Guidance Document for Fairtrade Coffee Pricing

Introduction

This guidance document replaces previous guidance documents on the different aspects of the Fairtrade price for coffee, merging these into a single document. The intention is to provide producer organisations, Fairtrade payers and conveyors and FLOCERT auditors with simple guidelines on Fairtrade coffee pricing. This guidance will be updated regularly, according to the changing circumstances in the coffee market and in the practice of the Fairtrade coffee business.

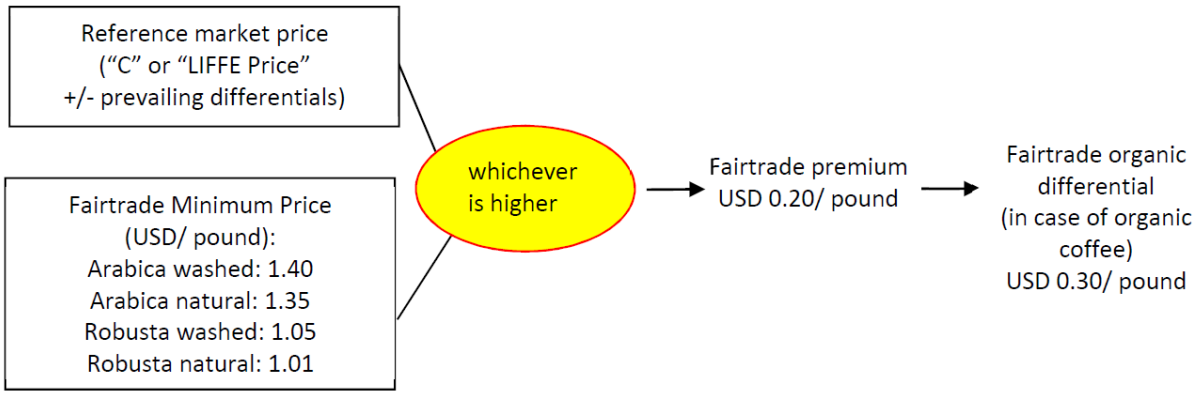
The different types of Fairtrade operators (producer organisations, exporters, importers, roasters, etc.), as well as Fairtrade International and FLOCERT staff involved, are invited to give feedback on these guidelines and will be consulted on a regular basis on their experiences with implementing the Fairtrade Standards in practice.

Fairtrade International is undertaking a consultation process on FOB deductions, to draft guideline documents for specific origins and to agree a range for the standard costs that can be deducted. The costs consider the diverse nature of coffee supply chains across many different countries and regions. This work has started with the main Fairtrade coffee supplying countries. The guidance document on FOB deductions are published separately on Fairtrade's website.

If operators have doubts regarding these guidelines or are asked to agree to terms significantly different to agreed best practice, they are encouraged to contact the Fairtrade International Coffee Help Desk for advice, before contracts are signed: coffeehelp@fairtrade.net

Fairtrade Price for Coffee

The Fairtrade price for green coffee is defined at FOB level. The Fairtrade price is the reference market price or the Fairtrade Minimum Price, whichever is higher, plus the Fairtrade Premium of 20 cents / pound and the Fairtrade organic differential of 30 cents / pound (in case of organic coffee). The reference market price is the sum of the terminal market price (ICE New York C contract for Arabica, ICE London RC contract for Robusta) of the relevant month, plus or minus the prevailing differential. A negative differential can never be applied to the Fairtrade Minimum Price. The Fairtrade Premium and the Fairtrade organic differential are not subject to negotiation and are meant for the producer organisation only.



The contracts and invoices need to show the breakdown of the Fairtrade price, separating explicitly the terminal market price, the prevailing differential, the Fairtrade Premium, the Fairtrade organic differential (in case of organic coffee) and eventual additional price premiums. No lumpsum differentials are allowed (country/quality differential, organic differential, or other). The date of price agreement and of the price fixation against the terminal market price, need to be confirmed in writing in the contract or in a separate communication.

Fairtrade Minimum Price

The Fairtrade Minimum Prices for green coffee are defined at FOB level and are mandatory for all green coffee operations along the supply chain. No negative differentials can be deducted from the Fairtrade Minimum Price, neither for low grades such as stocklots or segundas. For the costs that can be deducted from the FOB price, see the section on FOB deductions. Buyers along the supply chain must be able to justify the costs and deductions that are applied to the Fairtrade Minimum Price.

For information on Fairtrade Prices and Premiums see the Fairtrade International website: https://www.fairtrade.net/standards/price-and-premium-info.html

Prevailing Differential

The prevailing differential is the premium or discount relative to the terminal market price (ICE New York C for Arabica, ICE London RC for Robusta) at which coffee of the same origin and quality is offered in the mainstream market. Fairtrade International publishes on a 2-weekly basis a list of differential references as quoted in the Complete Coffee Coverage, issued daily by Coffee Publications Inc. https://www.fairtrade.net/products/coffee.html

Differentials that differ substantially from this reference must be justified through own purchase and sales records and / or other, independent sources that can be verified.

The minimum differential that can be applied for export grade coffee is the differential as defined in the terminal market for that origin and grade (ICE New York C for Arabica[1], ICE London RC for Robusta[2]), according to the grading requirements for tendering coffee. As a proxy for the cost from FOB to delivery at a certified warehouse, a 5 cents / lb deduction is used, unless a guidance document for a specific origin defines otherwise. E.g. ICE New York C differential for a particular origin is at par, the minimum differential for that origin and quality is -5 at FOB level. This deduction cannot be applied to the Fairtrade Minimum Prices.

For quality grades above the requirements of the futures markets, the differentials are subject to negotiation between buyer and seller. For a number of grades, references are quoted in the source mentioned in the link above.

For low grade coffees such as stocklots or segundas sold at a discount, the prevailing differentials in the mainstream market apply. A negative differential cannot be applied to the Fairtrade Minimum Prices for these coffees.

Price Fixation

The Fairtrade Standard for Coffee requires that the contracts have an open price with a price to be fixed at seller's call (PTBF) clause. The PTBF clause is considered a key tool for producer organisations to manage the price risk, especially considering that most don't use hedging tools.

The buyer may apply a deadline on the PTBF clause when it is reasonable to consider that the producer organisation has procured the coffee.

An outright priced contract may be used only as an exception in the following cases:

a) auction systems that would invalidate a price to be fixed contract, or

b) the seller has the coffee in stock at the time of making the contract, or

c) buyer and seller agree upon a joint price risk management strategy.

The latter must be beneficial for both the seller and the buyer and must be confirmed in writing, including who bears the costs and how to act in case the strategy fails.

In the case of outright priced contracts, prices must not be fixed for a period longer than one crop period.

The buyer cannot file an allegation against the seller with FLOCERT because of defaults due to a failing risk management strategy as mentioned here.

[1] https://www.theice.com/products/15/Coffee-C-Futures

[2] https://www.theice.com/products/37089079/Robusta-Coffee-Futures; http://www.thecoffeeguide.org/coffee-guide/futures-markets/tenderable-growths-packing-differentials-and-certification/

Stop Loss Orders

A careful use of stop loss orders during the harvest period, mutually agreed between buyer and producer, can be used as part of a price risk management strategy. The buyer cannot impose a stop loss order upon the producer organisation before the harvest starts and the coffee is procured, thus eliminating effectively the PTBF at seller's call clause and increasing the risk for the producer.

Price Risk Management & Hedging

The use of hedging tools to manage the price risk is in principle the responsibility of the buyer and / or the exporter who takes possession of the coffee. The buyer and the seller may agree upon sharing the cost of hedging, if they consider it to be mutually beneficial. The buyer is responsible for instructing the producer organisation that supplies the coffee on the use of hedging tools.

The buyer may not impose the cost of hedging upon the producer organisation that supplies the coffee and must secure that the cost of hedging does not undermine the competitiveness of the producer organisation.

The buyer cannot file an allegation against the seller with FLOCERT because of defaults due to the cost of hedging that undermines the competitiveness of the producer organisation.

FOB Deductions

The Fairtrade Minimum Price for green coffee is defined at FOB level. In case the producer organisation does not export itself, but hires in the service of an exporter or sells to that exporter, "fair and reasonable" costs of exportation can be deducted from the FOB price. These costs must be real costs, based on real processing yields and mutually agreed upon beforehand in writing. Upon request the calculations and registers that confirm the real costs and real processing yields must be shown.

Unless otherwise defined in a guidance document for specific origins, as "fair and reasonable" export costs are understood the following:

a) cost of transport to the processing plant (if the coffee is delivered elsewhere),

b) cost of processing and bagging,

c) cost of transport to the harbour and of export logistics,

d) legally established levies such as export taxes,

Additionally the processor / exporter may charge a gross margin that includes overheads.

Fairtrade International may establish a limit for these FOB deductions for specific origins, based on consultation of the real costs with operators of that origin.

All additional costs such as special preparations, special packaging, brokerage / sales commission, hedging, financing and storage, must be justified and mutually agreed beforehand and in writing.

The exporter cannot impose additional costs and cannot charge an additional net profit margin to the producers.

Other Deductions

Deductions such as weight loss and quality claims must be supported by documentary evidence, such as weight certificates, cupping reports, inspection reports on damages, etc. Samples must be kept for auditing purposes. Deductions as a substitute for a negative differential applied to the Fairtrade Minimum Price are not allowed.

Trading with Integrity

The Fairtrade Trader Standard stipulates that: "Fairtrade does not accept unfair practices that clearly damage producers' or other traders' capacity to compete or the imposition of trading conditions on suppliers that would make it difficult for them to comply with Fairtrade Standards." (T.S. 4.8.1 Unfair trading practices. Please refer to the document in this link)

The Fairtrade Minimum Price and the Fairtrade Premium, to allow them to invest, is at the heart of the Fairtrade system. While the reality of the market must be observed, and the dynamics of supply and demand be respected; infringement of the standards on Fairtrade pricing, to the detriment of the producers resulting in unfair practices that affect other operators in the system, is considered a non-compliance with the Fairtrade Standards requirements. This means that Fairtrade products can never be bought or sold below the FMP and Fairtrade Premium. Contracts with a price below the Fairtrade minimum are no longer valid Fairtrade contracts. For further information on this requirement please refer to the Trader Standard interpretation note on requirement 4.8.1.

The Fairtrade Trader Standard mentions a number of examples of unfair trading practices, such as bonded contracts and excessive transfer of costs and risks.