Submission No. 006

Bundaberg Sugar Ltd
ABN 24 077 102 526
4 Gavin Street
Bundaberg Qld 4670
PO Box 500
Bundaberg Qld 4670
Tel: +61 (0)7 4150 8500
Fax: +61 (0)7 4150 8522
www.bundysugar.com.au

16 July 2015

Ms Jennifer Howard MP
Chair
Agricultural and Environment Committee
Parliament House
George Street
Brisbane Qld 4000

By e-mail: aec@parliament.qld.gov.au

Dear Ms Howard

Submission to the Agricultural and Environment Committee on the Sugar Industry (Real Choice in Marketing) Amendment Bill 2015

Thank you for your letter of 17 June 2015 seeking submissions to the Inquiry for the Sugar Industry (Real Choice in Marketing) Amendment Bill 2015.

Please find attached a submission from Bundaberg Sugar Ltd which asserts that government intervention should not be progressed as it would be harmful to the Australian sugar industry and the Bundaberg region in particular.

I hope our comments in relation to the Bill are acknowledged by the Agricultural and Environment Committee and can result in a stable viable sugar industry moving forward.

Please feel free to contact me should you have any queries in relation to this matter.

Yours sincerely
Bundaberg Sugar Ltd.

Ray Hall
Chief Executive Officer

Submission to the Agricultural and Environment Committee on The Sugar Industry (Real Choice in Marketing) Amendment Bill 2015

Executive Summary

- There have been a considerable number of reviews over recent years which advocate deregulation of the industry as well as regional specific solutions to issues in order to maximise industry profitability.

- This is especially the case where complex issues are at the heart of the matters being considered as is the case for sugar marketing. It is incredulous to think that legislation is being considered when there is no clear understanding of the issues involved nor the consequences likely from the proposed legislation. Optimum outcomes will only be achieved by commercial negotiation.

- The conflict being experienced in the industry at the present time is essentially confined to one miller and their growers. It is not an industry wide issue. As such, any solution needs to be a regional specific solution.

- Bundaberg Sugar Ltd (BSL) does not believe there is an imbalance in market power favouring mill owners over growers given existing competition laws, the inter-dependence of millers and growers and the stability of Cane Supply Agreements (CSAs). What we are seeing, is not an imbalance of market power but rather, growers "negotiating" via government intervention to provide a more advantageous outcome through this negotiation phase. The conflict should simply be considered part of the transitioning phase of deregulation and certainly not a market failure as some would suggest.

- The objective of the Bill to provide cane growers with the right to have real choice over who sells and prices Grower Economic Interest (GEI) has only materialised in response to grower's contention of the lack of transparency over the marketing premium in the options being presented by Wilmar. The net marketing premium typically represents only 1% of the final sugar price and is vastly outweighed by the impact of variation in ICE11 movement and CCS variability. BSL believes there are other mechanisms available to provide this transparency however these will not progress until government removes itself from the process.

- We contend that the Bill goes much further than addressing the transparency issue and would have unintended adverse consequences on our company. Specifically, mandated pre-contract arbitration and grower choice of marketer has the potential to change the nature of our sugar milling business and have significant detrimental financial impacts on our business. It is not desirable that arbitration becomes a customary way to avoid the responsibility that should accompany local leadership in genuine negotiation at the mill area level, for the good of participants in that mill area.

- Should government not agree with our contentions and deem it appropriate to legislate, then BSL recommend that exemptions to the proposed legislation be made for those areas where the reason for the legislation are not relevant. As such, we would suggest that exemption to the effect of the Bill be made for millers who provide transparent sugar pricing outcomes for growers and/or where millers are in competition for cane supply from neighbouring millers.

- Finally, should government determine that State wide legislation is required and exemptions are not appropriate, then we would recommend that each miller be required to supply a percentage of their export sugar to QSL or a similar independent entity. This would provide marketing premium transparency.

Introduction

The explanatory notes to the Sugar Industry (Real Choice in Marketing) Amendment Bill 2015 (the Bill) states the policy objectives are to provide *"cane growers with the right to have real choice over who sells and prices Grower Economic Interest (GEI) sugar and addresses the imbalance in market power between mill owners and growers."*

These are the same two core issues which have been considered by the Senate Rural and Regional Affairs and Transport References Committee (the Senate Committee) Inquiry into Current and Future Arrangements for the Marketing of Australian Sugar (the Senate Inquiry) and the Federal Government's Sugar Marketing Code of Conduct Taskforce (the Taskforce). Given that there have been numerous and voluminous submissions to these inquiries, this submission does not provide detailed commentary on each of the discussion topics nominated. Rather, this submission provides some general comment on the discussion topics as well as additional information as it relates specifically to Bundaberg Sugar Ltd (BSL).

Background

BSL is a grower, miller, refiner, and marketer of sugar and related products in Australia. Other value adding operations include Bundaberg Walkers, a heavy engineering and foundry enterprise and Bundaberg Molasses which supplies molasses and related products. We are a large land owner with around 20,000 hectares of land and are the largest cane grower in Australia producing around 600,000 tonnes of cane per annum. BSL's two mills, Millaquin and Bingera, currently crush around 1.7M tonnes of cane per annum and produce around 240,000 tonnes of raw sugar. Of this sugar tonnage, around 160,000 tonnes is processed in our refinery with the remainder being exported through Queensland Sugar Limited (QSL). Most cane is transported by cane railway utilising around 330km of our own main line track.

BSL has for the past 14 years been owned by Finasucre, a Belgium based company. One of the significant advantages of this ownership has been access to capital. Sugar mills have large sunk capital invested in cane transport and processing equipment which incurs substantial annual maintenance expenditure. Access to capital is critical for continued viability in what is a low margin business.

In addition, BSL mills currently have low throughput by industry standards and have low utilisation of milling assets. To assist the continued operation of two mills in Bundaberg, (with consequent employment benefits in one of the highest unemployment areas of Australia) BSL has invested heavily in farm land to underpin mill throughput. Around one third of cane supply is from company owned farms.

Without the financial backing of Finasucre, the business landscape in Bundaberg would be substantially different today.

Regulation of the Sugar Industry

There have been a considerable number of reviews over recent years which advocate deregulation of the industry as well as regional specific solutions to issues in order to maximise industry profitability. A key influence of the final moves to full deregulation was the Hildebrand Report which found the need for a regionally-focused, business-orientated approach to the majority of industry matters. *"The industry must move from a "one size fits all" approach to developing regionally-based plans that strongly reflect local priorities."* The Independent Assessment: *"...found that there is too much reliance on a State-wide approach to industry matters. It is clear*

that the effective operation of each mill area, or mill region, lies almost entirely in the hands of the local co-dependent participants. And it is important that this responsibility is accepted without resort to wider loyalties."[1]

This was recently acknowledged by the Senate Committee: *"In the early 2000s, successive reviews of the Queensland sugar industry concluded that the regulatory system established under the Sugar Industry Act stifled the industry's productivity. The consistent message coming from the reviews was that the regulatory system 'created a set of formal and informal rules – called the principle of adverse effects – which have the effect of blocking productivity gains'. It was also found that the system created antagonism between growers and mill operators and fostered a resistance to change, which together hindered productivity and diminished innovation."*[2]

The Senate Committee also noted *".... that any move toward re-regulation would be contrary to the stated policy objectives of both the state and Commonwealth governments. More importantly, the committee is of the view that any move toward re-regulation of the industry would not be in the best interests of the industry – particularly over the longer term."*[3]

BSL agrees with the sentiment expressed by others above, and is opposed to any form of increased regulation as we believe that regulated outcomes provide suboptimal commercial solutions. This is especially the case where complex issues are at the heart of the matters being considered as is the case for sugar marketing. The Senate Committee noted that *"The inquiry brought to the fore a complete lack of clarity around the issue of GEI sugar and growers' rights to choose who markets their sugar."*[4] It is incredulous to think that legislation is being considered when there is no clear understanding of the issues involved nor the consequences likely from the proposed legislation. Optimum outcomes will only be achieved by commercial negotiation.

Further, the conflict being experienced in the industry at the present time is essentially confined to one miller and their growers. It is not an industry wide issue. As such, any solution needs to be a regional specific solution.

Market Power

BSL does not believe there is an imbalance in market power favouring mill owners over growers. If anything it is the reverse, especially in areas where there is competition for cane.

The Senate Committee stated: *"The committee notes that there is a legal framework which underpins the negotiation of CSAs. It is also acknowledged that the framework includes provisions in relation to*

- *Access to collective bargaining;*
- *Provisions for unconscionable conduct; and*
- *Misuse of market power"*[5]

And further: *"The committee has observed the strong inter-relationship and inter-dependence which exists between sugar cane growers and sugar milling companies. It is clear that neither sector would be able to survive without the other remaining profitable and sustainable."*[6]

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[1] ASMC Submission to the Taskforce, p. 6.
[2] Report of the Senate Inquiry, p. 10.
[3] Report of the Senate Inquiry, p. 35.
[4] Report of the Senate Inquiry, p. 25.
[5] Report of the Senate Inquiry, p. 36.
[6] Report of the Senate Inquiry, p. 37.

It is this inter-dependence and overarching competition laws which preclude millers from having monopoly power.

As the ASMC note, *"The long-standing virtually unchanged arrangements between mills and their growers that continue to be agreed in today's CSAs are a clear demonstration of a mature supplier/processor relationship that works."*[7] This consistency of arrangements provides the evidence that there is no imbalance in market power. If a miller did have monopoly power over growers, one would expect a deterioration in the growers' conditions within the CSAs over time. There is no evidence of this occurring.

On the contrary, it is arguable that in areas where there is the ability for mills to compete for cane (which is the case in most areas other than some Wilmar based areas) growers in fact have more negotiating power than mills. This can be evidenced by the recent movement of growers from the Tableland mill to Mossman mill. Certainly in the Bundaberg area, there is competition for cane across our whole milling operations with a substantial number of growers moving to Isis mill in 2006 and subsequent years. In addition, there is also significant competition for cane land from other crops. In our Bundaberg operations, these factors have resulted in sugar cane supply reducing from 3.8 million tonnes in 1999 to just 1.7 million tonnes this season.

What we are seeing then, is not an imbalance of market power but rather growers "negotiating" via government intervention to provide a more advantageous outcome through this negotiation phase. The conflict should simply be considered part of the transitioning phase of deregulation and certainly not a market failure as some would suggest.

This view is further substantiated when Messrs Dimasi and Samual (experts in competition law) concluded: *"We would strongly recommend that the industry does not adopt a Code of Conduct. The industry is transitioning, albeit slowly to a deregulated environment in which the market should be left to operate its own devices with the consequent advantages of deregulation that formed the motivation for pursuing that course of action in 2006. Put at its simplest, a Code of Conduct reinstates the regulatory environment rejected as being sub-optimal to the industry in 2006."* [8]

It appears the Senate Committee recommended a Code of Conduct (the effect of which is very similar to the Bill) based totally on the view that: *"The committee has doubts, however, about whether the current framework will prove sufficient for growers and millers to work their way through the current impasse and reach agreement on new CSAs and, ultimately, on the future of the industry."*[9]

However, while government continues to be engaged in the "negotiation" between Wilmar and growers there will be no commercial outcome. It is time government ceased intervening and providing one side with the potential to increase their market power in all future negotiations.

Sugar Marketing

As the ASMC note, *"De-regulation quickly delivered ground breaking innovation, with the introduction of forward pricing and price and currency risk management tools, a concept now embraced by approximately 70 per cent of Queensland cane growers. Most in the sugar industry would agree that forward pricing has been the most important change in marketing and pricing for*

[7] ASMC Submission to the Taskforce, p. 13.
[8] ASMC Submission to the Taskforce, p. 28.
[9] Report of the Senate Inquiry, p. 36.

the sugar industry in memory." [10] However, the area of sugar marketing and pricing is extremely complex and there is to a very large extent a lack of understanding of the issues involved.

The objective of the Bill to *"provide cane growers with the right to have real choice over who sells and prices Grower Economic Interest (GEI)"* has only materialised in response to grower's contention of the lack of transparency over the marketing premium in the options being presented by Wilmar. It is this issue which to a large extent has driven the current conflict.

In relation to the significance of the net marketing premium, the ASMC note that, *"The range impact on the payment made per tonne of sugarcane is from $0.08 per tonne at a $1.00 net premium on sugar price, through to $0.40 per tonne sugar cane for $5.00 net premium on sugar price. CCS has a much greater influence on the price of sugarcane than marketing premiums, the difference between a CCS of 13 and 15 is over $8 per tonne of sugarcane. For ICE11 movement, the average price of the prompt futures contract each year from 2010 to 2014 varied from $406 per tonne sugar, to $533 per tonne sugar. Applying this to the sugar price component of the cane payment formula translates to a movement of up to $10.29 per tonne of sugarcane for a grower. While the marketing premium is an important element in the payment made to growers for sugarcane, it is vastly outweighed by the impact of variation in ICE11 movement and CCS variability."*[11] As can be seen, the net marketing premium typically represents only 1% of the final sugar price.

BSL is one of the three milling companies which have not given notice under the Raw Sugar Supply Agreement with QSL. We have a good working relationship with local growers and have developed over recent years a mechanism to provide transparency to the determination of a domestic sugar price which is a component in deriving a final cane price for growers. The issues involved were very similar to those being debated by Wilmar and their growers, given the lack of transparency on pricing of "GEI" sugar passing through the refining process.

By negotiation with our growers, we developed a system which mirrors the export sugar price determined by QSL. Should QSL cease to exist in the future, then transparent mechanisms similar to those existing with QSL could be implemented with a new marketer of export sugar. Further, should it eventuate that there is no export sugar, then it is believed that transparency could be achieved utilising some proxy (agreed with growers) for the physical marketing returns which currently are a component of sugar price. Other components of the sugar price are transparent/auditable. Alternatively, some other method of determining a cane price for growers could be possible.

Arbitration and Grower Choice

For the reasons outlined above, BSL is opposed to any form of increased regulation. BSL emphatically objects to the Bill's clause 33A and 33B which form the core of the proposed legislative change.

In relation to clause 33A, the ASMC note that, *"There is only one example of pre-contractual arbitration in agribusiness in Australia currently. It applies to the grain exporters negotiating access to bulk grain port terminals and is part of the mandatory Port Terminal Access (Bulk Wheat) Code of Conduct. The Code applies to bulk grain port terminal operators to ensure that exporters of bulk wheat have 'fair and transparent access' to port terminal services. Arbitration in the Wheat Port Code deals specifically with infrastructure access disputes. There is no Industry Code in Australian agribusiness that prescribes arbitration as a measure to establish contracts between a supplier and processor, manufacturer, merchant or other receiver of goods. There is no*

[10] ASMC Submission to the Taskforce, p. 2.
[11] ASMC Submission to the Taskforce, p. 15.

case of market failure that would support the introduction of such heavy handed regulatory intervention in the Australian sugar industry."[12]

At the extreme, pre-contract arbitration can force a party to enter a business relationship even though the commercial basis for the relationship may cause failure of a business i.e. the terms of the arbitrated arrangements inadvertently cause a loss making situation for a party. This is especially the case with complex issues which are not well understood being in dispute such as sugar marketing and pricing.

In relation to clause 33B, the ASMC note, *"To introduce a new concept whereby sugarcane growers have a mandated direct influence on how sugar mills choose to sell the mills' raw sugar creates a direct impact on the legal title of sugar. If such a proposal was to be implemented,..... it would alter the fundamental basis of the existing sugar supply chain, and cause a re-examination of the building blocks of the 100-year-old cane payment formula."*[13]
BSL have grave concerns that this would be the ultimate outcome of the Bill. BSL does not know of any country in the world where the cane grower has a say as to where the miller sells its sugar.

As we have noted previously, the underlying reason for the Bill is to ensure transparency of the net marketing premium in certain mill areas. We contend that the Bill goes much further than addressing this issue and would have unintended adverse consequences on our company. We believe that the Bill will change the nature of our sugar milling business and have significant detrimental financial impacts on our business. It is not desirable that arbitration becomes a customary way to avoid the responsibility that should accompany local leadership in genuine negotiation at the mill area level, for the good of participants in that mill area.

Exemption

It is important to note that the conflict is only really between one mill owner and their growers, however the proposed legislation is dragging all other participants into the conflict with likely significant adverse outcomes for them. Further, industry reviews have stressed that regional specific solutions to issues are required in order to maximise industry profitability.

Should government ultimately decide (contrary to ASMC, other millers and BSL's submissions) that State wide legislation is required, then BSL strongly recommends that exemptions be made for those mill areas where the reason for the legislation are not relevant. As such, we would suggest that exemption to the effect of the Bill be made for millers who provide transparent sugar pricing outcomes for growers and/or where millers are in competition for cane supply from neighbouring millers. We suggest that if a miller supplies sugar to QSL or a similar independent entity for marketing, a miller is considered to have provided transparent sugar pricing mechanisms for growers under the Sugar Industry Act. Similarly if a mill owner's factory is within a competitive cane transport distance of another mill owner's factory, then these mill areas should be exempt from the legislation.

Finally, should government determine that State wide legislation is required and exemptions are not appropriate, then we would recommend that each miller be required to supply a percentage of their export sugar to QSL or a similar independent entity. This was the basis of the "growers choice" model previously agreed by all millers which guaranteed a minimum volume of one million tonnes to QSL. This would provide marketing premium transparency.

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[12] ASMC Submission to the Taskforce, p. 19.
[13] ASMC Submission to the Taskforce, p. 10.