

EXPLANATORY MEMORANDUM

THE DAIRY PRODUCE QUOTAS REGULATIONS 2005

2005 No 465

THE DAIRY PRODUCE QUOTAS (GENERAL PROVISIONS) (AMENDMENT) REGULATIONS 2005

2005 No 466

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.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Description**

The two instruments referred to above respectively

- re-enact with amendments the Dairy Produce Quotas Regulations 2002 S.I. 2002/457, as amended by the Dairy Produce Quotas (Amendment) Regulations 2004 S.I. 2004/312;
- amend the Dairy Produce Quotas (General Provisions) Regulations 2002 S.I. 2002/458.

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

The Department refers to the comments made by the Joint Committee concerning the Dairy Produce Quotas (General Provisions) Regulations 2002 S.I. 2002/458 in its 25th Report of the 2001-2002 Session. The Department does not consider that there is a statutory obligation to consult the Council on Tribunals as regards the amendments made by the second instrument to those Regulations as they have no effect on the scope of the Tribunal's activities. Nevertheless, a copy of the draft of the Dairy Produce Quotas (General Provisions) (Amendment) Regulations 2005 was sent to the Council for information. The Council had no comments on the draft.

As regards paragraph 4 of the Explanatory Note to the Dairy Produce Quotas (General Provisions) Regulations 2005, reference has only been made to the Dairy Produce Quotas Regulations 2005. It was hoped that the necessary information relating to the equivalent regulations which apply in Wales, Scotland and Northern Ireland could have been inserted in the Explanatory Note. But this has not proved possible. A request will be made for the Explanatory Note to be amended so that that information can be included in the Annual Edition.

4. **Legislative background**

4.1 The first instrument re-enacts with amendments the Dairy Produce Quotas Regulations 2002 to reflect the provisions of the new Community legislation governing the milk quotas system – Council Regulation 1788/2003 establishing a levy in the milk and milk products sector and Commission Regulation 595/2004 laying down detailed rules for applying Council Regulation 1788/2003 establishing a levy in the milk and milk products sector. The instrument also makes changes to the administration of the milk quotas system.

4.2 The second instrument, which amends the Dairy Produce Quotas (General Provisions) Regulations 2002, updates a number of definitions so that they are consistent with those in the Dairy Produce Quotas Regulations 2005 and the new Community legislation.

4.3 The Eleventh Report (session 2002/03) of the House of Commons Select Committee on European Scrutiny of 5 February on the mid-term review of the Common Agricultural Policy covered a number of legislative proposals (Explanatory Memorandum COM (03) 23 of 3 February 2003), including a draft Council Regulation establishing a levy in the milk and milk products sector (Part 7 of the EM). The Committee deemed the proposals to be politically important and stated that they should be debated in the Commons. The debate took place on 12 February 2003 with explanatory memorandum 10897/02. A Supplementary Explanatory Memorandum (COM (03) 23 of 21 May 2003 Part 7 – milk levy) was cleared as politically important in the Committee's Twenty-Third Report (session 2002/03) of 4 June.

4.4 The proposals were referred to Sub-Committee D of the House of Lords on 4 February 2003. Documents 10879/02 and COM (03) 394 formed the basis of the Sub-Committee's Tenth Report (2002/03) *Mid-Term Review of the Common Agricultural Policy: External Implications*, 25 February, published on 27 March. The Supplementary EM was referred to Sub-Committee D on 20 May 2003. The Government Response to the Report was received on 5 June and the Report was debated on 10 June.

5. Extent

Both instruments have effect as regards the whole of the United Kingdom, but the first instrument applies on a territorial basis largely to England.

6. European Convention on Human Rights

Not applicable.

7. Policy background

7.1 The milk quotas system is subject to Community law. Under the system all Member States are allocated a national milk quota. If in a quota year production exceeds the quota, then all over-quota producers have to pay a levy on their over-production. Administration of the quota system is complex and is carried out in the UK by the Rural Payments Agency, an executive agency of the Department for Environment, Food and Rural Affairs. Council

Regulation 1788/2003 and Commission Regulation 595/2004 introduce new provisions applicable with effect from the 2004/05 quota year. These changes have to be reflected in UK legislation.

7.2 The Dairy Produce Quotas Regulations 2005 (DPQR) have been made to give effect to these mandatory changes, to amend certain provisions relating to the administration of the milk quotas scheme and to consolidate the existing Regulations. They are to come into force on 31 March 2005 and it is intended that similar Regulations will come into force in Wales, Scotland and Northern Ireland on that date. The changes are described in the attached RIA.

7.3 The Dairy Produce Quotas (General Provisions) Regulations 2002 (GPR) apply in the UK to a number of the cross-border elements of the milk quotas regime, in particular the powers of authorised officers to enter premises for inspection purposes, and the setting up of Dairy Produce Quota Tribunals to resolve disputes on quota allocations. The proposed 2005 SI amending the GPR updates definitions so that they are consistent with those in the new DPQR and the new Community milk quotas legislation.

7.4 The Department consulted widely to inform the trade of the mandatory changes and seek views on the other proposals. The attached RIA gives more detail on the consultation.

8. Impact

A Regulatory Impact Assessment in respect of the first instrument is attached to this memorandum. An RIA has not been prepared for the second instrument as it has no impact on business, charities or voluntary bodies.

9. Contact:

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can answer any queries regarding these instruments.

Regulatory Impact Assessment

1. Title of Proposal

The Dairy Produce Quotas Regulations 2005 (DPQR) (SI 2005/465).

2. Purpose and intended effect of measure

(i) The objective

To re-enact with amendments the Dairy Produce Quotas Regulations 2002. Most of the amendments arise from the need to implement new European Community legislation. The new Regulations – and similar Regulations in Scotland, Wales and Northern Ireland - are intended to come into force on 31 March 2005.

(ii) The background

Mandatory changes

a) The recent agreement on reform of the Common Agricultural Policy gave rise to a new Council Regulation (1788/2003) and Commission Regulation (595/2004) introducing changes to the administration of the milk quotas regime. These changes, which must be reflected in domestic legislation, relate to the following matters:

- two options were identified for implementing the required change in butterfat adjustment. The one adopted received the support of most respondents in the consultation exercise. Levy will continue to be charged when production (i.e. the higher of volume deliveries or butterfat-adjusted deliveries) exceeds the national milk quota. However, when levy is payable and the sum of butterfat-adjusted deliveries is less than the sum of volume deliveries, then all downward adjustments of individual delivery figures will be proportionately reduced to bring the sum of adjusted deliveries into line with volume deliveries actually made. This means, in effect, that any levy will always be payable on butterfat-adjusted deliveries (*regulation 25*);
- direct sellers who fail to submit a declaration of sales by 14 May will pay any levy at the full rate (*regulation 30(14)*);
- producers will, if they have not already paid any levy due to their purchaser, be liable for its payment where purchasers default (*regulation 31*);
- the new Commission Regulation requires checks to be made on the compatibility between deliveries/direct sales of milk and production capacity. To help meet this requirement producers will be required to keep invoices for purchases of feed (*regulation 34(2) and paragraphs 2(1)(d) and paragraph 3(d) of schedule 2*).
- milk which is officially required to leave the farm for destruction for sanitary reasons will be excluded from the levy calculation. Producers will have to keep records relating to the destruction of such milk (*regulation 34(2) and paragraphs 2(1)(j) and paragraph 3(k) of schedule 2*). Exclusion from the

levy calculation will not, however, apply to milk which has to be destroyed for sanitary reasons once it has been delivered to a purchaser.

b) A number of other mandatory changes are necessary. The first two listed below were included in the 2003 consultation exercise on amendment of the DPQR 2002 and the other two in the 2004 consultation:

- in line with advice from the European Commission deadlines for the submission of documents or making of applications to the Secretary of State will relate to the date of receipt, rather than despatch of documents.
- the Secretary of State will have the discretion to require new applicants seeking approval as purchasers to lodge a security. This will normally take the form of a bank guarantee covering the maximum foreseeable levy liability (*regulation 5(4)*);
- purchasers who fail to submit a summary of producers' deliveries by 1 July will be liable to a penalty. The penalty will be equal to the theoretical amount of levy that would be due on 0.01% of the volume of milk involved per calendar day of the delay in submission. This change corrects an omission in the DPQR (*regulation 36(6)*);
- direct sellers who fail to submit a declaration of sales by 1 July will have their quota confiscated 30 days after the Secretary of State has served notice of confiscation. It is the Department's view that the current 30-day period of grace between notification of the intention to confiscate and the confiscation itself is an incorrect interpretation of the Commission Regulation (*regulation 38*).

Non-mandatory changes

c) *Levy calculation*

In making any levy calculation, the Secretary of State will share all the unused wholesale quota held by producers at the end of the quota year between all over-quota producers in the UK, irrespective of the purchaser supplied. This is a major change because, at present, the amount by which a producer can exceed his quota without paying levy depends upon the amount of unused quota held by other producers within the same purchaser group. This change was suggested by the trade and received the support of most respondents throughout the UK in the consultation exercise (*regulation 27*).

d) *Retention of quota at the end of a tenancy*

i) The Department consulted in 2003 on the proposed breaking of the link between quota and land. It was subsequently announced that the Department would not proceed with this in the light of the new Community legislation and responses received to the consultation, but would deal with the issue of protecting tenants who buy quota in their own right by allowing them, at the end of a tenancy, to retain quota that they have purchased if they remain producers and have not agreed with their landlord that the purchased quota should be attached to the land.

ii) In general, under Article 17(1) of the Council Regulation quota is transferred with the holding to which it relates. Consequently, at the end of his tenancy, a tenant generally loses any quota he has bought. Some tenants may consider the compensation arrangements for the loss provided for in the Agriculture Act 1986 and the Agricultural Tenancies Act 1995 inadequate or would prefer to take the quota with them to their next holding.

iii) After consideration of the legal and practical implications a new regulation has been introduced which both complies with Article 17(4) of the Council Regulation, under which it is made, and does not conflict with primary agricultural tenancies legislation. The new regulation (*regulation 14*) is applicable to tenancies ending after 31 March 2005 and will enable tenants who buy quota without land and who remain producers to retain that quota at the end of their tenancy provided that:

- the landlord has not paid for the quota;
- the tenancy of the land in question expires without any possibility of renewal on similar terms; and
- the tenant and his landlord have not agreed that, after expiry of the tenancy, the tenant should not retain the quota.

The notice relating to the retention of quota that tenants submit to the Secretary of State will have to include a statement from the tenant only that he and his landlord have not agreed that, after the expiry of the tenancy, the quota should be registered in relation to the land in question. Tenants who submit such a notice will not be entitled to compensation under paragraph 1 of Schedule I to the Agriculture Act 1986.

Administrative changes

e) Quota conversion

i) Currently, producers who have permanently converted quota (from wholesale to direct sale or *vice versa*) may not in the same year transfer out quota of the type to which they have converted. The restriction does not apply to those who temporarily converted quota in the preceding quota year. Under the new regulation the restriction will not apply where the preceding temporary conversion was in the same direction as the permanent conversion or to permanently converted quota transferred with land (*regulation 22*).

ii) Article 6(2) of the Council Regulation provides that quota conversion may take place only at the *duly justified* request of the producer. By making two consecutive conversions, first temporary and then permanent, in the same direction, the producer is demonstrating clear justification of his need for the quota type in question and can therefore be exempt from the restriction referred to. This is not, however, true of a producer who makes two different quota conversions and he should therefore remain subject to the restriction. The restriction does not apply to transfers of permanently converted quota with land because Article 17(1) of the Council Regulation requires that quota must be transferred with land.

f) Prevention of avoidance of levy

It is made clear that a producer who buys, leases or inherits cows from another producer mid-year and then keeps the cows on his holding and manages them with no

involvement from the first producer is not deemed to be acting as that producer's agent. This is intended to close a loophole which can be used to avoid the payment of levy and to ensure that non-producers do not erroneously retain producer status (*regulation 32*).

(iii) Risk assessment

Most of the changes are required either to ensure that Community law is complied with or to complete action following the 2003 consultation exercise.

Failure to adopt:

- the tenants' quota regulation would mean that tenant farmers would be unable to benefit from the flexibility and protection it affords;
- the change to levy calculation - which was proposed by the trade - would run counter to the wishes of the majority of those who commented on the proposal in the consultation exercise and indicate that we do not listen to the trade;
- the administrative changes would affect the Secretary of State's ability to minimise abuse of the quotas system.

3. Options

Doing nothing is not an option for the changes required by Community law. In addition, Ministers undertook to pursue the question of tenants' quota and regulation 14 fulfils that commitment. The larger amendment exercise has provided the opportunity to take up the trade's wish for a change in levy calculation and to tighten up some administrative rules so that they reflect the intention of the Community legislation more accurately.

4. Benefits

Business sectors affected – according to Dairy Hygiene Inspectorate figures there were some 13,300 dairy farms in England in February 2004, and there are currently 132 milk purchasers in the UK.

- Economic
Amendments at 2(ii)(a):

Butterfat adjustment – The new arrangements will give all wholesale producers greater certainty as to their levy liability. There is no change in the UK's overall levy liability.

Direct sales declarations – the higher rate of levy liability added to the existing penalty for the late submission of declarations should further encourage prompt returns and aid timely levy calculation.

Levy payment – it is producers who are liable to pay levy on any over-production but levy is collected by purchasers. The new regulation spells out, where there was previously some lack of clarity, that, where purchasers default without having collected levy, it must still be paid by producers. Thus,

producers are not subject to any new financial burden but the taxpayer is given greater protection since any shortfall in levy payment must be paid from the public purse.

Milk destroyed off-farm – unfit milk which is destroyed on producers' holdings is excluded from the levy calculation. Currently, however, unfit milk which the relevant authorities require to be destroyed off-farm is included in the calculation. The new regulation now also excludes such milk from the calculation, which will be of benefit to producers.

Amendments at 2(ii)(b):

Purchasers' security – this will allow applicants without a track record in business the opportunity of operating as a purchaser while at the same time protecting taxpayers' funds as purchasers are responsible for collecting any levy for the government and ultimately the EU.

Purchaser penalty – this too should encourage prompt returns and aid timely levy calculation.

Amendment at 2(ii)(c):

Tenants' quota proposal – there are no up-to-date figures for the number of dairy farmers who are tenants, nor is it possible to say how many tenants would prefer retention of quota to compensation. However, the Tenant Farmers Association (TFA), which is in a good position to assess the situation, welcomed the proposal. The Department believes that the regulation will give tenants more confidence to buy quota and help free up the movement of quota to areas where it is most needed.

- Environmental
None identified
- Social
None identified

5. Costs

- Economic
Amendments at 2(ii)(a):

Butterfat adjustment - in their end-of-year returns to the Secretary of State purchasers will additionally have to supply details of deliveries and butterfat content for individual producers. The change will also impose an increased administrative burden on the Rural Payments Agency (RPA) which administers the dairy quotas scheme.

Direct sales declarations - the increased levy liability penalty will only apply if direct sellers fail to provide their sales declarations on time. In recent years the number of late returns for the UK has ranged from 41 in 2000/01 to 14 in 2002/03.

Record keeping (compatibility checks and destroyed milk) - this should not be an onerous requirement since producers are in any case likely to keep invoices for tax and accounting purposes and there should not be many cases in which producers are unable to destroy milk on their holdings.

Amendments at 2(ii)(b):

Purchasers' security - most applicants are able to provide sufficient evidence of financial stability so there will be few cases where traders will be asked to lodge a security. A bank guarantee, the cost of which is met by the trader, will have to cover the maximum foreseeable levy liability which will vary according to the size of the business. The cost of the guarantee will vary too from bank to bank and according to the viability of the business. 1% of the value of the guarantee appears to be a representative figure.

Purchaser penalty - purchasers will only be subject to the newly applied penalty if they fail to provide declarations on time. The regulations make clear that account will be taken of the volume of milk involved and the seriousness of the failure. The penalty may not be applied if the failure is deemed not to be deliberate or seriously negligent, negligible or attributable to *force majeure*.

Quota conversion – the restriction represents little change to the current rules but it could affect the ability of some producers to respond to changing business circumstances.

Environmental
None identified

- Social
None identified

6. Issues of equity and fairness

The proposals are neutral in effect.

7. Consultation with small business: the Small Firms' Impact Test

i) The majority of dairy farms are small businesses, as are many milk purchasers (110 of the 132 in the UK acquire their milk from a producer base of up to 99). The National Farmers Union (NFU) and milk purchasers are amongst those who were kept informed of the changes at the regular meetings organised by the RPA at which they were given notice of the regulatory changes; they raised no concerns about them. It was at one of these meetings that purchasers suggested changing the basis on which liability for levy is calculated from purchaser to producer level and it is that suggestion which has been adopted.

ii) The Department originally consulted on a proposal to break the link between quota and land in 2003 but was unable to proceed with the proposal. The TFA was disappointed by this and the Department undertook to consider the issue further. The proposal was discussed with the TFA and NFU before the Department formally

consulted on a regulation making it easier at the end of a tenancy for a tenant to retain quota he has bought.

8. Competition assessment

The proposals will have no effect on competition.

9. Enforcement and sanctions

How will the proposal be enforced?

As part of the existing administration of the UK quotas system.

Who will enforce this legislation?

The Rural Payments Agency.

Will the legislation impose criminal sanctions for non-compliance?

Yes

10. Monitoring and review

The operation of the DPQR is subject to continual review through mechanisms such as the quarterly meetings of the Milk Quotas Experts Group organised by the RPA and attended by trade interests and the agriculture departments.

11. Consultation

i) Within government

The RPA and devolved administrations were closely involved in developing and drafting the Regulations.

ii) Public Consultation

Before the formal consultation the trade was informed of the proposed regulatory changes at meetings with the RPA and discussions on the tenants' quota proposal were held with the NFU, TFA and Country Land and Business Association. The consultation document was circulated widely to trade bodies representing farmers (including tenants), landlords, milk purchasers, quota brokers and agricultural consultants. We received ten responses, most in favour of the butterfat and levy calculation proposals which were adopted. Some felt that the administrative changes were unnecessary and added to the complexity of the quotas system but others recognised the need for them. Although the tenants' quota proposal was welcomed by most, concerns were expressed by some about the narrowness of the regulation, which is unavoidable under the terms of the relevant Community legislation, and landlords' involvement in the notice submitted to the Secretary of State.

As a result of concerns about:

- the practicality of, and additional bureaucracy associated with, the proposal to require producers to keep records of feeding plans, the proposal was amended to require the keeping of invoices for purchases of feed.
- the draft tenants' quota regulation, this was amended so that the notice submitted to the Secretary of State will not need a landlord's statement (in line with transfers of quota without land).

12. Summary and recommendation

The changes in the proposed new Regulations – most of which are mandatory – do not impose an excessive new burden on the milk production sector.

Declaration

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs

Signed : Whitty

Date: 16th February 2005

Lord Whitty

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