Queensland Sugar Limited:

Paper for the Federal Rural and Regional Affairs & Transport References Committee – Current and future arrangements for the marketing of Australian sugar.

Queensland Sugar Limited: Working for the Queensland sugar industry

Queensland Sugar Limited (QSL) is a not for profit company whose primary purpose is to promote the interests of the Queensland sugar industry. Its members comprise each of the Queensland mill owners and representatives of Queensland cane growers. QSL is currently the entity responsible for marketing to export customers the majority of raw sugar produced in Queensland and operating the six bulk sugar terminals used for storage and handling of all raw sugar produced in Queensland.

While it is the successor to the Sugar Board and Queensland Sugar Corporation which operated as a statutory single desk for many years, QSL has not been a statutory single desk since deregulation in 2006. Since 2006 QSL has negotiated commercial agreements for the acquisition of raw sugar from Queensland mill owners. In the years since then it has amended the terms on which it acquires and markets raw sugar numerous times to accommodate the requests of industry participants, including providing mill owners rights to market a substantial proportion of their own production.

While QSL's direct contractual relationship is with mill owners it has always consulted extensively with cane growers who supply those mills and cane grower organisations, and typically there has been a reasonable degree of alignment between what mills and cane growers want.

QSL is, however, becoming increasingly concerned with recent events in the sugar industry and the impact they are likely to have on Queensland cane farmers and smaller or independent milling companies.

Terms of Reference

QSL therefore welcomes the Federal Senate's referral to the Rural and Regional Affairs and Transport References Committee (Federal Committee) for inquiry and report on:

Current and future arrangements for the marketing of Australian sugar, including

- *The impact of proposed changes on the local sugar industry, including the effect on grower economic interest sugar;*
- *Equitable access to essential infrastructure;*
- *Foreign ownership levels in the industry and the potential to impact on the interests of the Australian sugar industry;*
- *Whether there is an emerging need for formal powers under Commonwealth competition and consumer laws, in particular whether there are adequate protections for grower-producers against market imbalances;*
- *Any related matters.*

QSL is pleased to provide the enclosed detailed submission to assist the Federal Committee with its inquiry. The submission responds to the Federal Committee's terms of reference, but also includes an overview of how the Queensland sugar industry currently operates to assist the Federal Committee in understanding the context in which recent events are occurring.

24-10-2014

QSL's concerns

QSL's primary concern is that, due to the monopoly position held by most mill owners as the sole acquirer of cane in the region surrounding the relevant mills, without regulatory intervention, cane growers will:

- Have no choice as to which entity markets 'grower economic interest sugar' produced from the cane they supply; and
- Not be able to obtain fair and reasonable terms for the cane they supply (including grower economic interest sugar).

Due to the perishable nature of cane, transport costs and the ownership and location of mills, the vast majority of growers cannot realistically seek to supply a different mill owner on a commercially sustainable basis.

At least one mill owner (Wilmar) now appears to be seeking to leverage the market power it has in relation to the acquisition of cane and the provision of cane crushing services to require that it is the marketer of grower economic interest sugar. This has caused an outcry and appears to have been overwhelmingly rejected by the growers who supply Wilmar. However, due to the lack of alternatives, growers are effectively faced with either agreeing to the terms Wilmar offers or leaving the industry.

QSL's first preference has always been for growers' concerns to be resolved by a negotiated contractual outcome. However, at this point, that unfortunately seems a very unlikely outcome.

The Queensland State government has sought to facilitate industry discussions for that very purpose in which QSL, grower organisations and most mill owners were willing participants. However, the largest producer of raw sugar, Wilmar, has made it clear to Minister McVeigh (the State Minister for Agriculture, Fisheries and Forestry) and other industry participants that it is not willing to negotiate or participate in those discussions.

Wilmar announced its new proposal for arrangements with growers on 3 April 2014. It has held extensive discussions with growers and grower groups since that date and 6 months later appears to be no closer to reaching any form of agreement which growers are happy with.

QSL is also aware that complaints have been made to the Australian Competition and Consumer Commission (ACCC) by grower groups about Wilmar's conduct with no apparent action having been taken to date.

As a result, QSL has reluctantly concluded:

- there is no real prospect of a negotiated outcome; and
- that the existing regulatory framework has not been sufficient to protect growers,

and consequently it is in the best interest of the sugar industry to seek regulatory reform to protect the long-term interests of cane growers. The industry is currently at a critical 'tipping point' and if action is not taken, there are real prospects of numerous cane growers leaving the industry and/or ceasing to make investment in the industry.

QSL's suggestions on regulatory reform

As noted above, QSL's first preference is for a commercially negotiated outcome that provides growers with fair terms – but given Wilmar's refusal to negotiate, the only terms that can be reached are unbalanced ones reflecting its monopoly position.

QSL's second preference (its first preference in the absence of a commercially negotiated outcome), is for a statutory 'grower choice' regime under which growers have a right to supply cane on terms permitting them the freedom of choice in which entities market the grower economic interest sugar for which they have price exposure under their cane supply agreements. The price derived for the cane supplied would be required to be calculated in a specified manner by reference to the net price achieved by their chosen marketer(s) net of certain permitted costs which the mill and/or marketer would be entitled to pass on.

A statutory grower choice regime could potentially be achieved by either:

- Amendments to the *Sugar Industry Act 1999* (Qld); or
- A mandatory industry code under the *Competition and Consumer Act 2010* (Cth).

To the extent that there are considered to be legal or practical difficulties with a grower choice regime (that are not currently evident to QSL), QSL's third preference would be to regulate the terms of access to the crushing services of mills (and related transport and logistics services) which are in a monopoly position. Access regimes have been recognised as being appropriate for a wide variety of monopoly infrastructure and could be implemented by:

- Amendments to the third party access regimes under Part 5 of the *Queensland Competition Authority Act 1997* (Qld) and Part IIIA of the *Competition and Consumer Act 2010* (Cth); or
- Amendments providing for a specific access regime in the *Sugar Industry Act 1999* (Qld).

Such amendments would provide growers with an alternative if they could not agree satisfactory terms for supply of their cane to their local monopoly mill.

QSL notes that its suggestions are consistent with:

- The policy proposal in the recently published Green Paper on Agricultural Competitiveness to 'introduce new marketing mechanisms which might restore balance of power to the producer'; and
- Methods for dealing with monopoly power that are used in other industries in Australia (including rail, ports, pipelines and communications).

QSL is also concerned to ensure fair and open access continues to be provided to the bulk sugar terminals to all producers and marketers of raw sugar. For as long as QSL is the operator of the terminals it can ensure that occurs, and considers that such open access is part of its primary objective to promote the best interests of the sugar industry. However, QSL suggests that a regulatory regime needs to be established to ensure that if the terminals become operated by other entities, which may have different incentives, that the existing approach to fair and open access is preserved.

Foreign investment

QSL is not seeking further regulation of foreign investment in the sugar industry. Foreign investment has benefited the Queensland sugar industry and QSL considers that any regulation should be aimed at the conduct in question (which could equally be engaged in by domestically owned mills, albeit that is not currently occurring).

Further assistance

QSL hopes that this submission assists the Federal Committee in both understanding the issues at play and determining the appropriate reforms to resolve those issues for the benefit of cane growers, the sugar industry as a whole, and the regional economies that depend on the sugar industry.
QSL is happy to provide any additional assistance that it can to the Federal Committee in developing an understanding of the industry and the current circumstances and in crafting recommendations for appropriate reforms.

1. Overview of the Queensland sugar industry

1.1 Location

The Queensland sugar industry currently consists of approximately 4000 sugar cane farms, 21 mills, 6 bulk sugar terminals and 2 sugar refineries. The map below provides a general overview of the location (and ownership) of the relevant mills and the nearby regions they source sugar cane from.

1.2 Deregulation and recent history of the sugar industry

The Queensland sugar industry was deregulated in 2006, having operated under a statutory single desk from 1912 until 2006. Prior to deregulation, title to raw sugar produced by a mill was vested by the *Sugar Industry Act 1999* (Qld) in QSL, with QSL having statutory obligations to pay back net proceeds received to the mills, who then paid back part of those net proceeds to growers.

Following deregulation, supply arrangements between growers and mill owners (for cane) and mill owners and raw sugar customers (including QSL, refineries and traders) were commercially negotiated and the previous statutory single desk was abolished.

For the reasons discussed in section 3.2 of this paper, competition between mills for acquisition of cane or supply of cane crushing services has not typically resulted despite deregulation.

However, competition for provision of marketing services has occurred. In the first season of deregulation, two mills (Mulgrave and Mossman) opted to market their raw sugar production independently of QSL (with Mulgrave marketing the raw sugar from both mills). The number of mill owners who have marketed with QSL over time has varied from that point on, with mills owned by MSF Sugar also marketing independently of QSL for a number of seasons.

As discussed in more detail in section 2.2, the raw sugar supply agreements (RSSA) that QSL currently has with Queensland mill owners have been amended in respect of the 2014 and future seasons to provide mill owners with the ability to market their 'supplier economic interest sugar' (which is explained further in section 2.3 below, but is approximately 33-50% of a mill's production) and formally recognise 'grower economic interest sugar'. As a result, a number of different entities now market Queensland raw sugar, and are actual or potential competitors of QSL (and the other mills exercising that right) for the provision of marketing and export services to Queensland mills.

1.3 Cane

In Queensland, sugar cane is mainly grown along the coastal strip from Mossman and the Atherton Tablelands in North Queensland to the New South Wales border, over a 2000 kilometre stretch. In Queensland, the average size of cane farms is approximately 100 hectares, but the size of individual farms varies substantially. There are currently approximately 4,000 Queensland growers. In addition a number of mills, including Wilmar, MSF Sugar and Mackay Sugar, own and/or lease cane farms near their respective mills.

Since deregulation, growers have supplied the local mill owner under cane supply agreements, with delivery occurring by a mixture of road and rail freight, depending on the region and existing infrastructure. The cane supply agreements typically provide for growers to receive a price for their cane which is calculated by reference to the ultimate price obtained for the resulting raw sugar produced from that cane, reflecting approximately two thirds of the value of the raw sugar as being attributable to the cane and one third attributable to the milling process. The method of this calculation is often referred to as the 'cane payment formula'.

As a result of the cane payment formula, while (under current contractual arrangements) growers transfer legal title to the cane to the mill owner they deliver it to, they retain an 'economic interest' in approximately two thirds of the raw sugar produced.

The resulting separation of legal and economic interests is a creature of contract and not the only possible outcome of such negotiations. Rather it is a historical legacy of the industry replicating in commercial contracts the transactions which previously occurred under the statutory regime.

While alternative legal structures such as tolling (where the grower would retain title and pay the mill a tolling fee for crushing their cane into raw sugar) have been discussed from time to time, the transfer of title to a mill owner was previously not a concern to growers as no mill owner was seeking to use it to control the marketing of the raw sugar the growers had an economic interest in.

As discussed below, the concept of grower economic interest (and the mirror concept of mill owner or supplier economic interest) is now formally recognised in the raw sugar supply agreements between QSL and the mill owners that supply it, and issues of title and grower economic interest have become far more critical to growers given the approach being taken by some mills to how grower economic interest sugar is to be marketed.

There is a small sugar industry based in northern New South Wales (which solely supplies New South Wales based sugar mills, except in 'bumper' crop years where there may be a small volume available for export). Sugar cane was grown in the Ord River district in Western Australia up until 2007 but that is no longer occurring.

The below table provides reported cane production figures for the various cane growing regions (as reported in the Australian Sugar Milling Council Annual Review 2012-13):

Cane crushed (tonnes)

Region/Season	2012	2011	2010	2009	2008
Northern	5,314,283	3,626,646	5,970,031	5,406,675	6,160,453
Herbert-Burdekin	11,104,867	12,471,413	9,752,738	11,154,318	12,332,782
Mackay-Proserpine	8,446,425	6,697,741	6,533,232	8,124,764	8,123,242
Southern	4,220,110	3,533,503	3,520,347	3,475,400	3,554,844
QUEENSLAND	29,085,685	26,329,304	25,776,348	28,161,157	30,171,321
NEW SOUTH WALES	915,027	1,613,468	1,666,171	1,653,768	1,931,894
Australia	30,000,712	27,942,772	27,442,519	29,814,925	32,103,215

1.4 Mills

The 21 Queensland mills are currently owned by 7 different mill owners (Wilmar, MSF Sugar, Mackay Sugar, Bundaberg, Tully Sugar, Isis and WH Heck and Sons) as set out below.

Mill Owner	Queensland Mills
Wilmar Sugar Australia Limited	Macknade, Victoria, Invicta, Pioneer, Inkerman, Kalamia, Proserpine, Plane Creek
MSF Sugar Limited	Maryborough, Tablelands, South Johnstone, Mulgrave
Mackay Sugar Limited	Racecourse, Marian, Farleigh, Mossman
Bundaberg Sugar Limited	Bingera, Millaquin
Tully Sugar Limited	Tully
Isis Central Sugar Mill Company Ltd	Isis
WH Heck & Sons Pty Ltd	Rocky Point

Four of those mill owners (including two of the three largest) are ultimately owned by international raw sugar producers or traders as set out below:

Mill owner	Ultimate owner
Wilmar Sugar Australia Limited	Wilmar (Singapore agribusiness trader with sugar interests in Indonesia, Brazil, New Zealand, India, Morocco and Myanmar)
MSF Sugar Limited	Mitr Phol Sugar Corp (Thai sugar producer which is the largest sugar producer in Thailand and Asia, with mills in Thailand, China, Vietnam)
Tully Sugar Limited	COFCO, a Chinese State owned enterprise with numerous interests in Chinese food processing, manufacturing and trading businesses
Bundaberg Sugar Limited	Finasucre (Belgian sugar and agribusiness entity with sugar interests in Belgium, the Netherlands and the Democratic Republic of Congo)

The table below shows the raw sugar production from each of the cane growing regions reported in the Australian Sugar Milling Council Annual Review 2012-13:

<u>Sugar produced (tonnes IPS – International Polarisation Scale)</u>

Region Season	2012	2011	2010	2009	2008
Northern	693,840	453,211	599,628	849,836	826,875
Herbert-Burdekin	1,574,457	1,671,450	1,320,937	1,713,781	1,791,903
Mackay-Proserpine	1,244,662	894,014	874,817	1,238,625	1,183,000
Southern	621,704	483,992	478,870	505,500	484,492
QUEENSLAND	4,134,664	3,502,667	3,274,252	4,307,742	4,286,270
NEW SOUTH WALES	113,040	179,881	176,563	186,583	188,198
Australia	4,247,704	3,682,548	3,450,815	4,494,325	4,474,468

There are two current proposals to invest in new mills in Queensland but QSL understands they require funding before they could go ahead:

- North Queensland Bio-Energy Corporation Limited, which would appear to be reliant on diverting very substantial volumes of cane away from Wilmar's Herbert River region mills – Macknade and Victoria; and
- I-Fed's Etheridge Integrated Agricultural Project, which proposes to establish cane farms in an area near the Gilbert River in north-western Queensland and would be reliant on establishing a new cane farming region and new infrastructure.

Each sugar mill owner acquires cane from local farmers under cane supply agreements (and in many cases also sources cane from farms directly owned by the mill owner) and crushes it to produce raw sugar.

Raw sugar produced by mills is then either:

- Sold to domestic refineries (see the section 1.6); or
- Exported by sale to international sugar refineries or QSL or other sugar traders, who ultimately sell to such international refineries.

The mill owners typically sell raw sugar to the domestic market directly.

1.5 Sugar terminals

The six bulk sugar terminals (Cairns, Mourilyan, Lucinda, Townsville, Mackay and Bundaberg) are leased from the relevant port authorities by Sugar Terminals Limited (STL) under long term leases.

In 1999 with the Queensland Government embarking on deregulation of the sugar industry, the terminals were separated from the marketing operations (which remained in QSL) but kept in industry ownership through the creation of STL. STL was established as a 'for profit' company with 360 million shares issued to growers (229.4m 'G class') and mill owners (130.6m 'M class') based on the net asset values of the 7 terminals located in Cairns, Mourilyan, Lucinda, Townsville, Mackay, Bundaberg and Brisbane. The Brisbane bulk sugar terminal was sold to Wilmar Gavilon in 2009. The 'G' class shares were listed on a restricted market on the NSX (National Stock Exchange of Australia).

Trading in STL's shares is restricted to mill owners for M class and growers for G class with requirements for growers to sell shares within a reasonable time if no longer actively growing cane. This is intended to ensure that terminal assets remain within industry control. However, the division between miller and grower shares has been largely ineffective as millers can purchase G class shares through their farming operations (which most have or can easily arrange) to qualify as a grower. QSL also has an interest in G class shares.

The current commercial arrangements between QSL and STL involve QSL subleasing the terminals from STL and operating them on behalf of the industry. The sublease payment is one of QSL's major marketing costs and is essentially STL's only material source of income. While STL has long term leases from the port authority, it offers QSL shorter term sub-leases for a number of years.

QSL stores all Queensland raw sugar in the bulk sugar terminals on an open access and cost-recovery basis, including domestic sugar and export sugar for which QSL is not conducting the marketing. For raw sugar supplied to QSL which QSL does not market, QSL stores and handles this sugar under storage and handling agreements with the relevant mill owner.

1.6 Refineries

There are two refineries in Queensland:

- the Racecourse refinery (owned by Sugar Australia Limited, which is 75% owned by Wilmar and 25% owned by Mackay Sugar); and
- the Bundaberg refinery (owned by Bundaberg Sugar and located on the same site as the Millaquin mill),

and two interstate refineries, Yarraville in Victoria and Harwood in New South Wales.

The two Queensland refineries are supplied with raw sugar produced by local Queensland mills. Approximately 15% of raw sugar production in Queensland is currently delivered for processing to these two refineries, leaving the remainder for export or supply to interstate refineries.

The Mossman mill has made adjustments to the back end of its production process to allow it to make food grade raw sugar, but is not a true refinery in the normal sense.
Queensland raw sugar also typically supplies Sugar Australia Limited's Yarraville refinery in Victoria, although that has also been supplied by raw sugar imported by Wilmar in more recent years.

The Rocky Point mill, as the most southern located Queensland mill, currently supplies all of its raw sugar production to the Manildra Harwood refinery in New South Wales (50% owned by Manildra Flours and 50% owned by the New South Wales Sugar Milling Co-operative Limited). The Manildra Harwood refinery is also supplied by the New South Wales mills owned by the New South Wales Sugar Milling Co-operative.

2. Overview of QSL and its current role in the industry

2.1 QSL and its role

QSL is a not for profit company limited by guarantee which is owned jointly by mill owner members and grower members, with voting rights divided evenly between QSL's two classes of members. By its constitution, QSL is required to act in the best interests of the sugar industry, and as a tax exempt not for profit entity cannot distribute profits to its members.

QSL's main activities are:

- acquiring raw sugar intended for bulk export from Queensland mill owners under the raw sugar supply agreements (RSSA);
- selling that raw sugar to international customers;

- chartering shipping for that raw sugar;
- financing and hedging activities related to that raw sugar;
- sub-leasing, operating and providing storage and handling services at the six bulk sugar terminals; and
- conducting other initiatives considered to be in the best interests of the Queensland sugar industry.

QSL does not own sugar mills or refineries, but has a minority interest in STL through a holding of G class shares.

As a result of QSL's structure, purpose and not for profit nature, it has opened up competition in the raw sugar industry in a way that a purely profit-driven entity in its position would not have. In particular:

- QSL has, from its inception following deregulation, structured the RSSAs as reasonably short term arrangements, with three year 'rolling' terms;
- QSL provides open access to the six bulk sugar terminals that it operates, at cost-recovery rates and to all raw sugar mill owners, irrespective of whether the relevant raw sugar is being marketed by QSL, ensuring that access to storage and handling facilities is not a barrier to entry while QSL is the operator of the terminals; and
- QSL agreed to amend the raw sugar supply agreements that it had entered with mill owners, to give mill owners the option to market their 'supplier economic interest sugar' from the 2014 Season onwards.

2.2 Raw sugar supply agreements

QSL currently has RSSAs with each of the seven Queensland mill owners under which each of the mill owners supply 100% of their raw sugar production intended for bulk export to QSL. Raw sugar to be supplied domestically or exported in bags or containers is not supplied under the RSSA and marketing can occur independently of QSL.

Each RSSA initially commenced with a 'rolling' term of three years that automatically extends for another 12 months on 30 June each year unless the mill owner or QSL gives a notice to terminate. Where a mill owner or QSL gives a notice to terminate for reasons other than default or insolvency type events there are no further automatic extensions.

As discussed in more detail in section 3.2, three mill owners (being Wilmar, MSF Sugar and Tully Sugar) have given notices to terminate such that their RSSAs did not extend on 30 June 2014. Consequently:

- Wilmar, MSF Sugar and Tully Sugar have RSSAs that now have a fixed term of the 2014-2016 Seasons and will expire on 30 June 2017; and
- the other mill owners (being Mackay Sugar, Bundaberg Sugar, Isis and WH Heck & Sons) have an agreement that covers the 2014-2017 Season and expires on 30 June 2018 subject to the potential for a further extension to occur on each 30 June.

QSL operates a 'pooling' system under which certain costs and risks are shared by each of the contracted suppliers in accordance with the terms of the RSSAs.

Consequently the sales price received by a mill owner which supplies QSL under an RSSA reflects the outcome of such pools (as opposed to a fixed dollar price).

The majority of the value of bulk raw sugar exported by QSL and other exporters is priced with reference to the prices of ICE 11 raw sugar futures contracts on the ICE 11 futures exchange operated by ICE futures US Inc. The ICE 11 futures contract is the pre-eminent mechanism for price discovery and management of price risk for the trade of raw sugar around the world. As a result, the price for raw sugar exported from Australia will generally be the ICE 11 futures price for the relevant shipment period plus a premium reflecting supply and demand differences between various geographic regions, commonly referred to as a regional premium. A small volume of raw sugar is sold on a different basis, either under a long term contract with a fixed dollar price or under the United States of America Tariff Rate Quota system or European Union Quota system.

Under the RSSAs, export revenue that is directly attributable to the regional premium achieved on QSL's sales of export raw sugar is pooled and distributed through a mechanism known as the "QSL Shared Pool". Every milling company that delivers sugar under the RSSA for a season is given an allocation from the Shared Pool. In addition to regional premium revenue, the Shared Pool allocation will also include a share of the costs of operating the bulk export system. The main costs distributed through this mechanism are:

- Costs of operating the bulk sugar terminals at each of the ports;
- Financing costs;
- The cost of operating QSL;
- Quality adjustments; and
- Sea freight from Queensland ports to customers, typically at Asian ports.

The exposure to the ICE 11 futures that arises from QSL's export sales program is shared amongst each milling company. Milling companies are able to choose how they want the revenue from their share of the ICE 11 futures exposure determined. This is achieved through the operation of a number of 'pricing pools', whose values are based upon pricing on the ICE 11 futures market. Pricing pools provided by QSL under the RSSA, allow for the price risk management decisions to be made by one of the following:

- QSL;
- the milling companies themselves; or
- a third party risk manager (so that a different mill owner or an international sugar trader could manage pricing for a mill owner).

Supplier milling companies can elect to have their sugar supplied to QSL under their RSSA priced in one or more of the pricing pools. Regardless of who manages the price risk, the final price achieved in each pricing pool is adjusted by an allocation from the Shared Pool to arrive at a final net price for each pricing pool. The net price for a pool therefore includes the miller's elected ICE 11 outcome plus its share of regional premiums and marketing costs.

Many mill owners have entered cane supply agreements that give growers the ability to manage their price risks by allowing them to:

- select QSL pools in which a proportion of the raw sugar produced from their cane will be priced (which the mill owner can then 'back to back' by making an election for an equivalent volume of raw sugar under its RSSA); and
- enter into forward pricing arrangements (which are then 'back to backed' with QSL under the mill's RSSA).

2.3 Supplier Economic Interest Sugar and Grower Economic Interest Sugar

In December 2013, each of the seven mill owners entered into new RSSAs with QSL, which provided mills with the right to elect to market the proportion of the raw sugar they supply to QSL for which the mill retains the pricing exposure under the cane payment formula in their cane supply agreements with their growers (known as 'supplier economic interest sugar').

Traditionally, mill owners receive one third and growers two thirds of the net returns achieved, through the cane payment formula for deriving the cane price which existed prior to deregulation and continues to generally be used. The concepts of 'supplier economic interest sugar' and 'grower economic interest sugar' reflect this attribution. The relevant proportion varies for each mill, depending on variables, including whether the mill owner grows any of its own cane and the terms of its cane supply agreements. However, supplier economic interest sugar is anticipated to be between 33% and 50%.

Some milling companies use different terms to refer to grower economic interest sugar. Terms such as:

- a growers' nominal sugar price exposure; or
- cane pay sugar,

refer to how much raw sugar needs to be priced and marketed to determine the price paid for the cane a grower supplies, and thus refer to the grower economic interest in the final product marketed.

Arguments that growers' interests are 'nominal' are incorrect and misleading (irrespective of the terminology used by individual mills) given that growers actually have a higher exposure to the ultimate raw sugar price achieved than mill owners. The self-serving and hypocritical nature of such statements is clear when a mill clearly recognises supplier economic interest (as each of the suppliers have in the RSSAs) but refuses to recognise the flip side of grower economic interest.

Mills who assert that mill owners should be able to bundle marketing with the acquisition of cane simply because mills have title to the raw sugar produced and growers have 'no rights' to that raw sugar, are overlooking the fact that the current market arrangements about legal title are a result of the exercise of a mill's monopoly power, and not necessarily the likely state of the market without that conduct.

The option for a mill owner to market its supplier economic interest sugar has been exercised (in respect of the 2014 Season) by each of Wilmar, MSF Sugar, Mackay Sugar and Tully Sugar. For each of those suppliers,

QSL sells back to the supplier (or a related body corporate) a volume of raw sugar reflecting its supplier economic interest sugar, which they can then market themselves or on-sell again to others to market. The grower economic interest sugar is marketed by QSL, except in respect of some transitional arrangements for MSF Sugar who recently returned to the QSL system.

As a result, there are currently a number of entities marketing raw sugar from Queensland, including:

- QSL;
- Wilmar (through marketing Wilmar's own supplier economic interest sugar);
- Copersucar (a Brazilian sugar trader that is doing so through marketing Mackay Sugar's supplier economic interest sugar);
- MSF Sugar (through marketing MSF's own supplier economic interest sugar); and
- China Foods (through marketing Tully Sugar's supplier economic interest sugar).

Each of those entities competes with other international raw sugar traders, such as Bunge, Czarnikow, Cargill, Louis Dreyfus and Sucres et Denrées, for the sale of raw sugar into the global market.

The impact of proposed changes on the local sugar industry, including the effect on grower economic interest sugar, is discussed in section 3.2.

3. Responses to the Terms of Reference

3.1 Foreign ownership and potential impact on the interests of the Australian sugar industry

The majority of the sugar cane milling sector came under foreign ownership in 2010 when CSR Limited (which milled 60% of the total raw sugar production in Australia) sold its entire sugar business (then named Sucrogen) to the Singapore based agribusiness Wilmar. Wilmar subsequently acquired the Proserpine mill from administrators when the mill experienced financial difficulties in 2011.

However the Australian sugar industry has been no stranger to foreign ownership for over 20 years.

The Australian sugar industry has had some level of foreign ownership in the milling sector since 1991, when Tate and Lyle acquired Bundaberg Sugar Limited. At its peak Tate and Lyle, through its ownership of Bundaberg Sugar, controlled 20% of the Australian milling capacity. In 2000 Tate and Lyle sold the Bundaberg Sugar business to Finasucre, a Belgian sugar company.

Guinness Peat PLC also had a substantial interest in MSF Sugar Limited (then known as Maryborough Sugar Factory Limited) up until 2010, when it sold its stake to the Mitr Phol Group, a sugar company from Thailand. Mitr Phol acquired 100% ownership of MSF Sugar Limited in 2012.

Tully Sugar Limited was also acquired in 2012 by COFCO Tunhe LTD, a Chinese company.

As a result of that merger activity, the only mills that remain in Australian ownership are Mackay Sugar, Isis and WH Heck & Sons in Queensland, and the New South Wales mills.

QSL acknowledges that foreign ownership has provided benefits, primarily by way of new owners often providing significant capital investment in the milling sector that the previous Australian owners had not been willing or capable of making. Until recently, the foreign owned mill owners were also generally happy to continue utilising the existing marketing arrangements.

QSL considers that foreign ownership in and of itself has not created the issues with raw sugar marketing and cane price determination that the industry is currently facing. Rather, the issues appear to have arisen through a combination of:

- the monopoly position that most mills have in respect of the supply of milling services to growers; and
- the incentives that owners of sugar mills who are involved in wider agribusiness or global sugar trading have to take advantage of that market power to increase the volume of raw sugar they have to market.

Consequently QSL is not advocating for additional regulation of foreign investment in the sugar industry, but for regulatory reforms that more specifically target the actual anti-competitive behaviours that are causing concerns.

3.2 The impact of proposed changes on the local sugar industry, including the effect on grower economic interest sugar

Current status of the terminating mills' proposals

As noted earlier in this submission, 3 mill owners have given a notice to terminate their RSSA with QSL, being Wilmar, MSF Sugar and Tully Sugar.

QSL understands that MSF Sugar and Tully Sugar are currently in discussions with their contracted cane growers about the terms on which they will deal with each other in the 2017 and future seasons. However, at least publicly, it is not apparent whether MSF Sugar or Tully Sugar are insisting upon a particular arrangement at this stage. As a consequence it is hard to predict the impact on their growers of MSF Sugar's and Tully Sugar's decision to terminate their RSSAs. However, given what is occurring in the Wilmar cane supplying regions (as discussed in more detail below), QSL is concerned that both mills have the potential to exercise market power and that their growers may, depending on the future conduct of the mill owners concerned, be in need of regulatory protection.

Wilmar has, by contrast, made public its proposed arrangements for the 2017 and future seasons and appears to be insisting upon them, despite those arrangements seemingly having been rejected by the vast majority, if not all, of its currently contracted growers. As the current public example, this submission focuses on the changes proposed by Wilmar and their effect as the best evidence of how the likely changes in the industry will impact on cane growers and the market for the provision of raw sugar export and marketing services.

What the current system provides for in respect of grower economic interest sugar

The current cane price formulae used by milling companies to determine the value of cane are based upon the notional quantity of raw sugar that can be produced from that sugar cane, and have largely been in place for over a century. The formula recognises the extent of capital investment that both the grower and miller have in the assets required to produce the major product from cane (being raw sugar). This mechanism has provided growers with transparency so that they can see that they are getting a fair price based upon current market circumstances, and that the costs of marketing and operating the various infrastructure required to produce and distribute the product are shared equitably.

While the growers transfer legal title to the cane, the cane payment formula and RSSAs effectively recognise grower economic interest sugar. The cane supply agreements typically provide growers with some ability to make choices in relation to that quantity of raw sugar to which they have price exposure, in recognition of the different interests and different risk appetites of the growers, as distinct from the mill owner.

As discussed further below in this submission, attempts to remove that choice and influence over grower economic interest sugar force the grower to accept the risk appetite of a single marketer (who will pursue the commercial interests of its shareholders, not growers). In particular, global agribusinesses which are heavily exposed to trading risks have very different appetites for risk compared to some family owned cane farms. Large multi-national agribusinesses typically have a strong balance sheet, access to debt funding, a portfolio of assets (which can be both geographically diverse and diversified across industries) and control of the level of dividend returns to shareholders, which allow them to handle volatility far more effectively than a typical grower (who has a much lesser ability to withstand adverse short term changes). This is some of the key reasons, growers value QSL's approach as:

- through structures like limits on raw sugar which can be forward priced or sold without physical delivery, there is a more cautious approach taken to managing downside risks;
- through the RSSA providing some parameters around how QSL will market and price raw sugar and calculate the returns provided to mill owners (which can then be referred to in cane supply agreements), there is greater certainty and transparency for growers; and
- QSL does not have the conflict of interests that other international sugar traders do as a result of their non-Australian based trading businesses.

Some milling companies incorporate a value in the price paid for cane for the by products from the crushing process (such as molasses and cane fibre) in addition to the value paid for grower economic interest sugar. However, the vast majority of growers only receive recognition for the sugar content in their cane.

Wilmar

Wilmar is the Australian subsidiary of a Singapore based global agribusiness, which focuses on the trading of agricultural commodities. It is the largest mill owner in Queensland with eight sugar mills and raw sugar production comprising approximately 48% (based on the 2012 Season) of Queensland's annual raw sugar

production, which equates to approximately 60-65% of export volumes (based on the typical proportions of production that Wilmar and other mills supply domestically and for export).

Wilmar's eight raw sugar mills are:

- Victoria and Macknade mills in the Herbert River Valley near Ingham (120 km north of Townsville);
- Inkerman, Kalamia, Pioneer and Invicta in the Burdekin Valley near Ayr (70km south Townsville);
- Proserpine Mill located in Proserpine (approximately 120 km north of Mackay); and
- Plane Creek Mill in Sarina (40 km south of Mackay).

Wilmar owns raw sugar refineries in Australia and New Zealand, through its 75% interest in the Sugar Australia refineries, as well as global sugar interests including:

- PT Jawamanis Rafinasi (a leading sugar refiner in Indonesia);
- PT Duta Sugar International (another Indonesian sugar refiner);
- 27.5% of Cosumar S.A (the only Moroccan sugar producer and refiner);
- An interest in Shree Renuka Sugar Limited (an Indian based sugar producer which owns mills in India and Brazil and Indian sugar refineries); and
- A 55% interest in a Myanmar joint venture with Great Wall Food Stuff Industry Company Limited to produce and sell sugar.

Wilmar's previous conduct

It has increasingly appeared to QSL that Wilmar has, over the last few years, been looking at ways to remove QSL from the marketing of Queensland raw sugar. It was initially proposed that QSL should subcontract Wilmar to conduct all its marketing operations. Having failed to convince other mill owners of that position, Wilmar has threatened on numerous occasions to provide a notice to terminate its RSSA.

In 2013, before signing the most recent version of the RSSA, Wilmar was engaged in discussions with grower groups regarding the introduction of a 'grower choice' model in which growers supplying Wilmar would be able to choose which of QSL and Wilmar would market the grower economic interest sugar. If that system had been implemented QSL and Wilmar would have competed for the supply of marketing services for that grower economic interest sugar.

However, QSL understands that despite providing 'grower choice' the model proposed by Wilmar was rejected by grower groups principally because Wilmar's model was not a long-term solution and was premised on Wilmar simply paying growers a premium over that achieved by QSL, irrespective of the ultimate raw sugar price achieved by Wilmar. Given that QSL was operating on a not for profit basis, grower groups were concerned that this was part of a predatory pricing strategy to lure sufficient volume away from QSL such that the pricing QSL could achieve would be damaged and the price Wilmar would then have to pay for cane would be reduced (and its marketing competitor eliminated). To be acceptable to growers and in the interests of the industry, it seems to QSL that a 'grower choice' model needs to place the marketing entities which can compete to provide the marketing services for the grower economic interest sugar on equal footing with each other.

While no agreement was able to be reached with the growers in those 2013 negotiations, QSL would have been willing (and remains willing) to accept an arrangement where it competes for the right to market raw sugar from a grower's cane on a level playing field. However, it appears that Wilmar is now unwilling to negotiate on the basis of any arrangement which involves QSL (or any other entity for that matter) having the ability to compete with Wilmar for the provision of marketing services in respect of grower economic interest sugar.

Wilmar's current conduct, effect and grower responses

Although QSL has not been a party to the discussions between Wilmar and its growers, from what is publicly available, and what is being reported to QSL by growers, the proposal that Wilmar is insisting growers accept involves:

- All growers that currently supply Wilmar continuing to do so – under three year 'rolling' exclusive cane supply agreements, with the way the price is derived for cane supplied to be altered to reflect the altered marketing arrangements below;
- All raw sugar that is produced by the Wilmar mills being marketed by a joint marketing company (the JMC), to be jointly owned by Wilmar and the growers (in some form that is unclear);
- The JMC contracting another Wilmar offshore subsidiary to conduct all marketing for the JMC under a 15 year exclusive contract;
- The price paid to growers for cane to be derived from the proceeds achieved by the JMC/Wilmar less an allocation of costs;
- The current split of trading profits being changed in favour of Wilmar. The proposal states that Wilmar will only share 50% of trading profits with the JMC. The trading profits would then be split using the cane price formula between growers and Wilmar. The end result would be that instead of the current two thirds/one third split of trading profits in favour of growers, the proportions would be reversed with Wilmar keeping two thirds of trading profits and growers keeping only one third; and
- Creating opportunities for Wilmar to optimise profits for themselves at the expense of the JMC. There is no evident requirement for Wilmar to fairly allocate trading profits and the "right" sales contracts to the JMC given that Wilmar will be trading sugar from multiple different origins around the world. Even if this requirement did exist, it would be practically very difficult to enforce due to the lack of transparency regarding how Wilmar allocates supply under omnibus contracts (which allow supply from different country locations) or how it makes use of arbitraging opportunities. As an example, a practical situation that could arise is Wilmar having a late shipment from Brazil to China that was going to result in delay penalties with their customer. Even though this contract may not be the best price opportunity for JMC Sugar and the JMC would have nothing to do with the delay penalty, Wilmar would have a motivation to allocate JMC sugar against the China sale to avoid the delay penalty, with the JMC sugar then missing out on more potentially lucrative sales opportunities.

Under Wilmar's proposed model, growers are not given any choice of marketer and grower economic interest sugar produced from the cane they deliver must be marketed through the JMC/Wilmar. In addition, because the JMC may sell to Wilmar's vertically integrated refineries or Wilmar's trading arm which may in turn further on-sell the raw sugar, growers are concerned with the lack of transparency. In particular, QSL understands growers are concerned that there is no assurance that the maximum price achievable is being transferred

back to the JMC nor indeed what the right attributable price may be (particularly where there is transfer pricing or other transactions between Wilmar group companies or issues of what is an appropriate allocation of contracts or trading profits as discussed above). QSL notes the recognition in the Agricultural Competitiveness Green Paper[1] that transparency through the supply chain for agricultural products is important for getting fairer outcomes in negotiations with processors (such as sugar mill owners) and retailers who have market power

As growers actually want choice around how the raw sugar is marketed, CANEGROWERS and ACFA have developed a new 'Pathways to market' model (being an alternative form of 'grower choice' model revised from the 2013 model presented by Wilmar). The newly proposed model would result in Wilmar acquiring title to the cane but being required to sell some of it to QSL or other sugar traders to the extent that growers elect to have their grower economic interest sugar marketed independently of Wilmar. Details of the proposed 'Pathways to market' model can be obtained from the CANEGROWERS website.[2] However, Wilmar has consistently refused to deal with grower groups on the basis of the CANEGROWERS/ACFA proposed 'grower choice' model or on any basis which decouples marketing services from the acquisition of cane.

In justifying those refusals to deal, various Wilmar personnel have stated:

- growers do not have any legal or contractual rights over the sugar;[3] and
- Wilmar will proceed with exiting the QSL supply arrangements regardless of whether it has grower support for its proposed model, and does not need the growers' approval to proceed with its proposed arrangements.[4]

Growers appear to be critically concerned that Wilmar's insistence on a model growers do not accept leaves them with no choice.

Regional cane markets and the market power of mills

To understand why growers consider they have no choice in respect of dealing with Wilmar, it is instructive to consider how the relevant markets operate.

In assessing merger and joint venture transactions in the industry, the ACCC has previously adopted geographic market definitions for the markets for supply and acquisition of cane and supply of cane crushing services based on a 50km radius around each mill.[5]

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[1] https://agriculturalcompetitiveness.dpmc.gov.au/sites/default/files/green_paper.pdf
[2] http://www.canegrowers.com.au/page/Industry_Centre/advocacy/wilmar-proposal-caution/
[3] Wilmar Sugar News Release, Canegrowers and ACFA rejected Grower Choice, 26 May 2014 (which can be accessed at http://www.wilmarsugarmills.com/index.php/media-centre)
[4] Comments of David Burgess, Wilmar (the substance of which are reported at http://www.abc.net.au/news/2014-04-09/growers-wary-of-new-sugar-selling-concept/5377572).
[5] Sucrogen Limited's proposed acquisition of College Land in the Burdekin Region (2013, ACCC Reference 50467); Wilmar International Limited's proposed acquisition of Sucrogen Limited (2012, ACCC Reference 42800); Sucrogen Limited proposed acquisition of Proserpine Co-operative Sugar Milling Association Limited (2011, ACCC Reference 46119); Maryborough Sugar Factory Limited and Bundaberg Sugar Limited – proposed joint venture in sugar milling

QSL considers that is likely to accurately describe the geographic scope of competition between mills for acquisition of sugar cane /supply of crushing services because:

1. Sugar cane is highly perishable. Once cut, sugar cane must be processed within approximately 16 hours, or its quality and therefore its commercial value substantially deteriorates;
2. Sugar cane is a bulk commodity that is expensive to transport relative to its value, such that there is also a cost limitation on how far it can be economically transported; and
3. Historically, other than in cases of a mill closing, QSL understands that growers have only switched between mills (owned by different corporate groups) where there are two mills closely located, such as:
    - Bingera (Bundaberg Sugar) and Isis (which are approximately 40 km apart);
    - Tully (Tully Sugar) and South Johnstone (MSF Sugar) (which are approximately 50 km apart); and
    - Tablelands (MSF Sugar) and Mossman (Mackay Sugar) (which are approximately 70 km apart).

Other than in those exceptional cases where there are two mills closely located and under separate corporate ownership, for most growers there is only one mill which it is economically viable for them to supply.

This is currently the case for at least seven of the existing Wilmar mills, either because there are no other mills within economically viable delivery distance or the only mills which are within that distance are other Wilmar mills. In particular in respect of:

- Cane growers in the Herbert River region: outside of Wilmar mills the next nearest sugar mill is 97 km to the north (Tully – Tully Sugar);
- Cane growers in the Burdekin region: outside of Wilmar mills the next nearest sugar mills are 297 km to the north (Tully – Tully Sugar) and 291 km to the south (Farleigh – Mackay Sugar); and
- Cane growers in the region surrounding the Proserpine mill: outside of Wilmar mills the next nearest sugar mill is 116 km away (Farleigh – Mackay Sugar).

QSL acknowledges there may be a limited degree of competition for some growers in the region surrounding the Plane Creek mill, for which the next non-Wilmar sugar mill is 33 km away (Racecourse – Mackay Sugar). However, even if it would theoretically be economically viable for cane to be delivered the extra distance to reach a non-Wilmar mill (as in the case of Plane Creek), there are likely to be physical capacity constraints at the next nearest mill (ie the mill is already fully utilised) that may limit the extent to which switching mills is possible for growers.

Consequently, most (if not all) growers in the regions surrounding a mill effectively only have one choice of mill owner to supply to.

QSL considers that most mill owners have market power through:

- Being the only existing mill which is economically viable for cane growers in those markets to supply to (such that there are no alternative acquirers for a grower's cane);

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operations (2010, ACCC Reference 41684); and Bundaberg Sugar Limited and Mulgrave Mill – proposed merger of certain milling assets (2007, ACCC Reference 27572).

- Having multi-year cane supply agreements with its growers such that any proposed new mill would find it difficult to ensure it would have enough volume to establish a return (creating an effective barrier to entry);
- The costs of developing a new mill being very significant (as demonstrated by the fact that the last new mill to be developed in Queensland was Tablelands in 1997) and cannot be economically justified based on global raw sugar prices which now reflect increasing supply from other 'lower cost' countries like Thailand and Brazil, creating another barrier to entry; and
- Growers having no effective countervailing power.

In relation to the lack of countervailing power of growers, QSL acknowledges that it is theoretically possible in the longer term for growers to change the use of their land from cane to other crops or livestock. However, that is not a real possibility in the relevant time frame (being the 2017 Season when Wilmar's, MSF Sugar's and Tully Sugar's RSSAs will expire), as there are significant hurdles for growers to switch out of sugar cane to these other uses, including the length of time and significant costs to establish such alternative uses.

In particular, QSL understands that sugar cane crops are typically planted with a view to harvesting the crop over an approximate five year period, with part of the crop ploughed out annually throughout the cycle to balance the age/maturity of the crop. Planting is an expensive part of the cane production process, and growers need multiple harvest years in order to generate a return above the costs invested in the planting. In other words it will already be too late for some growers to switch crops prior to the post-RSSA marketing arrangements commencing, and other growers will now be struggling with planting decisions when part of the period of anticipated returns for cane planted in the next planting period would extend into the period in which the terminating mill's post-RSSA marketing arrangements would apply. To switch to alternative crops, growers would need to plough out the existing sugar cane to prepare the land for alternative crops and establish the market infrastructure to enable these alternative crops to be sold, all of which involves time and money before any revenue is able to be earned. For livestock, growers would also need to plough out the existing sugar cane to prepare the land for pastures, incur fencing costs and survive the lengthy time periods required to build up a herd ready for market.

These barriers mean that it is highly unlikely that substitution of cane for other crops or livestock will be economic for growers in the time frame prior to each of the terminating mill's new marketing arrangements commencing.

Arguments that collective bargaining by growers being permitted under the *Sugar Industry Act 1999* (Qld) somehow resolves the imbalance of negotiating position arising from a mill's market power simply ignore the fundamental dependency of growers on the mill for the reasons noted above. It is also false to assert that mills are dependent on growers in the same way. In particular it should be noted that mill owners can buy additional land for cane farming themselves (including from growers forced to exit the industry through the mill owners' behaviour) and significant acquisitions of land or existing cane farms by mill owners have occurred in recent years. The current circumstances of those collectively negotiating on behalf of growers with Wilmar (ie being completely unable to negotiate in any meaningful way, terms and conditions that growers support) clearly demonstrates that collective bargaining is not a sufficient protection.

Why is this a competition problem?

QSL considers that Wilmar's refusal to deal with growers on a basis which decouples cane crushing from sugar marketing services is clearly an anti-competitive outcome that is being materially facilitated by the market power it has in regional cane markets.

The easiest way to demonstrate that is to contrast how Wilmar is conducting itself in relation to growers with how a mill owner would conduct itself in a competitive market for cane acquisition/cane crushing services. If Wilmar was in a competitive market in which a non-Wilmar mill was capable of competing for the provision of cane acquisition/cane crushing services, Wilmar would not simply reject an arrangement which decoupled crushing services from marketing in the face of the current levels of grower opposition to the Wilmar marketing model, as doing so would result in growers delivering cane to the competitor's mill (leaving Wilmar's mill(s) under-utilised and inefficient). This is not a merely hypothetical example – since deregulation there have been multiple examples of switching between mills that are located closely enough to compete for a particular grower's cane. Examples include:

- Growers in the Tablelands region who had traditionally supplied the Tableland mill recently switched to supplying the Mossman mill, due to preferring Mackay Sugar's marketing arrangements – marketing through QSL – to MSF Sugar marketing the raw sugar produced from their cane. This was despite the fact that supplying the Mossman mill involved substantial additional transport costs. QSL understands that the Tablelands mill lost approximately 80% of its previous cane supply through such switching; and
- Isis has successfully competed away substantial volumes of cane from Bundaberg Sugar mills, to the point that this was one of the factors that led to the Fairymead mill closing, with competition continuing between the Bingera and Isis mills.

Wilmar is only in a position to insist upon its desired marketing arrangements without the risk of growers seeking to supply to a different mill owner because the growers have no alternative acquirer. That is aptly demonstrated by the fact that despite an outcry from growers as what is being proposed, there have been no contracted growers switch supply to other mills (or develop a new mill) as there is no economically viable alternative to delivering their raw sugar to Wilmar (and both Wilmar and the growers know that).

Conclusions about the effect on grower economic interest

Based on the situation currently developing in the Wilmar supplying cane regions (the Burdekin, Herbert River and Proserpine regions), QSL is becoming deeply concerned that growers will increasingly:

- Have no choice as to which entity markets grower economic interest sugar produced from cane they supply; and
- Not be able to obtain fair and reasonable terms for the cane they supply, including their grower economic interest sugar.

In the short term, this will simply result in mill owners having the ability to increase profits at the expense of growers. But in the long term, this is likely to result in exits from the industry by non-mill owned growers, and a foreclosing of competition that would otherwise eventuate for the provision of sugar marketing services.

3.3 Whether there is an emerging need for formal powers under Commonwealth competition and consumer laws?

QSL understands that CANEGROWERS and the Australian Cane Farmers Association have complained to the ACCC about Wilmar's conduct on the basis that it is alleged to constitute unconscionable conduct and/or a misuse of market power, and that that investigation is ongoing.

It appears to QSL that a refusal by a mill to deal with growers on a basis that decouples cane acquisition/cane crushing services and marketing and export services where the mill has an apparent purpose of preventing other companies (including but not limited to QSL) conducting marketing for grower economic interest sugar, is likely to be a misuse of market power in contravention of s 46 of the *Competition and Consumer Act 2010* (Cth) (the CCA)).

However, given that there has been no evident action taken by the ACCC to date following those complaints, QSL is now concerned that the current *Competition and Consumer Act 2010* (Cth) is not as adequate as it may appear to deal with the current circumstances.

In determining whether regulatory intervention is appropriate, it is instructive to consider:

- how other agricultural cropping related markets have transitioned to competition after deregulation; and
- the alternative market structures which are likely without conduct of the type described above.

In particular, competition for the provision of marketing services has resulted from deregulation in both the cotton industry and the grain industry. QSL is deeply concerned that the conduct of some mills may foreclose competition for the provision of marketing services for raw sugar which is currently occurring and would be anticipated to develop further in the absence of such conduct.

In the cotton industry (which is probably most similar to the sugar industry due to the need for processing of the initial cropping product), growers are given a choice of marketing by cotton gins charging a fee for processing, with growers then having a choice between selling the resulting bales of cotton to the cotton gin owners (who also market cotton) or delivering the bales to a different cotton marketer at an alternative storage facility. In other words, a tolling structure has been adopted so that ginning services (the equivalent of cane crushing/milling services) are not tied to marketing services.

Similarly, in the grain industry, growers now have a range of marketing entities they can choose from to market their grain. In addition, the potential impediments to competition which may arise from storage infrastructure in the grain industry (and are mitigated by access regulation) do not exist in the sugar industry due to QSL's open access policy in respect of the bulk sugar terminals.

QSL would have preferred for the growers' concerns to be resolved by a negotiated contractual outcome. However, that unfortunately seems a very unlikely outcome.

The Queensland State government has sought to facilitate industry discussions for that very purpose in which QSL grower organisations and most mills were a willing participant. However, the largest producer of raw sugar, Wilmar, has made it clear to Minister McVeigh (the State Minister for Agriculture, Fisheries and Forestry) and other industry participants that it is not willing to negotiate or participate in those discussions.

Wilmar formally announced its new proposal for arrangements with growers on 3 April 2014. It has held extensive discussions with growers and grower groups since that date and 6 months later appears to be no closer to reaching any form of agreement which growers are happy with.

As a result, QSL has reluctantly concluded that there is no real prospect of a commercial negotiated outcome, that the existing regulatory framework provides insufficient protections, and consequently it is in the best interest of the sugar industry to seek regulatory reform to protect the long-term interests of cane growers.

Accordingly QSL suggests that there is a clear need for regulatory intervention.

QSL suggests it would be appropriate to provide for a statutory 'grower choice' regime under which mills are required to acquire cane on terms permitting growers the freedom of choice in which entities market grower economic interest sugar for which they have price exposure under their cane supply agreements. That could potentially be achieved by either:

- Amendments to the *Sugar Industry Act 1999* (Qld); or
- A mandatory industry code under the *Competition and Consumer Act 2010* (Cth).

Such a grower choice regime would effectively provide for growers to have the right to supply cane to a Queensland mill owner on the basis that:

- the grower would have choice as to how the relevant grower economic interest sugar (which unless otherwise agreed would be calculated in accordance with a formula specified in statute that would replicate a traditional cane pay formula) would be marketed;
- the price derived for the cane supplied would be required to be calculated in a specified manner by reference to the net price achieved by their chosen marketer(s) net of certain permitted costs which the mill and/or marketer would be entitled to pass on.

Such a grower choice regime could be supplemented by an arbitration regime which applies where a grower and mill owner are unable to reach agreement on the detailed commercial terms required to give effect to the principles of the grower choice regime. Negotiate-arbitrate regimes of this sort are commonly used to provide a check on entities that have market power through ownership of monopoly infrastructure. In addition, as many cane supply agreements are collectively negotiated under the *Sugar Industry Act 1999* (Qld), such an arbitration regime could be very effective, as a single dispute would be likely to resolve the issues in a large number of agreements in one go and the credible threat of arbitrated terms would incentivise the parties to reach a commercial agreement.

While there would be some complexities, a statutory grower choice regime of that type is QSL's preference as it most closely aligns with the sorts of contractual regimes that have been under discussion between growers and mill owners in recent years.

However, to the extent that, for reasons that are not currently evident to QSL, there are considered to be legal or practical difficulties with such a regime, QSL suggests (for the reasons discussed in section 3.4) that an alternative would be to:

- amend the third party access regimes under Part 5 of the *Queensland Competition Authority Act 1997* (Qld) and Part IIIA of the *Competition and Consumer Act 2010* (Cth); or
- provide for a specific access regime in the *Sugar Industry Act 1999* (Qld),

so that the terms of access to the crushing services of mills, and related transport and logistics services which are in a monopoly position, can be regulated. Such an amendment would provide growers with an alternative if they could not agree satisfactory terms for supply of their cane to their local monopoly mill.

Reforms of either of the types referred to above provide a targeted solution to the current issues in the sugar industry, in the same manner as the bulk wheat ports mandatory access code is intended to in respect of issues in the grain industry.

If the government is interested in pursuing more general reforms to Australia's competition legislation, QSL considers that removing the 'taking advantage' and 'purpose' tests from section 46 of the CCA and replacing them with an 'anti-competitive effects' test would make the misuse of market power provision more useful in actually preventing anti-competitive conduct by entities with market power.

3.4 Equitable access to essential infrastructure

Sugar cane transport from farm to mill

Sugar cane is transported to mills by road transport or through the use of specific purpose cane railways. Currently the majority of sugar cane ultimately arrives at the mill for processing by cane railway. Where cane railway infrastructure is used the infrastructure including the railway rolling stock is owned by the milling company. These railways are of different gauge to the typical rail gauge in Queensland and the networks between mills are rarely interconnected, which means the closest cane railway siding generally to a grower, is likely only to lead to one milling company's mill. If growers want to supply another mill they must transport their cane to an alternative railway siding.

Sugar cane needs to be processed within approximately 16 hours of being cut/harvested before the amount and quality of the raw sugar that can be produced starts to deteriorate. The ratio of cane delivered to sugar produced is approximately seven to one, such that the bulky nature of the cane relative to the final amount of sugar that is produced and the perishable nature means there are economic limits to how far the cane can be realistically transported. Therefore most cane growers are captive to the terms for cane processing services

and price determination process offered by the local milling company who owns their closest cane railway siding.

In this part of the submission we have used the specific circumstances of cane growers who supply Wilmar as real and current examples of the imbalance of negotiating power of growers who are not happy with their local commercial arrangements, but who are unable to switch to alternative mills due to access to infrastructure issues.

Raw sugar transport from mill to port

Most mills have very limited storage capacity with most only being able to store less than 24 hours of raw sugar production. Thus, once raw sugar is produced it generally must be moved quickly to port. The transport from the mill to the port facilities in most cases is open to normal commercial competitive processes and does not normally present any equity access problems for competitors.

Transportation of raw sugar from the mill to the port occurs by a mixture of road transport and railway. QSL currently operates the six dedicated bulk sugar terminals in Queensland. These terminals are located at Cairns, Mourilyan, Lucinda, Townsville, Mackay and Bundaberg. Whether a terminal receives raw sugar by rail or road infrastructure is largely a function of historical economics.

The terminals of Townsville and Lucinda receive raw sugar by rail only. The railway gauge used to transport sugar to the Lucinda Bulk Sugar Terminal near Ingham is the same gauge as the local cane railway and is not standard Queensland railway gauge. This has occurred due to the proximity of the mills and associated farms to the local port. The sugar-specific railway rolling stock used to deliver sugar to Lucinda is currently owned by Wilmar (the local milling company). Any new competitor wishing to open a new mill would need to invest in significant infrastructure in terms of transportation of cane to a new mill and further infrastructure would be required to get raw sugar to the port, unless it can negotiate access to Wilmar's cane railway. This terminal is the only terminal with significant equity issues with regard to access to raw sugar transport infrastructure.

Townville Bulk Sugar Terminal is a dedicated sugar port for sugar produced in the Burdekin Valley near Ayr, 70 km south of Townville. This terminal currently receives raw sugar by rail on a standard Queensland gauge rail, with the rolling stock being provided by Aurizon on commercial terms to Wilmar (the local milling company). The Townville Bulk Sugar Terminal could be modified to receive by road transport if commercially required to do so.

Mackay Bulk Terminal receives raw sugar by both road transport and railway. Raw sugar produced at Proserpine mill is transported by railway using rolling stock owned by Aurizon and provided to Wilmar (the milling company) on commercial terms. All the other mills in the Mackay region currently transport sugar to the bulk sugar terminal by road transport. Plane Creek mill used to supply raw sugar by rail and has subsequently moved to road transport.

The Cairns, Mourilyan and Bundaberg Bulk Sugar Terminals receive raw sugar by road transport.

Port access

As previously stated, QSL provides open access to the six bulk sugar terminals that it operates, at cost-recovery rates and to all raw sugar mill owners, irrespective of whether the relevant raw sugar is being marketed by QSL (such that access to storage and handling facilities is not a barrier to entry).

For as long as the terminals are operated by QSL, access to storage at the bulk sugar terminals will be provided fairly and equitably and not provide a barrier to competition.

However should the terminals be operated by individual milling companies, access for competing mill owners or marketing services providers may become difficult to negotiate on fair and reasonable terms in the absence of regulatory intervention.

Suggested changes

From QSL's perspective, the essential infrastructure which is creating the issue of mill owners having market power (as discussed earlier in this submission) is the natural monopoly position of the mills themselves and the related logistics infrastructure, particularly in relation to the cane rail networks. That infrastructure is uneconomic to duplicate, such that the mill owner effectively has an entrenched monopoly in respect of providing services using those facilities.

As noted above, if marketing services could be decoupled from the supply of cane, that would appear to resolve the primary concerns of growers. However, if that is not considered practicable from a legislative or commercial perspective, an alternative would be to seek to regulate the cause of the monopoly itself.

That is, if it were possible for growers to obtain access to a mill's crushing and logistics services on regulated terms such that, rather than selling their cane, growers could pay the mill a crushing or tolling fee, that would result in growers actually having title to the raw sugar produced and therefore having control of the decisions in respect of marketing of their sugar. QSL anticipates that the possibility of such a regulatory outcome would also prove useful in providing an incentive for the mill owner to contractually agree a reasonable 'grower choice' model (which appears to be the preference of growers).

While QSL acknowledges that Part IIIA of the CCA already provides a statutory third party access regime, it is not well suited to application in these circumstances because of the exclusion of a production process (which presumably a mill would be regarded as) from the type of services that can be regulated by Part IIIA[6], and because of potential doubts about whether a particular mill or mills would meet the criterion of being of 'national significance'[7]. Consequently QSL would suggest both the exclusion of the production process exception (either generally or in respect of the mills) from Part IIIA of the CCA and equivalent amendments to

[6] s 44B *Competition and Consumer Act 2010* (Cth), definition of 'service'.
[7] s 44H(4)(c) *Competition and Consumer Act 2010* (Cth).

Part 5 of the *Queensland Competition Authority Act 1997* (Qld) (where it would only have to be shown that the facilities in question were of 'significance ... to the Queensland economy'[8]). Removing the production process exception in these circumstances would not be anticipated to be problematic, as the mill would still be operating in exactly the same way by crushing the same cane – the only thing that would be altered is the legal constructs regarding transfer of title and the payments due.

If there are any concerns with amending the more general legislative access regimes in the manner suggested, QSL considers it would also be possible to produce a sugar industry specific access regime by legislation (including, for example, as amendments to the *Sugar Industry Act 1999* (Qld)).

Third party access regimes of the type suggested have proven successful in mitigating issues arising from market power derived from monopoly infrastructure as diverse as rail, port, pipelines and communication networks, providing strong precedents for how such a regime could resolve the current competition concerns in regional cane markets.

In respect of the terminals, QSL would be willing to see them subjected to an access regime, subject to the extent of regulation sought being determined with regard to the nature of the operator and the incentives it has. As QSL considers it already operates the terminals on a cost recovery basis, it is likely that either the potential for regulation or light-handed regulation would be sufficient. However, any proposed access regime would need to be sufficiently flexible to apply more extensive regulation where one or more terminals became operated by other entities which would not necessarily operate them on the same basis as QSL.

4. Conclusions

As outlined in this submission, QSL is concerned that due to the monopoly position held by most mill owners as the sole acquirer of cane in the region surrounding the relevant mills, without regulatory intervention, cane growers will:

- Have no choice as to which entity markets grower economic interest sugar produced from cane they supply; and
- Not be able to obtain fair and reasonable terms for the cane they supply, including their grower economic interest sugar.

As an entity whose primary object is to promote the interests of the sugar industry, QSL is keen to ensure those outcomes do not come about.

Accordingly, in the absence of a commercially negotiated outcome, QSL's suggests it would be appropriate to provide for a statutory 'grower choice' regime under which mills are required to acquire cane on terms permitting growers the freedom of choice in which entities market grower economic interest sugar for which they have price exposure under their cane supply agreements. That could potentially be achieved by either:

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[8] s 76(2)(c) *Queensland Competition Authority Act 1997* (Qld).

- Amendments to the *Sugar Industry Act 1999* (Qld); or
- A mandatory industry code under the *Competition and Consumer Act 2010* (Cth).

Such a grower choice regime could be supplemented by an arbitration regime to incentivise the parties to reach a commercial arrangement and provide a mechanism for reaching a cane supply agreement which allows for grower choice where the parties could not reach a commercial agreement.

To the extent that there are considered to be legal or practical difficulties with such a regime, QSL suggests that alternatives would be to:

- amend the third party access regimes under Part 5 of the *Queensland Competition Authority Act 1997* (Qld) and Part IIIA of the *Competition and Consumer Act 2010* (Cth); or
- provide for a specific access regime in the *Sugar Industry Act 1999* (Qld),

so that the terms of access to the crushing services of mills (and related transport and logistics services) which are in a monopoly position can be regulated. Such an amendment would provide growers with an alternative if they could not agree satisfactory terms for supply of their cane to their local monopoly mill.

In respect of the terminals, QSL would be willing to see them subjected to an access regime, subject to the extent of regulation sought being determined having regard to the nature of the operator and the incentives it has. As QSL considers it already operates the terminals on a cost recovery basis, it is likely that either the potential for regulation or light-handed regulation would be sufficient. However, any access regime proposed to apply would need to be sufficiently flexible to apply more extensive regulation where one or more terminals became operated by other entities that would not necessarily operate them on the same basis as QSL.

QSL appreciates the Federal Committee's consideration of this submission and is happy to provide any further assistance the Federal Committee may find useful in its investigations and in developing potential recommended reforms.

In addition, QSL would encourage members of the Federal Committee to visit growers in the Burdekin, Herbert River, Proserpine and Plane Creek regions that supply Wilmar and the regions which supply the Tully, Tableland, South Johnstone, Mulgrave and Maryborough mills to get first hand evidence of how growers are being treated and the concerns they currently have.