is defined as a procedure 'reasonably prescribed by National Foods from time to time' and the **Specifications** are defined as those set by National Foods as amended by them from time to time.

The position of the parties would be more balanced, and the contract fairer, if both parties were involved in deciding these matters. The definitions of the terms above could be amended to read:

'**Quality Assurance Program**… is one agreed upon by both parties'.

'**Milk Supplier Audit Procedure**…is one agreed upon by both parties from time to time';

Specifications are defined as those set by both parties as amended by agreement between the parties from time to time'.

b) The dispute settlement provision in Clause 11 could be amended to include a clause that nominated a third party (eg., the Chairman of the Tasmanian Dairy Industry Authority or his/her delegate) to settle the dispute between the parties. This mechanism would prevent a situation arising in which the parties are in dispute and unable to agree upon a mediator to assist in resolving their dispute.

c) ***Clause 1.2 National Foods Australia Pty Ltd***

I respectfully disagree with the interpretation of clause 1.2 in the contract that each producer is potentially liable under this contract to the three companies referred to in clause 1.2. The parties to the contract are clearly identified and producers are only contracting with National Foods Australia Pty Ltd (defined in clause 1.1 as 'We' and 'Us'). This is reinforced by clause 18.8 which states that the relationship between the parties 'is one of principal and independent supplier'. Producers are not contracting with National Foods Milk Limited; National Foods Dairy Foods Limited; or Butterfields Specialty Foods Pty Ltd. The term 'agent' in this instance is used in the popular sense, not in the sense that National Foods Australia Pty Ltd creates legal obligations attaching to agency between the producers and National Foods Milk Limited; National Foods Dairy Foods Limited; or Butterfields Specialty Foods Pty Ltd.[1] However, the fact that National Foods Australia Pty Ltd acts as a general commercial agent for these companies is still significant for producers. In simple terms, producers could be indirectly liable for losses suffered by those companies that were caused by problems in the goods supplied by the producers. This is so, notwithstanding that the indemnity clause has been removed from clause 14 of the contract.

[1] See *International Harvester Co of Australia Pty Ltd v Carrigan's Hazeldene Pastoral Co.* ((1958) 100 CLR 644 at 652.

d) ***Clause 2: Purchase of Milk***

The amendments to this clause (particularly to sub-clause 2.7) have, in my opinion, shifted the balance of obligations between the parties from a situation largely burdening producers to a more balanced, fairer set of rights and obligations between the parties. As noted in the legal advice provided, National Foods is under no obligation under the contract to purchase 'over contract' milk. In my opinion, this term is consistent with my definition of 'fair' set out above. Whether National Foods is obliged to purchase 'over contract' milk or merely has a discretion to do so, is a consequence of the strength of the bargaining positions of the respective parties. In its present form (favouring National Foods), the term is no more unreasonable than it would be if it were an obligation and thus favouring the producers.

I note an apparent omission in sub-clause 2.15 which, I believe, should read in part, '…during a Term will be reduced by *any Logistics Charge* which we charge You…'

e) ***Clause 4: Collection and Transportation of Milk***

At 4.3, National Foods is required to inform the producer of the volume of milk it has collected. This could be amended to require National Foods to provide a copy of the recorded volume, although in practice this may already happen. Sub-clause 4.6(b) could be amended to include a time frame or at least to stipulate a reasonable period of time within which National Foods will notify the producer of any significant changes to milk collection schedules. This would better enable producers to protect their interests and to assess their rights and obligations under the contract. The term is still balanced in favour of National Foods in that there is no obligation on their part to consult or negotiate with the producer about any such changes to collection schedules. Logistics may require this, however members of the industry would know whether this is the case. Without knowing more about what is involved in managing these schedules, I would not recommend this clause be amended. However, I do point this out for consideration in any future contract negotiation.

f) ***Clause 5: Quality and Sample Testing***

Sub-clause 5.1 is weighted in favour of National Foods. This may be required for the reasonable conduct of National Foods' business. The sub-clause could be amended to provide that, in the event of a conflict between any of the regulations and the Specifications, the final determination as to the standard to be applied will be decided by agreement between the parties. At a minimum National Foods should be required to

consult with the producer before making this decision. If the parties negotiate the Specifications and other standards together, as suggested above, that might reduce or remove the need for the provision in sub-clause 5.1. The provisions in sub-clause 5.3 favour the interests of National Foods unfairly: National Foods can impose an Improvement Program on the producer at the producer's cost; however, the producer has no opportunity to contribute to the development of such a Program. Given the significance of this Program in the Supply Chain Audit procedure, this provision should be amended. I suggest amending sub-clause 5.3(b) to read:

> 'After each Milk Supplier Audit, We will set out in writing and provide to You our proposed Improvement Program for your consideration. The Proposed Improvement Program will set out such measures as we reasonably believe are necessary to address the Supply Chain issue identified by the Milk Supplier Audit, taking into account the costs to producers of implementing such measures. The Proposed Improvement Program will then be subject to negotiation with you, with an agreed Improvement Program being implemented at your cost.'

Similarly, sub-clause 5.3(c) favours the interests of National Foods. A fairer provision would be to amend sub-clause 5.3(c) to allow for a third party, rather than National Foods, to assess the Improvement Program and the producer's compliance with their obligations under the Agreement in relation to the Supply Chain. Alternatively, this assessment could be carried out by representatives of both parties to the contract.

Sub-clause 5.6 could also be amended to more fairly balance the rights and obligations between the parties. In its current form, the provision allows National Foods a discretion to impose a Testing Surcharge if it is of the reasonable view that such a test is necessary. A fairer provision would be to allow National Foods a discretion to impose the Testing Surcharge if the additional testing reveals a problem or confirms the concern that prompted National Foods to ask for the test in the first place.

g) ***Clause 7: Termination***

One of the grounds for termination by National Foods is if a producer engages in conduct 'which adversely affects' National Foods' reputation or the reputation of National Foods' trade marks: (7.3(a)(iii), 7.3(b)(ii)). There are equitable remedies upon which National Foods could rely rather than terminating the supply agreement. It is understandable why National Foods might want to include in the contract some obligation on the part of the producer not to harm National Foods' reputation, or that of its trade marks. However, the term is drafted widely and could catch a range of legitimate conduct. (It is at least

arguable for example, that the present public dispute between National Foods and members of the dairy industry could be regarded as such conduct). Given the importance of the supply agreement to a producer, having a termination clause drafted this widely is not, in my opinion, fair.

h) ***Clause 8.2: No Claims***

In my view, the amendments that have been made to this provision have addressed the concerns expressed in the submission and the term is fair.

i) ***Clause 9: Assignment***

The contract sets out clearly what the rights and obligations of each party are. It is not clear therefore (apart from habit or convenience) why the producer must first ask permission of National Foods before transferring or assigning the benefit of the contract, whereas National Foods is under no such constraint. The contract itself deals with the rights and obligations between National Foods and its contracting party, whoever that party is. Any party receiving an assignment or transfer from a producer would have to comply with the contractual obligations just as the producer itself was obliged to do.

j) ***Clause 10: Change in Your Operation***

I suggest that sub-clause 10.2 be amended as follows: 'With Our prior written consent, *which will not be unreasonably withheld*, You may transfer….'

k) ***Sub-clause 18.9: Entire Agreement***

I note the concerns raised in the submission about this clause. This is a standard clause and not unfair to have included in the contract. The concerns raised by the producers in their submission relate to discussions and perceived agreements with National Foods field officers regarding things such as additional infrastructure development, increased herd arrangements and milk pricing assurances. I recommend a separate clause be included which identifies the capacity of National Foods' field officers to bind National Foods and the extent to which the producers may rely on representations made by these field officers. Even if such a clause were not included, I note that in some circumstances, equitable doctrines such as promissory estoppel and unconscionability might provide producers with protection where discussions, agreements and representations take place in the context of the contractual relationship but outside the provisions of the agreement itself.

Concluding Remarks

I have not been asked to comment on the extent to which the *Trade Practices Act 1974* (Cth) might provide assistance to the producers and I have not done so. I note however that in sub-clause 13.2 the statutory terms implied into 'consumer' sales by the *Trade Practices Act 1974* (Cth) have been expressly incorporated into this contract. For the purposes of balance it may be appropriate for relevant provisions of Part IVA of that Act (Unconscionable Conduct) also to be expressly incorporated into the contract with the producer being defined as if they were a 'consumer' for the purposes of that part.

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