Submission No. 007

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17 July 2015

Ms Jennifer Howard MP
Chair
Agriculture and Environment Committee
Parliament House
George Street
BRISBANE QLD 4000

By email: aec@parliament.qld.gov.au

Dear Madam

Sugar Industry (Real Choice in Marketing) Amendment Bill 2015

CANEGROWERS and the Australian Cane Farmers Association (ACFA) welcome the introduction of the Sugar Industry (Real Choice in Marketing) Amendment Bill 2015. It marks a significant step forward and as a pro-competition initiative will complete the deregulation of the sugar industry that was commenced by the Queensland Government in 2006.

The price of sugarcane in Queensland has always been linked to the market value of sugar. This link has given growers a clear economic interest in the sugar produced from their cane. For 100 years the market value of sugar was determined by the industry-owned marketing company QSL and its predecessors.

The deregulation of the industry that occurred in 2006 was only implemented by the Queensland Government when agreement was reached with the industry (ASMC on behalf of all mills and CANEGROWERS were party to the agreement) that QSL would continue to be the preferred marketer of sugar under voluntary marketing arrangements. This understanding was clearly outlined in a Memorandum of Understanding between the parties and signed by Premier Beattie before the deregulation commenced. This is documented in the Explanatory Notes to the 2006 implementing legislation.

The agreed structure ensured that growers' interest in the marketing of sugar continued as joint-owners of and through their interaction with QSL. The unilateral decision taken by some mills to withdraw from QSL, the agreed preferred marketer, overturns a central pillar of the agreement to deregulate the industry. It breaks growers' historic nexus with the market, replacing it with structures in which growers have no say or ability to influence.

Mills, claiming complete mill choice in marketing, are denying growers' choice in how growers' economic interest (GEI) sugar is sold.

Exercising their monopoly power in cane processing, mills are refusing to negotiate around the provision of marketing services. By coupling sugar production and marketing activities in this way, mills are engaging in anticompetitive behaviour. They are denying growers' rights and preventing them from exploring competitive offers and being able to engage the sales and marketing services of others.

The only way to address the imbalance in market power between the mills and growers and provide some level of grower choice in sugar marketing is the introduction of some light form of regulation. Amending the *Sugar Industry Act 1999* to require that cane supply contracts contain provisions to enable growers' choice in how their economic interest sugar is priced and sold would restore commercial balance between growers and the mills they supply.

To be clear, we are not asking the government to make provisions for how this is to occur. That is a matter for commercial negotiation. We are simply asking that growers economic interest in the sugar produced from their cane (a point uncontested in the industry, as reflected in the provisions of the Raw Sugar Supply Agreements each mill company has with QSL) is formally acknowledged and a framework established that gives growers choice in how that GEI sugar is priced and sold. This pro-competitive action will provide for real competition in the provision of sugar marketing services.

It is important that growers are treated in a non-discriminatory manner in the negotiation of cane supply agreements and that a dispute resolution process is available to growers and their bargaining agents to resolve any deadlocks in the negotiation of these agreements. The *Commercial Arbitration Act 2013* provides a mechanism that could be used for this purpose.

The Sugar Industry (Real Choice in Marketing) Amendment Bill 2015, is a form of light handed pro-competition regulation that will ensure both cane growers and mill owners have choice in how the sugar in which they respectively have an economic interest is priced and sold, thus completing the deregulation of the sugar industry that commenced in 2006.

CANEGROWERS and ACFA submission and supporting documents are attached.

Yours faithfully

Paul Schembri
Chairman
CANEGROWERS

Don Murday
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Australian Cane Farmers Association

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Rectifying an imbalance in market power

Sugar Industry (Real Choice in Marketing) Amendment Bill 2015

2006 Agreements

The changes in industry regulations introduced in 2006 were predicated on an agreement between the Queensland Government and the industry (all mills and CANEGROWERS were party to the agreement) that QSL would continue to be the preferred marketer of sugar under voluntary marketing arrangements that were entered into before the deregulation occurred.

The agreed industry/government position was contained in the relevant agreements between CANEGROWERS, ASMC and the Queensland Government and reflected in the relevant legislative materials.

A. The **Memorandum of Understanding** (MoU) between the Queensland Government, CANEGROWERS and ASMC dated 13 October 2005, signed by the then Premier Beattie and the Chairmen of CANEGROWERS and ASMC provides in part:
   a. "Queensland Government:
      1. Will prepare amending legislation for introduction into Parliament to remove compulsory vesting and enable the altered arrangements to operate prior to the commencement of the crushing season in 2006.
      2. Will only introduce the amending legislation into Parliament when it is satisfied there is sufficient support from suppliers to successfully implement the recommendations of the Working Group.
   b. The Australian Sugar Milling Council:
      1. Advises that all members of the Australian Sugar Milling Council remain committed to working with QSL to assist QSL to remain the preferred marketer by suppliers and customers of Queensland produced bulk raw sugar for export.
   c. CANEGROWERS:
      1. Reaffirms its support for increased flexibility with the retention of benefits that exist under the current export marketing arrangements.
      2. Supports the introduction of the transition to a contractual basis for raw sugar marketing from 2006, provided there is sufficient support from suppliers to successfully implement the recommendations of the Working Group.

B. **Sugar Industry Amendment Bill 2005 – Explanatory Notes** as tabled in the Parliament of Queensland

> "The MOU recognises that while the State Government intends to pursue its policy to remove regulatory encumbrances from the sugar industry, it is committed to support an orderly transition from legislative to contractually-based marketing arrangements for bulk sugar export sales.
>
> It is recognised that, in moving to a new marketing system, the key to success is for all parties to work towards delivering greater flexibility and enhanced outcomes whilst continuing the benefits and synergies of presenting a coordinated face to Queensland's bulk raw sugar customers. The peak industry bodies have committed to working with Queensland Sugar Limited to assist it to remain the preferred marketer."

In view of the commitments given by industry, including ASMC for itself and each of its milling company members, the Queensland Government's policy objectives and the entering into the voluntary marketing arrangements between QSL and millers in 2005 before the deregulation process commenced and legislative changes introduced, it is clear that the 2006 deregulation was not based on a principle that millers were thereby free to independently market and sell the raw sugar produced in their factories. The process and associated agreements make it clear that all parties envisaged and agreed a partnership between growers and millers in the marketing of sugar. In this partnership, both millers and growers would share in the risks and rewards associated with the marketing of raw sugar produced in Queensland.

In light of this MoU and the associated amendments to the Sugar Industry Act 1999 regulated marketing arrangements were replaced with voluntary structures. It was the unilateral decision taken by some mills to terminate the industry agreed voluntary marketing arrangements that has reinstated the imbalance in market power between mills and growers, in favour of mills and it enabled mills to make marketing decisions that affected growers without reference to those growers.

Three milling companies have announced their intention to take control of the marketing, denying growers *Real Choice* in marketing.

In 2012 Wilmar Sugar Australia (Wilmar) reached agreement with QSL to export market some of the raw sugar produced in its mills on its own account. This company specific marketing agreement between Wilmar and QSL was extended to all other mills in an amendment to the RSSA that applied from the commencement of the 2014 season.

In April 2014, Wilmar issued a public statement without regard to the requirements of its Cane Supply Agreements and without consultation with its growers or the wider industry indicating its intention to exit the current sugar marketing arrangements from the end of the 2016 season. Shortly after, two other milling groups, MSF Sugar (owned by Thailand's Mitr Phol Group) and Tully Sugar (owned by China's COFCO) also announced their intention to exit current marketing structures from the end of the 2016 season. These international companies plan to take control of the marketing of all of the sugar coming out of their mills.

1. Call for Action to the Queensland Government for *Real Choice* in sugar marketing

To address the imbalance in market power between mill owners and growers CANEGROWERS and the Australian Cane Farmers Organisation (ACFA) support the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015*.

The Bill aims to secure for growers the right to have ***Real Choice*** over who sells and prices Grower Economic Interest (GEI) sugar and the right for millers to have similar choice for Mill Economic Interest (MEI) sugar.

CANEGROWERS and ACFA recommend that the Queensland Government introduces the pro-competition[1] ***amendments*** to the *Sugar Industry Act 1999* contained in the Bill without delay.

2. Current Situation – mills are denying growers *Real Choice* in marketing

There is no feasible alternative market for cane.

In each of the sugarcane producing regions the local cane growing community must deal commercially with a raw sugar miller. In most regions, a single company owns all of the mills; there is no feasible alternative market for cane; and there are few if any worthwhile alternatives to sugarcane production. Although the Act currently makes provision for some limited collective bargaining for growers, it has proven to be ineffective in circumstances where there has been a monopoly miller and no process to resolve deadlocks in negotiations.

There is a clear imbalance in economic strength favouring the milling sector. This imbalance that clearly favours sugar mills to the detriment of cane growers is highlighted in the *Raw Sugar Marketing Arrangements Study* prepared by Deloitte Access Economics (**attached**).

Deloitte Access Economics concludes that "a form of light-handed regulation could be introduced by adopting a federal mandatory code of conduct for the sugar marketing arrangements under the Commonwealth *Competition and Consumer Act 2010* (CCA) and /or through the enactment of equivalent regulatory structures by amending the Queensland *Sugar Industry Act 1999*." This would be a pro-competitive way of addressing the imbalance in market power between growers and millers.

This imbalance, characteristic of sugar industries around the world and recognised by governments in all sugar producing counties, has resulted in a suite of regulations governing the commercial relationship between millers and growers in each of those countries.

The imbalance and the power of the regional monopoly enjoyed by each mill was first recognised in Australia in the early years of the 20th century, when sugar industry regulations were introduced to prevent mills from exercising their ability to "squeeze the primary producer".

These regulations ensured growers and mills shared market rewards and risks.

Although not described as such at the time, the concept of Grower Economic Interest (GEI) sugar was given effect.

Wilmar no longer contests the fact that growers have an economic interest in the sugar produced. Wilmar has "agreed to a defined term and formula to be included in supply

[1] CANEGROWERS-ACFA are not seeking to revert to a legislated single desk marketing structure.

contracts to recognise the principle of grower economic interest ("GEI")" (Wilmar Media Release, 25 June 2015).

Unless addressed, the mills' anti-competitive actions will have ramifications across the whole industry.

These unilateral mill decisions will deny growers any choice in how their share of the production, their GEI sugar, is marketed in the future. This misuse of market power is designed to undermine the stability and integrity of the industry's existing marketing structures and alter the way in which rewards and risks are shared across the industry in favour of the mill. Unless addressed, these anti-competitive actions will have ramifications across the whole industry, affecting all milling companies and their supplying growers.

3. Recommendation – amend the *Sugar Industry Act 1999* to introduce *Real Choice in Marketing*

CANEGROWERS and ACFA support the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015* that introduces pro-competition amendments to the *Sugar Industry Act 1999*.

These amendments recognise the economic interest that both growers and mill owners have in the sugar produced and assign rights to growers and mill owners in relation to their respective economic interest sugar.

The amendments:

- Recognise that both growers and millers have an economic interest in the sugar.
- Define Grower Economic Interest (GEI) sugar.
- Define the proportion of the "on supply" sugar for which the mill owner must bear the sale price exposure. This is equivalent to the concept of Mill Economic Interest (MEI) sugar.
- It requires the calculation of GEI and MEI sugar in a way that is consistent with current industry practice.
- It assigns rights to growers and millers respectively for the marketing of GEI and MEI sugar.
- It provides for a commercial dispute resolution system to resolve any deadlocks.
- To the extent that they arise, competition issues are addressed by suitable additions to the authorisation for cane supply agreements specified in Chapter 6 of the Act.

As a consequence of the Bill a dispute resolution mechanism incorporating the *Commercial Arbitration Act 2013* will be available to resolve any deadlocks in the negotiation of cane supply agreements and all cane supply agreements, unless otherwise agreed by the mill owner and the grower, will need to make provision for the following:

1. The price for cane is linked to the selling price for sugar.
2. A contract must include a determination on the calculation of GEI and MEI sugar.
3. The grower and the mill owner each have a right to determine how their respective GEI or MEI sugar is marketed, priced and sold and in the absence of any determination for GEI sugar, these functions shall be undertaken by a GEI sugar marketing entity.

4. The Queensland Government has the power to make these changes

The changes, consistent with the principles of National Competition Policy (NCP), are designed to increase competition for sugar produced in Queensland. The Queensland

Government has the policy instruments necessary to introduce NCP consistent regulations that recognise GEI sugar and to give growers the right to determine how that sugar is priced and sold.

A strong case for government intervention to address the clear imbalance in market power within the industry is also outlined in the opinion prepared by former High Court Judge The Hon Ian Callinan AC (**attached**). Mr Callinan's advice concludes with the statement:

> *"17. The answer to the question I am asked, therefore, is that the Queensland legislature does have power to restore or to enable Queensland canegrowers to protect their economic interests in the sugar extracted from the sugar cane supplied by them to millers, including by giving growers a choice as to the entity which prices and markets their economic interest sugar."*

It is clear that the Queensland Government has the power to intervene legislatively.

It was concerns about the imbalance of market power and its misuse by regional mill monopolies that underpinned the original establishment of sugar industry regulations by the Queensland Government in 1915.

5. The Bill is consistent with Australia's international obligations

As a non-discriminatory amendment to the *Sugar Industry Act 1999*, the Bill does not interfere with Australia's international obligations under the WTO, or any bilateral or regional trade agreement Australia has entered or is currently negotiating. With specific reference to the Singapore-Australia Free Trade Agreement (FTA), the legal firm Maddocks provided advice that the proposed Mandatory Code of Conduct does not directly or indirectly expropriate property rights and would be consistent with Australia's international obligations (**attached**). The same conclusion applies to the non-discriminatory *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015.*

6. Possible enhancement to the Bill

Given that in a choice environment some growers may elect to have the mill market a proportion of their GEI sugar and others may elect to have QSL market a portion of their GEI sugar, it would be helpful if the Bill was amended to require mills not to discriminate against growers who elect to market their GEI sugar other than with the miller.

Making the changes contained in the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015* safeguards those longstanding arrangements and secures a commercially workable foundation upon which the industry can continue to grow.

To provide certainty for the forward pricing and marketing of sugar for the 2017 season that will be produced from continuing ratoon crops and to support investment decisions that are currently being made about planting new crops and maintaining existing ratoon crops and maintaining and enhancing milling infrastructure, CANEGROWERS and ACFA ask for your support without delay.

Attachments

1. *Grower Economic Interest (GEI) Sugar – rectifying an imbalance in market power(17 July 2015)*
2. *Deloitte Access Economics – Raw Sugar Marketing Arrangements Study (11 June 2015)*
3. *The Hon Ian Callinan AC – Opinion Re: Legislative Power (21 January 2015)*
4. *Maddocks Lawyers – Advice regarding expropriation claims in relation to draft mandatory industry code for Australian sugar industry (11 June 2015)*

Attachment 1

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Grower Economic Interest (GEI) – Rectifying an imbalance in market power

1. Introduction

In each of the sugarcane producing regions, the local cane growing community must deal commercially with a raw sugar miller. In most regions, a single company owns all of the mills; there is no feasible alternative market for cane; and there are few if any worthwhile alternatives to sugarcane production. With one exception, the mill owner is either a large multinational company or linked to a large multinational in which Australian sugar accounts for a small part of its total business activities. There is a clear imbalance in economic strength favouring the milling community.

This imbalance, characteristic of sugar industries around the world and recognised by governments in all sugar producing counties, has resulted in a suite of regulations governing the commercial relationship between millers and growers in each of those countries.

The imbalance was first recognised in Australia in the early years of the 20th Century when, in the absence of effective competition laws, the then federal government appointed a Royal Commission to review the sugar industry. In its report the Royal Commission expressed concern about the imbalance in market power in the industry and the mill owner's ability to *"squeeze the primary producer"*. In light of this finding, a single channel marketing system was introduced that ensured the risks and rewards flowing from the marketing of raw sugar were shared. The regulations also enabled cane growers to come together to bargain collectively with mills to negotiate the terms and conditions for the supply of cane to the mill.

With the advent of Australia's national competition policy framework the marketing structures evolved, becoming voluntary rather than compulsory. Nonetheless the continuing imbalance in negotiating power was recognised with growers authorised in the *Queensland Sugar Industry Act 1999* to collectively bargain with the mill for the supply of cane.

Systems were introduced to enable mills and growers to manage their raw sugar price risk independently of the physical sale. In 2013, in response to mills seeking the ability to sell their share of the sugar produced on their own account, and with CANEGROWERS agreement, structures were changed to enable this to occur should mills choose to do so. With this change, growers' share of sugar production continued to be marketed through the longstanding export channel and, in this way, growers' interests were protected.

In April 2014, exploiting the relatively weak provisions of the *Competition and Consumer Act 2010* (CCA) which prohibit a corporation with a substantial degree of power in a market (in

this case combining regional milling monopoly power with marketing) from taking advantage of that power to eliminate or substantially damage a competitor (in this case QSL, the marketer of grower economic interest sugar) and prevent market entry or deterring or preventing a person from engaging in competitive conduct (in this case denying growers the ability to determine who markets their share of the sugar produced), Wilmar Sugar issued a public statement indicating its intention to exit the current sugar marketing arrangements from the end of the 2016 season. Shortly after, two other milling groups, MSF Sugar (owned by Thailand's Mitr Phol Group) and Tully Sugar (owned by China's COFCO) also announced their intention to exit current marketing structures from the end of the 2016 season.

By denying growers real choice in how their share of sugar production is marketed, this misuse of market power is designed to undermine the stability and integrity of the industry's marketing structures and alter the way in which risks and rewards are shared across the industry in favour of the mill. These anti-competitive actions will have ramifications across the whole industry, affecting all milling companies and their supplying growers.

2. Establishment and Evolution of GEI sugar

Grower Economic Interest (GEI) sugar has been a cornerstone concept of the Australian sugar industry since the price of sugarcane was linked to the price of sugar.

2.1. The 1900s

The first major review of the Australian sugar industry by the Commonwealth government was undertaken by a Royal Commission[2] in 1912. The Royal Commission had a wide-ranging brief which included, among other things, the requirement to inquire into and report on costs, profits, wages and prices in the Australian sugar industry.

In the absence of legislative guidelines, the distribution of proceeds to the various segments of the industry from the sale of sugar was determined in the large part on the basis of direct negotiations between refiners and millers, and in turn, between millers and growers. In such circumstances the Royal Commission considered that the distribution of proceeds among segments of the industry could be considered to be fair where there is strong competition, where there is potential for competition or from collective bargaining (Brown et al 1912). The Royal Commission observed:

"It would be futile to contend that the foregoing factors (competitive forces) are wholly inoperative in Australia with respect to the prices of sugarcane, raw sugar and refined sugar respectively. It would be no less futile to contend that their operation is reasonably effective as a means of securing an equitable distribution of the profits in the sugar industry".

The Royal Commission found that the price for both refined and raw sugar was set by domestic refiners. The price for sugarcane, in turn, was set by the mill owners.

[2] Brown, W.J., Hinchcliffe, A., Anderson, R.M.M., and Shannon, M.R. (1912), *Report of the Royal Commission on the Sugar Industry*, Government Printer, Melbourne, 2 December.

The Royal Commission was concerned that competitive forces in the Australian sugar industry were not "effective as a means of securing an equitable distribution of the profits in the sugar industry". It noted that, "growers as a class do not, in our opinion, receive their fair share of the profits of the industry as a whole".

It recommended steps be taken to ensure "squeezing of the primary producer" did not occur. It reported, "Australian statesmanship should seek to prevent as well as to ameliorate – to deal with evils as they arise without waiting for them to reach a stage when any remedy must involve far-reaching social and industrial dislocation" (emphasis given by the Royal Commission).

The role of government identified by the Royal Commission has not changed. It is to establish a regulatory structure that prevents the misuse of market power, addresses market failure and establishes a competitive market.

In 1915 the Queensland Government introduced two pieces of legislation to coincide with the Commonwealth-Queensland sugar agreement:

- *Sugar Acquisition Act 1915*
- *Regulation of Sugar Cane Prices Act 1915*

The Sugar Board, established in 1923, was given the task of selling the vested sugar. It engaged the Colonial Sugar Refiners company to market the sugar. The majority of acquired sugar was sold into the domestic market and the balance exported, largely to markets in the British Commonwealth and mostly at administered prices. The combined effects of the legislation was to recognise that both growers and millers have an economic interest in the sugar produced and to regulate the distribution of proceeds from the sale of sugar between millers and growers, to ensure growers get a fair share, by regulating the price of cane.

In one of the first decisions the Central Sugar Cane Prices Board[3] noted that the intention of the Queensland Government when it increased the price for raw sugar was to increase the remuneration of those in the industry, "not only to benefit millers but also to assist growers and other persons engaged in the industry".

With 1915 being a drought year, the harvest was poor. In effect, the Central Board's decision recognised that both growers and mill owners had an economic interest in the sugar produced and ensured that the impacts of crop production risks were borne by both cane growers and mill owners.

Amongst the matters the Central Board was required to take into consideration in setting the price of cane were the estimated commercial cane sugar (CCS) contents of the sugarcane; the crushing capacity and efficiency of the mill; and the selling price of sugar, raw and refined.

The Central Board introduced sugar payment scales that distributed the proceeds of sugar sales two-thirds to the growers and one-third to mill owners at base levels of industry efficiency. It was based on their view that the value of assets and the costs of production fell to growers and mill owners on a two to one ratio. The scales were designed to provide

[3] [3] Central Sugar Cane Prices Board (1916), 'Awards made in accordance with *the Regulation of Sugar Cane Prices Act 1915*: Bingera Mill, *Queensland Government Gazette*, Brisbane, 5 January, 75.

incentives to growers to improve the CCS in cane and to mill owners to improve their recovery of sucrose from the cane.

The sugarcane payment scales reflected the sugarcane payment formula:

Price of cane = Price of sugar x 0.009 x (CCS – 4) + constant.

Although subject to intense scrutiny, including as part of the rigorous *Investigation into the Distribution of Proceeds of Vested Sugar* conducted by Queensland Sugar Limited in 1993, the sugarcane payment formula has remained a pillar of the financial relationship between growers and the mills they supply since its introduction. The key change has been the addition of a few cents per tonne of cane to the price of sugar by increasing the level of the constant. In 1995, it was increased.

Until 1996 the sugar price was determined collectively by QSL (or its predecessors) as an average price per tonne from the net proceeds (gross sales revenues *less* costs of operation) of sale. In those years when there was more than one pool in operation, the pools were established principally on the basis production risk.

2.2. Domestic Market Changes

Australia's domestic sugar market was deregulated in 1989 when the Commonwealth-Queensland sugar agreement was removed and the embargo on raw sugar imports was replaced by a tariff.

The fact that domestic prices were no longer administered, but market determined, caused the (then) Sugar Board to change its approach to selling sugar into the Australia domestic market. Aware of the potential conflicts of interest, the possible dilution of the price of raw sugar that might arise with the CSR Raw Sugar Marketing selling raw sugar to the CSR refined sugar group and to ensure transparency in its domestic sales activities, the Sugar Board established its own in-house marketing team to manage the domestic sales program.

In 1996, the Queensland Sugar Corporation (QSC, the successor organisation to the Sugar Board) first introduced a mechanism to provide producers the opportunity to manage part of the price risk they faced separately to QSC's management of the physical sales activity.

This first evolution of Producer Pricing and its successors enabled the raw sugar pricing function to be separated from the physical sales activity. The mechanism enabled producers to hedge their sugar price risk associated with the sugar they produced using the New York futures market (now the Inter-Continental Exchange (ICE)) either on their own account or through QSC and to use QSC to close out their futures market transaction by linking it with a physical sales transaction.

This structure evolved. In 2000, the government-owned corporation QSC was abolished and Queensland Sugar Limited (QSL), an industry-owned company limited by guarantee with ownership held 50% by growers (CANEGROWERS and ACFA each holding a membership entitlement) and 50% by mills, was established. QSL took over the industry marketing role formerly undertaken by QSC and all raw sugar produced in Queensland was vested in QSL.

This evolution of industry structures also saw the establishment of Sugar Terminal Limited (STL) as a separate company limited by shares and jointly owned by growers and millers.

Shortly after its establishment, QSL introduced a Call Pool as its principal producer pricing mechanism. This was replaced in 2005 by a Self-Managed Pricing System (SMPS) providing pricing options for mills. In 2006 the current QSL pricing platform was introduced. This latest development makes price risk management tools available to both growers and mill owners, enabling them to fix prices three to four seasons beyond the current season.

An important consideration in the introduction and evolution of producer pricing was the calculation of the price exposure of mill owners and cane growers respectively. The cane payment formula resolves this issue. In most[4] forward pricing agreements associated with cane supply agreements a grower's sugar price exposure is calculated as:

Sugar exposure (tonnes of sugar) = Tonnes of sugarcane x 0.009 x (CCS – 4). The constant is dealt with separately in the cane supply agreements.

This mechanism enables mill owners and canegrowers to manage their exposure to the ICE11 raw sugar price independently from each other and independently from QSL should they choose to do so.

The Raw Sugar Supply Agreements (RSSA) that QSL has with each mill acknowledges the price exposure held by their supplying growers, describing the quantity of sugar as Grower Economic Interest (GEI) sugar.

> In the RSSAs, "*Grower Economic Interest Sugar* means Raw Sugar for which Growers, excluding those Growers who are Related Bodies Corporate of a Supplier, bear the price exposure under the cane supply or other agreements between the Supplier and the Grower".

The same RSSAs define Mill Economic Interest sugar. The term supplier economic interest sugar is used because mills are seen as suppliers of raw sugar to QSL. Supplier Economic Interest sugar is defined by difference. It is the total amount of sugar produced less the quantity of GEI made.

> In the RSSAs, ***"****Supplier Economic Interest Sugar* means that part of the Total Raw Sugar for which, pursuant to cane supply or other agreements with Growers, the Supplier or its Related Bodies Corporate have the price exposure. For the avoidance of doubt, this excludes any Raw Sugar for which a Grower (other than a Grower that is a Related Body Corporate of the Supplier) has the pricing exposure to".

2.3. Sugar Industry Amendment Bill 2005

In 2004 the Queensland Government decided it would deregulate the industry and a bill was introduced to amend the *Sugar Industry Act 1999* "to remove statutory vesting and to provide transitional arrangements to facilitate the orderly marketing of the Queensland sugar crop."

The amendments were introduced following the establishment of a Working Group in 2004 to develop voluntary marketing arrangements and work towards a new system for the

[4] The cane supply agreements used in Mackay refer to the term Percent Recoverable Sugar (PRS). Although different to CCS, the distribution of proceeds is based on historical CCS. It also takes account of income derived from molasses and cane fibre.

marketing of raw sugar. As reflected in the *Explanatory Notes*[5] to the *Sugar Industry Amendment Bill 2005*, the Heads of Agreement between the Queensland Government, CANEGROWERS and the Australian Sugar Milling Council, reached ahead of the development of the Bill, recognised that the key to success in moving to a new marketing system was continuing the benefits and synergies of presenting a coordinated face to Queensland's bulk raw sugar customers.

The transitional arrangements which the Queensland Government established were to move the industry from legislative to contractually-based marketing arrangements for bulk export sales. It was in this context that the peak industry bodies CANEGROWERS and ASMC committed themselves and all of their members to working with QSL to assist it to remain the preferred marketer and the key principles agreed to in the new marketing system reflected the industry's commitment to QSL continuing to be the industry's bulk raw sugar export marketing company[6].

The changes were introduced on the understanding that under the contractually-based marketing arrangements, the price of cane would continue to be linked to the price of sugar. Through this mechanism, cane growers and mill owners continued to share in the risk and rewards from bulk raw sugar export sales.

2.4. Voluntary Marketing Arrangements

In 2004 mills entered Voluntary Marketing Agreements with QSL to enable it to continue as the single channel exporter of raw sugar from Queensland. Under these agreements growers and their representatives were legally removed from decisions about marketing raw sugar produced in Queensland despite the cane price being directly linked to the price of raw sugar.

Between 2005 and 2014 mills drove the evolution of raw sugar marketing structures. First, the voluntary marketing agreements were replaced with raw sugar supply agreements (RSSAs). Following a decision made by Wilmar, without reference to its supplying growers, that it wanted to export the raw sugar its mills produced on its own account, QSL developed a mechanism (a separate sales contract with Wilmar) that enabled this to occur.

In 2013 all mill owners sought the ability to market the raw sugar produced in their mills on their own account, independently of QSL. Mills imposed significant pressure on QSL to change its marketing structures.

QSL, aware of growers' economic interest in the sugar it sold, developed a series of options and consulted its members, both growers and millers together. This resulted in an agreement to develop a new RSSA implementing what was labelled as "Option B". This option recognised both Grower and Mill Economic Interest sugar and defined these two terms as above. The RSSA recognised the right of mill owners to sell their Mill Economic Interest sugar into the domestic and export markets using QSL or by other means, as they saw fit. Growers were not afforded the same rights in the RSSA.

[5] https://www.legislation.qld.gov.au/Bills/51PDF/2005/SugarIndAB05Exp.pdf

[6] A Memorandum of Understanding between the Queensland Sugar Industry and the Queensland Government (2005), http://www.daff.qld.gov.au/__data/assets/pdf_file/0006/75903/Sugar-Memorandum.pdf.

Although not party to the revised RSSA, for the first time grower representatives were involved in the decision to implement “Option B” and in the negotiation of the agreement. A key consideration in the development of the revised RSSA was to establish the quantity of sugar each mill was entitled to export on its own account. The industry’s longstanding cane payment arrangements, as reflected in the forward pricing agreements mills have with their growers, provided the solution.

Cane payment structures make it clear that both growers and mill owners have an economic interest in the sugar mills manufacture. The RSSA recognises this interest. It first defines GEI sugar and, using the definition of GEI sugar, defines MEI sugar as the difference between the total quantity of sugar manufactured at a sugar mill and the quantity of GEI sugar produced by that mill.

The revised RSSA with its more flexible export marketing structures was agreed, finalised and signed by all mills in January 2014.

2.5. 2014 Unilateral Mill Decisions

Despite being an active contributor to the development of and a party to the updated RSSA, in April 2014 Wilmar announced its decision to exit the current sugar marketing arrangements with QSL from the end of the 2016 season. Similar announcements by MSF Sugar and Tully Sugar followed shortly thereafter.

The decisions taken by these milling groups, each made independently of their supplying growers, effectively wrested control of the marketing of all sugar (both GEI and MEI) manufactured in their mills from QSL. Unless these mills withdraw their notices to exit, from the end of the 2016 season, the returns that growers receive for their cane will be totally dependent on the net return the mill they supply receives for the sale of the raw sugar it manufactures.

Wilmar Sugar, MSF Sugar and Tully Sugar are exercising a choice over the sugar their mills produce. In doing so the millers, by exerting their regional mill monopoly power, are denying growers the right to exercise choice over how GEI sugar is priced and sold. They are re-establishing the commercial imbalance described by the 1912 Royal Commission. The decision alters the risk profile of the industry, moving it in favour of mills. Unconstrained by regulation, “competitive forces in the Australian sugar industry will not be effective as a means of securing an equitable distribution of the profits in the sugar industry”.

This is counter to the intent expressed in the 2005 Memorandum of Understanding between the Queensland Sugar Industry and Queensland Government. CANEGROWERS and ACFA believe the three milling companies decisions to exit QSL is an unintended consequence of the removal of industry regulations and calls on the Queensland Government to use the power it has to restore the balance by enacting pro-competitive changes to the *Sugar Industry Act 1999*. These changes should define grower and mill economic interest sugar and assign rights to growers and mill owners in relation to the pricing and selling of their respective economic interest sugar.

3. Commercial Underpinnings of Grower Economic Interest

Until 2005 legislative arrangements supported a structure in which growers shared the full spectrum of risks and rewards from the market place. In 2010 the commercial structures that followed deregulation continued this approach. The treatment of marketing losses associated with the 2010 season is one illustration. Another is the way in which the full range of marketing costs, including but not limited to those associated with establishing and operating the bulk sugar terminals and the funding of QSL's raw sugar quality incentive scheme, are shared between growers and mill owners.

3.1. Marketing Losses – 2010

The 2010 season commenced with widespread optimism across the industry. A good cane crop was in prospect and sugar prices were high. The ICE No.11 March 2010 raw sugar futures briefly spiked to a 29 year high on 5 January 2010. Prices retreated for a period before recovering strongly, moving to their highest level since 1974. In this price environment, QSL accelerated its pricing (hedging) activities and sales program. During the 2010 harvest it became clear that severe rain and floods would prevent the entire the crop from being harvested. This prevented mills from delivering to QSL all the sugar they had previously indicated would be delivered.

With less sugar to deliver than planned, QSL was required to close out its futures contracts by lifting hedges on its own account rather than have the hedges closed out through futures market transactions linked to a physical sales contract. It incurred losses on those futures market transactions. QSL passed these on to mills in the form of non-delivery fees. The mills in turn passed the marketing losses on to growers in the form of a lower cane price through the cane payment arrangements.

Notwithstanding the fact that growers were not consulted individually or collectively by mills when the mills provided QSL with their production forecasts for the season, all growers were required to share in the marketing losses incurred by QSL.

This decision re-confirmed the fact that growers and millers shared in the risks and rewards associate with the marketing of sugar produced in Queensland and have a strong economic interest in the sugar produced and marketed. The net price achieved from the sale of sugar is directly linked to the price of sugarcane.

A direct consequence of the industry debate surrounding the apportionment of the marketing losses between growers and millers was formal acknowledgement by the milling sector that growers' economic interest in raw sugar does not stop with the delivery of cane to a sugar mill. That economic interest extends to raw sugar marketing and the returns that are achieved from its sale.

3.2. Sharing Marketing Premiums and Costs

All revenues and costs associated with QSL's operations are shared by growers and mills through the operation of QSL's pools. All revenues are credited to suppliers through one or more of QSL's price pools and all costs incurred in connection of raw sugar export are charged by QSL to its suppliers through the operation of QSL's Shared Pool.

The Shared Pool contains the revenues QSL generates from export sales that are in addition to the raw sugar futures price (ICE11 for world market sales and ICE16 for US market sales).

The additional revenues include:

- The premium paid for Queensland raw sugar reflecting the value of its freight advantage into the East Asian market compared with the next best alternative source of supply.
- The value paid for shipment flexibility such as on-time delivery.
- The value paid for accessing higher quality (in addition to polarisation) Australian raw sugar compared with alternative product that may be available on the world sugar market within the same shipment period.
- A polarisation premium.
- QSL sells raw sugar on to its customers on a “cost, insurance and freight (cif)” basis. Other sellers of raw sugar sell their product on “free on board (fob)” basis. QSL collects revenues from its customers to cover the sea freight costs of shipping sugar.

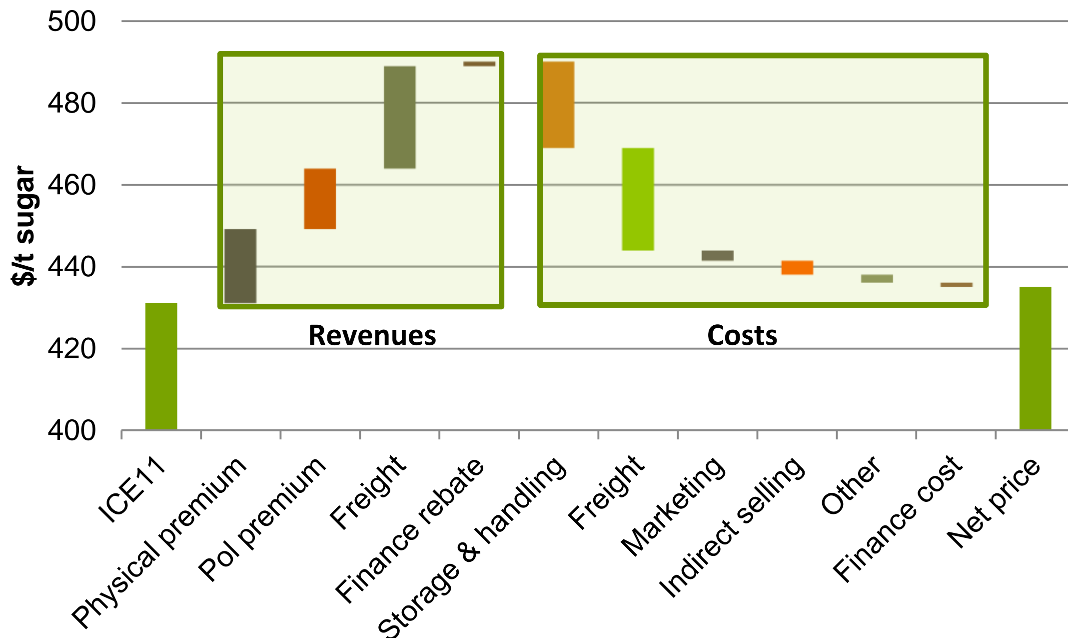
The Shared Pool also receives charges incurred by QSL in the course of completing its sales and costs associated with QSL’s related pooling activities. These include:

- Sea freight costs of shipping sugar (i.e. the cost of delivering raw sugar to customers).
- Discharge port costs (including charges such as those for the supervision of weighing and sampling raw sugar at the customer’s port).
- Banking and execution costs (costs of confirming Letters of Credit, banking fees, future brokerage and other commissions incurred).
- Quota purchases (the cost of acquiring US quota from milling companies that do not supply to QSL under the RSSA).
- Any other costs that relate to marketing activities of QSL, which can include costs for unwinding forward pricing and sales if these tonnages are not received (such as occurred in 2010 season).
- Profits associated with third origin sugar transactions.
- The cost of sugar storage and handing at the bulk sugar terminals.
- The cost of QSL’s raw sugar quality management scheme.
- Raw sugar brand allowances.
- QSL’s direct operating costs (such as rent, wages etc).
- The financing costs of the advance payments scheme and funding of futures’ margins associated with forward pricing

Generally, these revenues and costs are pooled and the costs are allocated to pools pro-rata, based on the tonnage in each pool. However, some revenues and costs are allocated to specific pools, for example those associated with sales to the US market are allocated to the US Quota Pool.

Operating the export marketing system is a significant management task. The Shared Pool receives in excess of $250 million in revenue and defrays a similar amount in costs each year. In managing this aspect of its export marketing operation, QSL stands at arm’s length from Wilmar and other Australian milling companies and their related parties. QSL independently manages these revenues and costs in accordance with its constitutional requirement to act in the best interests of the industry and to maximise returns before returning the net sales proceeds to industry. It does not face the conflicts of interest that can be associated with transactions made between related parties in the supply chain.

1. Shared Pool – a $250M marketing task



The final price QSL declares for each of its pools is determined once all (futures and other) revenues from the sale of the sugar have been collected and all relevant expenses incurred have been deducted.

3.3. Investing in Industry Infrastructure

The industry made a significant investment in the establishment and operation of bulk raw sugar storage and handling. This investment was financed by pool revenues and effectively borne two-thirds by growers and one-third by millers. It introduced a significant structural change to the way sugar was handled and moved the burden of providing raw sugar storage from mills to the wider industry.

Through the QSL Shared Pool, growers continue to share the costs of maintaining and operating the bulk sugar terminals.

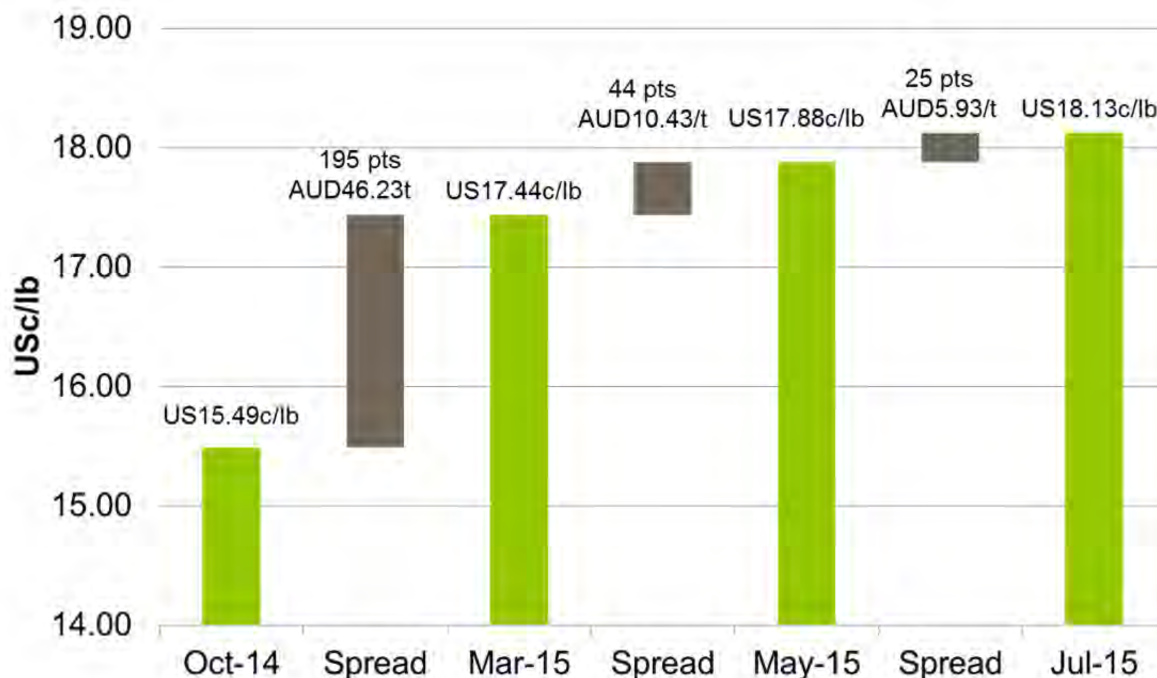
One benefit of the industry's storage capacity is that it provides flexibility over the timing of raw sugar sales. With Brazil the world's largest raw sugar exporter, the world sugar market frequently has a price structure that offers incentives for raw sugar producers to store sugar produced in the second half of the calendar year for sale in the first half of the following calendar year. Prices available for 2014 and 2015 are no exception (figure 2).

The ICE11 raw sugar futures market is presently offering those who are able to store sugar a price incentive of US1.95c/lb (AUD46.23/t) to hold the sugar for delivery in March 2015 rather than in October 2014. A further price incentive of US0.44c/lb (AUD10.43/t) is available to deliver the sugar against the May 2015 contract.

This market structure combined with the storage capacity paid two-thirds by growers and one-third by mills provides opportunity for sellers of Queensland sugar to earn significant

trading profits. All the trading profits QSL generates are paid into the Shared Pool and distributed to growers and millers on the basis of longstanding payment arrangements. Under Wilmar Sugar's marketing proposal, 50% of the trading profits are captured by Wilmar Sugar trading and 50% by the JMC which then distributes the profits to Wilmar Sugar Australia and growers.

2. ICE11 Raw Sugar Prices (29 August 2014)



4. Growers work hard to improve the sugar trading environment

With the price of sugarcane directly linked to the price of sugar, growers have actively engaged in all efforts to improve the prices received from the sale of Australian raw sugar.

Recognising their economic interest in the sugar produced, growers, working closely with mills, were strongly involved in the setting of sugar prices in the regulated price environment, both domestically and internationally:

- Domestic prices were administratively determined until 1989.
- Internationally prices were heavily influenced by government policy.
    - For many years prices for Australia's sugar sales to the major markets in the British Commonwealth were determined through a British Commonwealth Sugar Agreement.
    - Australia participated in the various International Sugar Agreements, including those that required the industry to invest in additional raw sugar storage capacity.

With the failure of international agreements to effectively regulate world sugar prices, growers actively lobbied in favour of and supported actions taken by the Australian Government to remove distortions from the world sugar market.

- In 1989 a successful case was taken in the GATT against the US sugar regime.

- This case secured Australia's quota access to the US market and prevented the US government from implementing an export subsidy program for its surplus sugar.

- Throughout the 1990s, growers were strong advocates for discipline on agriculture to be included in the Uruguay round of trade talks.
- In 1999 the Australian industry with the full support of grower organisations, was instrumental in the creation of the Global Sugar Alliance.
- In 2005 the WTO ruled in favour of Australia, Brazil and Thailand finding that all sugar produced by the EU was subsidised and that the EU was in violation of its WTO sugar export subsidy commitments

CANEGROWERS provides the management resources on behalf of the industry and actively supports the Australian government's trade agenda – multilateral, regional and bilateral.

5. Interdependence of growers and millers

Growers work closely with mills to ensure the long term sustainability of the industry. The most recent illustration of this is the restructuring of the industry's research and development activities and the establishment of a financially sustainable basis for R&D to continue.

The growing and milling sectors have long recognised their interdependence. Growers rely on the mill to which they supply for the efficient processing of their cane and mills rely on cane growers for a supply of cane to their factories. A critical mass of cane production in a region is essential for the economic viability of sugar production and related activities in a region. With the planting of sugarcane being an investment made for a five year crop cycle, for the growth and development of the industry growers need confidence and trust in the long term relationship with the mill to which they supply.

The decisions taken by Wilmar, MSF Sugar and Tully Sugar to exit QSL have shaken this relationship to its core, undermining confidence and reducing growers' appetite to invest.

6. Mill marketing proposals

To-date, only Wilmar Sugar has put forward a model for how it plans to market sugar for the 2017 season and beyond. Reflecting their disregard for the interests of growers and demonstrating their use of monopoly power, MSF Sugar and Tully Sugar have not revealed their marketing model and have not engaged with growers in the development of their marketing model, whatever it may be.

6.1. Wilmar's model

The features of Wilmar Sugar's proposed approach to marketing are:

1. To market all of the raw sugar produced in its mills.
   - In making this decision Wilmar denies growers' a say over how their economic interest sugar produced is taken to the market
2. Wilmar Sugar acknowledges and ascribes to growers a notional sugar exposure (NSE).
   - It appears that Wilmar's calculation of NSE is equivalent to the calculation of GEI sugar defined in the RSSA.

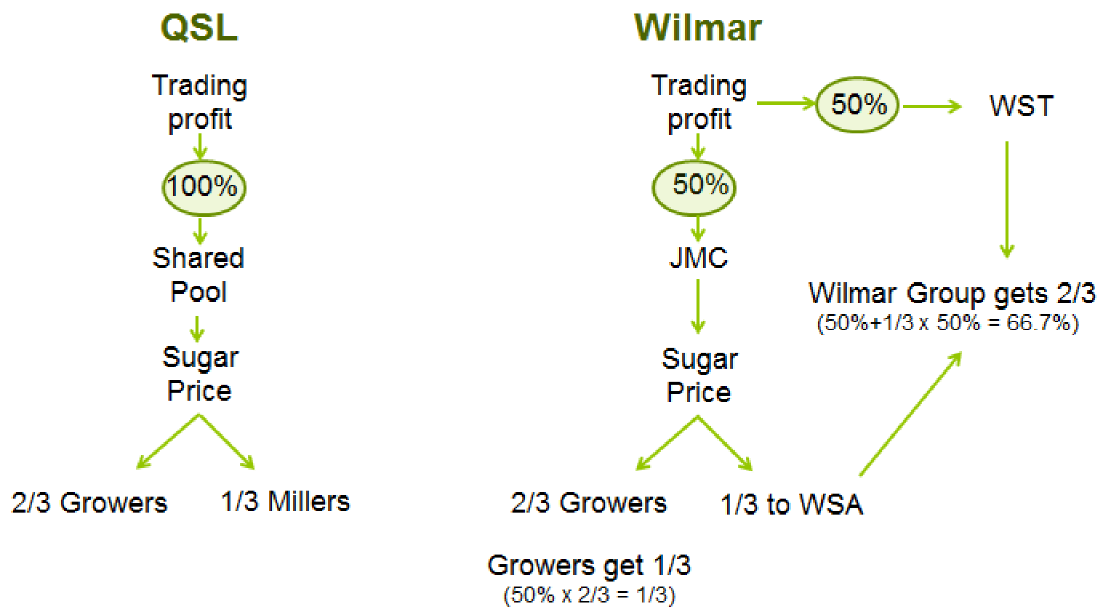
3. Wilmar Sugar is proposing that growers have NO choice in how their share of the sugar (either GEI or NSE) is sold.
4. Wilmar plans to establish a "Joint Marketing Company" (JMC) to oversee the marketing of its sugar
   - The Board of the JMC will include grower representatives.
5. The JMC will not market the sugar and will not make day-to-day marketing or price risk management decisions. It will enter a fifteen (15) year non-contestable services agreement with Wilmar Sugar Trading (a member of the Wilmar Group) to market the sugar.
   - Growers will not be involved in any marketing decisions.
6. The JMC will enter a separate service level agreement with Wilmar Sugar Australia to manage the flow of net proceeds from sale to growers.

Principal amongst the CANEGROWERS and ACFA concerns with the Wilmar Sugar model is its lack of transparency and the risk of intra-company transfer pricing to which it exposes growers. Wilmar Sugar's documents make it clear that Wilmar Sugar Trading's (WST) activities will not be open to grower scrutiny, nor will its trading books be subject to grower audit. Even if WST's trading operations were open to grower audit, that audit would only examine the actual transactions made. It would not reveal an arbitrage or other futures market related transactions that WST has engaged in and made on the basis of its knowledge of its own dealings with the Queensland component of its trading portfolio.

Wilmar Sugar's model enables the Wilmar Group to capture market rewards while sharing the associated risk with growers. With QSL selling sugar, growers share in 100% of the profits generated from QSL's trading activities (figure 3). Wilmar Sugar's documentation makes it clear that the JMC will share in only 50% of the trading profits Wilmar Sugar Trading generates on its trading activities associated with sugar produced in Queensland. This dilutes the returns growers will receive from trading profits.

- Under QSL's marketing structure, all trading profits are paid into the Shared Pool and distributed to growers on the basis of cane payment arrangements. Growers are entitled to and receive approximately two-thirds of the trading profits.
- Under Wilmar Sugar's model, Wilmar Sugar Trading retains 50% of the trading profits and pays the remaining 50% to the Joint Marketing Company. The JMC then distributes the profits on the basis of cane payment arrangements. This means growers are entitled to and receive approximately one-third (50% of two-thirds) of the trading profits.

3. Profit Sharing for GEI sugar – QSL model compared with Wilmar JMC



Note: WST refers to Wilmar Sugar Trading and WSA refers to Wilmar Sugar Australia.

Wilmar's model heavily skews the returns to Wilmar. The Wilmar Group receives two-thirds of the trading profits while growers receive one-third. This means Wilmar will need to generate <u>twice</u> the trading profits that QSL generates for growers to achieve a better return from the Wilmar's proposed marketing approach.

As noted, the 1912 Royal Commission was concerned that the competitive forces in the Australian sugar industry were not effective as a means of securing an equitable distribution of profits in the industry. Wilmar's proposed marketing structure shows that in the absence of regulations, mill owners are again looking to capture a greater share of the industry's profits at the expense of growers.

7. *Competition and Consumer Act 2010* (CCA)

The unconscionable conduct provisions of the commonwealth CCA have not been a helpful source of protection to producers in the agricultural sector and government intervention is required to provide transparency in the supply chain. This includes recognition that certain classes of suppliers, such as sugarcane producers, are predisposed to suffering from a special disadvantage because of their production of sugarcane, a perishable good, and exposure to a regional monopsony (monopoly buyer) of that product.

When considering the misuse of market power, the intervention must:

i. Level the balance of market power in negotiations for the intermediate product (which in the case of the sugar industry is sugarcane) between contracting parties, primary producers and the regional monopoly mill they supply.
ii. Ensure transparency in the transmission of market prices along the supply chain and does not allow for final market risks to be borne by the primary producer when the market rewards are captured by the processor of the primary product.

iii. Provide transparency of contract processes to allow for compliance and enforcement "audits" to ensure there has been no misuse of market power.

An important reason for government action is to prevent or ameliorate the effects anti-competitive conduct is likely to have in the marketplace, rather than waiting to remedy the situation when the market behaviour has caused far-reaching social and economic dislocation.

A process that gave the ACCC greater power to regulate anti-competitive behaviour and impose penalties where anti-competitive behaviour has been found would shift the decisions framework from the judicial system to a regulatory system, making it more accessible to small producers facing large multinational adversaries. Until the ACCC has those powers, state government intervention is both warranted and consistent with the central tenets of National Competition Policy.

Section 46

The Chairman of the Australian Competition and Consumer Commission (ACCC) made several remarks in the 25 February 2015 Public Hearings of the Senate Economics Legislation Committee (Estimates) in relation to Section 46 of the Australian *Competition and Consumer Act 2010* (CCA) in response to questions from the Committee.

In those Senate Estimates hearings Senator Dastyari expressed a concern of many small businesses that the current system does not enable them to easily address anticompetitive behaviour of larger businesses.

In his response Mr Sims identified deficiencies in the CCA saying in relation to Section 46 in part:

> "… the provision is a competition provision. It only kicks in if you are misusing your market power to damage one of your competitors. If you are just doing something nasty to someone downstream or upstream, it is not a misuse of market power" (Hansard, p139).

In their final report, *Competition Policy Review* (31 March 2015), the Harper Committee also found Section 46 of the CCA is "deficient in its current form". The Committee reports:

> "It does not usefully distinguish pro-competitive from anti-competitive conduct. Its sole focus on 'purpose' is misdirected as a matter of policy and out of step with international approaches.
>
> Section 46 should instead prohibit conduct by firms with substantial market power that has the purpose, effect or likely effect of substantially lessening competition, consistent with other prohibitions in the competition law. It should direct the court to weigh the pro-competitive and anti-competitive impact of the conduct" (Harper Review, p9).

On 15 May 2014, CANEGROWERS and ACFA wrote to the ACCC raising concerns about mills misusing their regional mill monopoly processing power by coupling their sugar production and marketing activities in contravention of Section 46. By denying growers' rights and preventing them from exploring competitive offers and engaging the sales and marketing services of others, sugar mills are engaging in anticompetitive behaviour. In the short term,

this exercise of their monopoly market powers will substantially damage or eliminate QSL as a competitor. In the longer term it will prevent the entry of new suppliers, and with it, will prevent the development of a market of these services. We also expressed concern that Wilmar's proposed marketing structure is an arrangement that would be in contravention of Section 47 of the CCA which prohibits exclusive dealing.

The ACCC Chairman and the conclusions drawn by the Harper Review make it clear that as presently cast the provisions of Section 46 do not adequately deal with cases where there are significant imbalances in market power between different segments of a supply chain as occurs between sugarcane growers and the mill they supply and where the use of that market power has the likely effect of substantially lessening competition.

In response to Senator Canavan's question in relation to Section 46 of the CCA: It is clear that Section 46 of the CCA does not effectively deal with monopsonistic situations such as those confronting sugarcane growers where mills' actions have "the purpose, effect or likely effect of substantially lessening competition in that or any other market" (Harper Review, p23). A *bona fide* role for government is to restore balance in the market for sugarcane and to establish a regulatory structure that prevents the misuse of market power, addresses market failure, and ensures cane growers are not disadvantaged by the mills they supply.

In the case of the Senate's present review of sugar marketing, time is of the essence. Growers need a framework in which they can have confidence to enable their ongoing investment in the industry. In the normal course of business, pricing and investment decisions are made well before the commencement of a season. For the 2017 season, a critical time is the commencement of the 2015 season, when the first investment decisions will be made following the Wilmar, MSF Sugar and Tully Sugar announcements of their withdrawal from QSL and subsequent notice of termination of cane supply agreements.

Passage of the Enactment of the Sugar Industry (Real Choice in Marketing) Amendment Bill 2015 will provide a timely resolution of a competition policy issue faced by the sugar industry, and issue so clearly enunciated by Mr Simms and by the Harper Review Committee.

8. Compliance with Australia's International Obligations

Chapter 8, the investment chapter of SAFTA, provides for investor-state dispute settlement (ISDS). Article 16 contains the dispute settlement mechanism for the obligations set out elsewhere in the investment chapter (Articles 3 – 15). This means that Singaporean investors with investments in Australia can bring a claim against the Australian Government directly for perceived breaches of the SAFTA investment chapter. This includes in relation to actions by State Governments. Of course, simply bringing a claim does not guarantee its success.

- ISDS is focused on investment obligations such as treating foreign investors in a non-discriminatory way, protecting investments from expropriation and providing a certain minimum standard of treatment.

- ISDS does not prevent the Government from changing its policies or regulating in the public interest. It does not freeze existing policy settings. It is not enough that an investor does not agree with a new policy or that a policy adversely affects its profits.

The provisions of SAFTA do not impede the Government from amending existing legislation or introducing new non-discriminatory legislation or regulations that address market failure and are in the pursuit of good government in Queensland.

As a non-discriminatory amendment to the *Sugar Industry Act 1999*, the Bill does not interfere with Australia's international obligations under the WTO, or any bilateral or regional trade agreement Australia has entered or is currently negotiating. With specific reference to the Singapore-Australia Free Trade Agreement (FTA), the legal firm Maddocks provided advice that the proposed federal Mandatory Code of Conduct does not directly or indirectly expropriate property rights and would be consistent with Australia's international obligations (**attached**). The same conclusion applies to the non-discriminatory Queensland *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015.*

9. Commercial Dispute Resolution

A problem faced in cane supply contract negotiations is that there is no recourse to a commercial dispute resolution system if agreement cannot be reached.

A recent example is that despite a number of signed letters from Tully Sugar and its owner COFCO, Tully Sugar has not agreed to include a dispute resolution process in the terms of the collective cane supply agreement.

With the collective agreement unresolved, the only choice growers had if they wished to supply cane for the 2014 season, was to sign an Individual Cane Supply Contract with the mill.

This is strong evidence of the mill exercising its regional mill monopoly power and the imbalance in negotiations between growers and mills, even when agreements have previously been entered in good faith.

Attachment 2

Deloitte Access Economics

Raw Sugar Marketing Arrangements Study

CANEGROWERS and Australian Cane Farmers Association

11 June 2015

Deloitte.

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11 June 2015

Dear Mr Males & Mr Ryan

Re: Raw Sugar Marketing Arrangement Study

In accordance with our engagement letter dated 23 April 2015, this report reviews current and potential future sugar industry impacts in light of legislative changes that applied to sugar marketing arrangements from 2006.

This is the final document. We accept no duty of care or liability to you or any third party for any loss suffered in connection with the use of this document. This document has been updated to contain the latest information available.

If you have any comments on this final document, please contact Helen Stehbens (Principal Advisor) on [redacted] or [redacted] alternatively, myself on [redacted] or [redacted].

Yours sincerely,

Mark Ingham

Partner

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Figure 2.5 : CANEGROWERS and ACFAs proposed pathways to market for GEI sugar..............17

Glossary

ACCC	Australian Competition and Consumer Commission
ACFA	Australian Cane Farmers Association
COFCO	China National Cereals, Oils and Foodstuffs Corporation
CSA	Cane Supply Agreement
CCA	Competition and Consumer Act
GEI	grower economic interest
GFA	GEI Facilitating Agreement
MEI	miller economic interest
MT	megatonne
QCA	Queensland Competition Authority
QSL	Queensland Sugar Limited
RSSA	Raw Sugar Supply Agreement
SIA	Sugar Industry Act
SIC	Sugar Industry Commission

Executive Summary

Queensland has gained a reputation of being an exporter of premium quality sugar. The development of this reputation has, in part, been supported by a comprehensive legislative and regulatory environment. This environment changed from 2006 and the challenge for the industry as it undergoes further structural change is whether there needs to be further regulatory change. In particular, preservation of competition in sugar marketing could be an area of focus as the industry undergoes further structural change.

The sugar industry in Queensland is one of the major agricultural export earners for the State. In April 2015, CANEGROWERS and the Australian Cane Farmers Association (ACFA) requested that Deloitte Access Economics consider examine the impact of potential changes in industry structure and market participation that may eventuate as a result to changes to the sugar marketing arrangements. This report was prepared primarily on the basis of publicly available information.

The Queensland sugar industry has been a highly regulated industry since the first legislation was enacted in 1915. However, major changes to this environment have been actuated through legislative changes, which have been applied since 2006. One of the key changes has been the removal of Queensland Sugar Limited's (QSLs) exclusive marketing powers for all of Queensland's export sugar. This has provided the opportunity for millers, who process the cane into raw sugar, to sell the raw sugar directly, without recourse to QSL.

Although growers do not have an explicit legal title in the cane once it is delivered to the millers, they have a clear economic interest in the sugar produced as reflected in the cane payment arrangements. By changing the traditional, long held practice of growers retaining an economic interest in the product from cane production through to marketed raw sugar, the influence of growers will decrease significantly, as will, the strength of the industry-owned marketing body, QSL.

The structure of the industry has evolved since the introduction of the current regulatory framework. Mill ownership has been significantly consolidated over the last two decades. In 1997, 12 companies operated 29 sugar mills across Australia. By 2013, seven companies operated 24 sugar mills. This consolidation has resulted in Wilmar International Ltd operating the largest number of mills in Queensland with eight mills while Mitr Phol Sugar Corp and Mackay Sugar both operate the second largest number of mills with four each. This consolidation experienced in milling activity has not been observed in the growing task in Queensland.

A change in the balance in market power between millers and growers, and between millers and marketers, may be detrimental to the overall strength and sustainability of the Queensland sugar industry into the future. The change in the structure of the industry over the last decade and a rising imbalance of market power has warranted a further review of the current sugar industry regulatory environment to ensure it provides the best overall outcome for the sugar industry into the future.

After reviewing the current and potential future sugar industry impacts in light of legislative changes that applied to sugar marketing arrangements from 2006, Deloitte Access Economics made the following conclusions:

1. future industry changes should address the imbalance of market power between growers and millers and enable growers to elect who markets GEI sugar. This would be pro-competitive for the industry's marketing process and would help limit the extent of market fragmentation;
2. a form of light-handed regulation could be introduced by adopting a federal mandatory code of conduct for the sugar marketing arrangements under the CCA and / or through the enactment of equivalent regulatory structures by amending the Queensland SIA; and
3. in the instances where commercial negotiation is not possible, a commercial dispute resolution process may be required to resolve any pre- or post-contractual deadlocks when reaching an agreement over future cane supply and raw sugar marketing arrangements.

1 Introduction

1.1 Introduction

DAE was engaged by CANEGROWERS and ACFA to review the potential industry impacts of a number of sugar mills withdrawing from the current marketing arrangements with QSL. Wilmar International Limited (Wilmar), Mitr Phol Sugar Corp (MSF Sugar) and China National Cereals, Oils and Foodstuffs Corporation (COFCO) have signalled their intention to withdraw from the current marketing arrangements under the industry-owned, not-for-profit marketing body, QSL.

The millers have proposed taking over pricing and marketing of all sugar - including grower economic interest (GEI) sugar - from July 2017. GEI sugar represents approximately a two-thirds share in the value of sugar sold by marketing entities.

The proposed withdrawal from current marketing arrangements by millers has caused opposition from many growers concerned about lack of transparency involved in the marketing process of GEI sugar and the potential risks that this may have on growers' returns.

1.2 Structure of report

The remainder of the report is structured as follows:

- **Chapter 2** provides a high level background to the industry and issues facing the industry in regard to marketing arrangements;
- **Chapter 3** analyses the impact of changes in industry structure on the balance of market power in the sugar industry and potential competition issues that may arise from imbalances in market power; and
- **Chapter 4** provides options that may be adopted to ensure the maximisation of the efficiency of the sugar industry in general.

2 Background

Deloitte Access Economics was engaged by CANEGROWERS and ACFA to review the potential industry impact of a number of sugar mills withdrawing from the current marketing arrangements with QSL during the 2017 season.

Sugar is one of the largest and most important rural industries in Queensland. It has also developed a unique industry structure within the agricultural sector. Regulation has, for the most part, been updated to reflect industry changes over time.

2.1 Sugar industry overview

Sugar is one of the most important and largest rural industries in Queensland, with sugarcane being the largest agricultural crop in Queensland and nation's seventh largest agricultural crop[1]. Up to 35Mt of sugarcane is harvested annually, which creates 4.5Mt of raw sugar (plus other by-products). Approximately 95% of the nation's sugar originates from Queensland, generating up to $2 billion dollars in export earnings for the Queensland economy[2].

The Australian sugar industry consists of approximately 4,000 cane farms covering 380,000 hectares, 24 sugar mills owned by eight separate milling companies and six bulk storage ports. The sugar industry directly employs approximately 16,000 workers across the growing, harvesting, transportation and milling sectors[3].

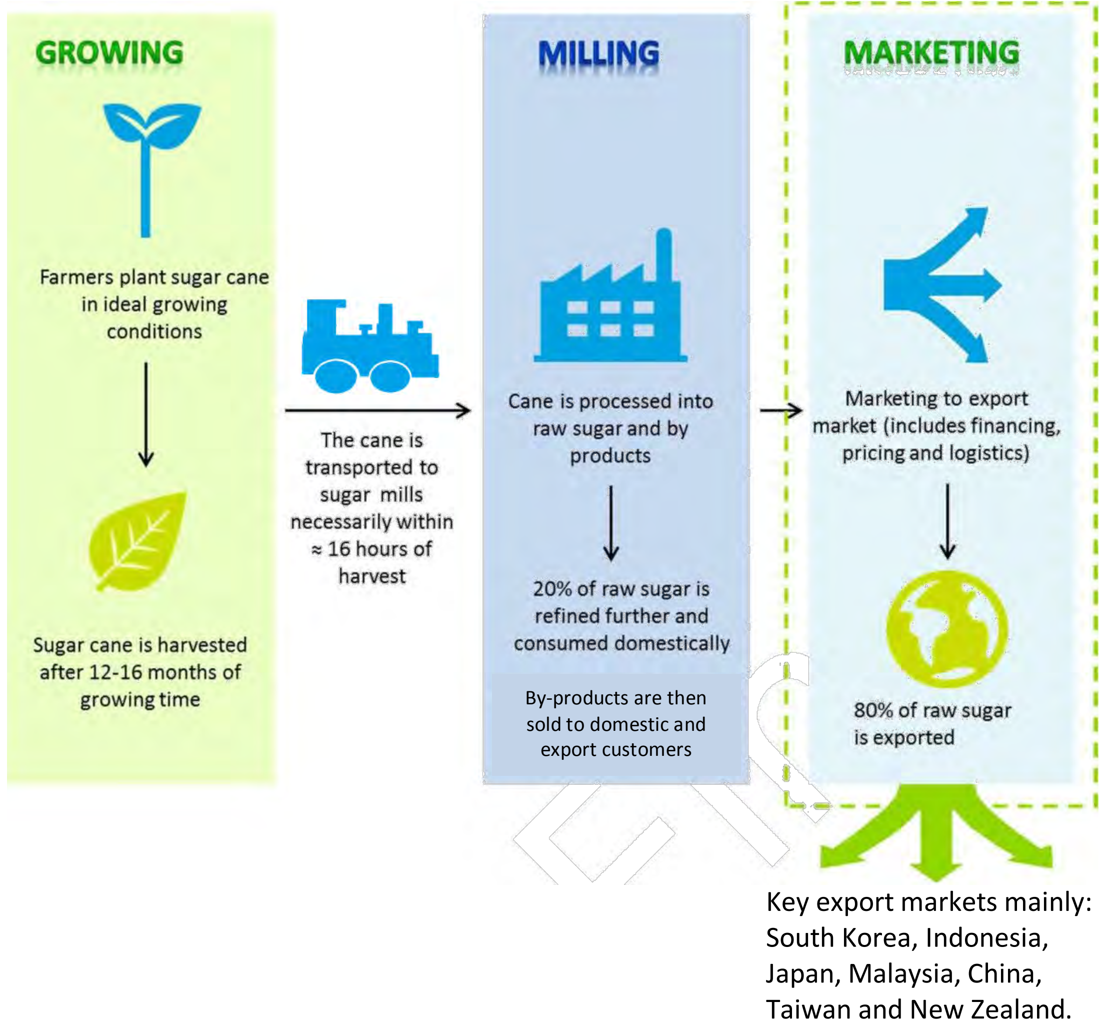
Figure 2.1 below provides an overview of the Australian sugar industry. As illustrated in the figure, the sugar industry is somewhat different to other agriculture industries due to the short time frame available (around 16 hours) from the time of harvest to commencement of crushing or milling of the cane. This provides strong interdependencies between the grower and miller. The dependence of the grower on the miller is further heightened by the lack of viable alternative mills located within a suitable proximity to the harvest location. These constraints on processing time and processing location, observed in the sugar industry, are somewhat unique within the agriculture industry, and mean that growers typically have no economic alternative than to do business with their local millers.

[1] www.sugarresearch.com.au

[2] www.agriculture.gov.au/ag-farm-food/crops/sugar

[3] www.asmc.com.au and www.canegrowers.com.au

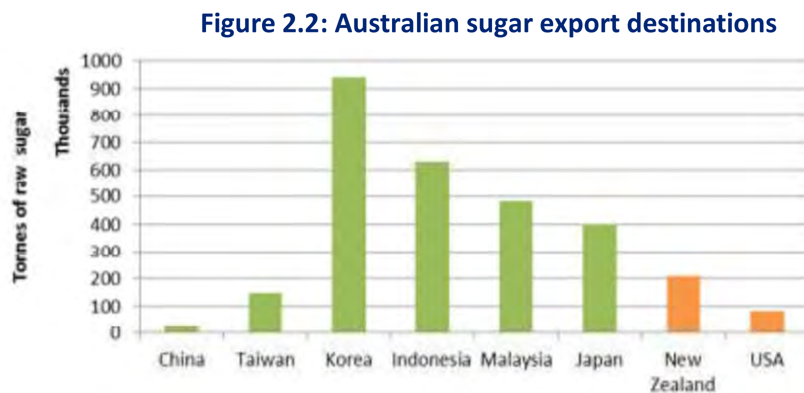
Figure 2.1: Queensland sugar industry structure



2.2 Raw sugar exports

Australia produced approximately 2.5% of global sugar output in 2014/15, ranking it between the seventh and ninth biggest producer, depending on seasonal variations each year[4]. Despite this, Australia is one of the world's largest exporters of raw sugar, and depending on seasonal variation, ranks from second to fourth largest exporter of raw sugar after Brazil[5]. Figure 2.2 illustrates that the primary export destinations for Australian sugar are all within East Asia, with South Korea, Indonesia, Japan and Malaysia being the most important markets, with relatively small amounts also exported to New Zealand and the USA[6]. Australia's capacity to store two million tonnes of sugar in a network of bulk port terminals means that customers in the Asia-Pacific region can be supplied all year round.

Figure 2.2: Australian sugar export destinations



Source: CANEGROWERS submission to Joint Select Committee on Northern Australia, 18 March 2014

Australian sugar is a preferred product by many of the world's major raw sugar importers, due to its reputation of quality, innovation and service. The Australian sugar industry's superior levels of efficiency, reliability and cost competitiveness are reflected in high market share and long-standing customers[7]. As approximately 80% of sugar produced in Queensland is exported, marketing plays a vital role in the industry and is seen as a specialised task that is complementary to growing and milling[8]. Changes to the structure of the marketing component, potential impacts of those changes on the sugar industry and possible options for adjusting to the changes are the focus of this report.

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[4] http://apps.fas.usda.gov/psdonline/circulars/sugar.pdf

[5] www.canegrowers.com.au/page/Industry_Centre/About_Us/About_the_Industry/; www.thefarmsite.com/reports/contents/AustraliaSugar23April2014.pdf

[6] www.agriculture.gov.au/agriculture-food/crops/sugar

[7] www.canegrowers.com.au/page/Industry_Centre/About_Us/About_the_Industry/

[8] www.agriculture.gov.au/ag-farm-food/crops/sugar

2.3 Legislative and regulatory changes in the sugar industry

Legislation to regulate the Sugar Industry in Australia was introduced in 1915, following a 1912 Royal Commission, leading to compulsory acquisition of raw sugar as well as regulations making the price of cane directly dependent on the price of raw sugar. This linked sugar cane pricing to returns for growers and millers.

Towards the end of the twentieth century, there was a drive by industry and government for regulatory reform, gradually leading to a deregulation of the sugar industry in Queensland. A summary of the regulatory changes are outlined as follows:

- 1991 – *Sugar Act 1991* was introduced - the Queensland Sugar Corporation (QSC) was established as a statutory authority;
- 1992 – The Council of Australian Governments (COAG) commissioned an Independent Committee of Inquiry into National Competition Policy, resulting in a package of reforms called the National Competition Policy. These reforms included:
  - 'Trade Practice' laws extended to prohibit anti-competitive activity;
  - introduction of 'competitive neutrality' allowing private firms to compete with Government fairly; and
  - review of all laws restricting competition (unless community benefits outweigh restrictions).
- 1995 – The Sugar Industry Review Working Party (SIRWP) review of sugar legislation using the National Competition Policy found that the *Sugar Act 1991* restricted competition by:
  - restricting supply of land that could be used for sugar cane production;
  - compelling all growers and mill owners to bargain collectively;
  - prohibited growers from transferring cane supply between mills without consent; and
  - vesting ownership of raw sugar to the QSC, thereby creating a monopoly on the sale of Queensland sugar.
- 1996 – the SIRWP report made 74 recommendations for industry reform, including:
  - for the Queensland Government:
    - retention of domestic and export monopoly, subject to the pricing of domestic sales at export price parity;
    - permission for growers to negotiate individual agreements with mills and transfer their supply to other mills when collective supply agreements expire; and
    - placement of a ten-year moratorium on the future review of marketing arrangements.
  - for the Commonwealth Government:
    - removal of the tariff on raw sugar imports.

- 1999 – *Sugar Industry Act 1999* (“the SIA”) replaces *Sugar Act 1991*. In regards to marketing, it retains QSCs compulsory acquisition and single-desk selling powers for Queensland sugar;
- 2000 – Sugar Industry Amendment Bill 2000:
  - established QSL to replace QSC as the exclusive marketer of Queensland raw sugar;
  - set up a review of sugar vesting arrangements;
  - clarified that cane growers have the ability to move from collective to individual supply agreements; and
  - ownership of export terminals moved to Sugar Terminals Ltd and distributed shares of company to growers and millers.
- 2004 – Sugar Industry Reform Bill 2004:
  - established Working Group to 'develop voluntary marketing arrangements as soon as possible' and 'to work towards a new system for marketing of raw sugar prior to the requirement for review in 2006;
  - removed restrictions on growers being able to transfer cane from one mill to another;
  - the statutory bargaining system replaced by a system providing growers greater choice in regard to bargaining with millers;
  - changes in the dispute resolution process that included compulsory arbitration to be replaced by a system decided by industry parties for 2006 and beyond; and
  - exemptions from the vesting of sugar were made possible (for specific purposes) from 1 July 2004.
- 2005 – Sugar Industry Reform Bill 2005:
  - memorandum of understanding between the Queensland Government, the Australian Sugar Milling Council and CANEGROWERS to progress into new marketing system arrangements;
  - provided the legislative changes necessary for the implementation of the new marketing system;
  - removed statutory vesting of the Queensland sugar crop;
  - allowed the introduction of voluntary marketing arrangements; and
  - authorised QSL, for the purposes of the Trade Practices Act 1974 (TPA), to negotiate, for three years, commercial export contractual arrangements with millers for collective selling and uniform pool pricing.
- 2007 – Primary Industries Acts Amendment and Repeal Bill 2007:
  - amended Sugar Industry Act 1999 by removing mediation functions of the Office of the Sugar Industry Commissioner (SIC).
- 2008 – Primary Industries and other Acts Amendment Bill 2008:
  - dissolution of the Office of Sugar Industry Commissioner; and
  - changes to access rights arrangements and determination of access rights arrangements.

2.4 Impacts of reforms from 2006

In 2004, a tri-partite Working Group was established to develop recommendations for the review commencing in 2006. This working group developed a paper which provided recommendations as to how to replace compulsory vesting arrangements with a contractually based marketing company. While other corporate structures were involved, it was determined that QSL should be used as the base model. More specifically, 11 recommendations were made that are detailed in Table 2.1 below.

Table 2.1: Working Group 2004 recommendations

Recommendations	
1	QSL should be the vehicle used as the basis for a contractually based sugar marketing company.
2	In order to ensure maximum participation and ensure that transformation takes place in a timely manner, the Working Group proposes that the initial contractual arrangements between the marketer and suppliers include obligations on the marketer to meet defined milestones by due times. A failure to meet a milestone could enable the supplier to opt out of the supply contract.
3	Sections of the Sugar Industry Act 1999 covering vesting and marketing of sugar in QSL operate only for the 2005/06 season. To facilitate the introduction of commercial, contractually based marketing arrangements from the 2006/07 season, transitional arrangements would need to be introduced during 2005 to enable QSL to enter into contractual arrangements with suppliers.
4	The Board of the marketing company should take appropriate steps to address the ownership structures of the company once commercial operations have been commenced. Structural change will necessitate referral to and support of current members.
5	There should be sufficient grower and miller representation on the Board of the marketer to ensure transparency and a number of independent directors to bring a depth of experience and diversity of skills and perspectives. The present composition and skill base would need to be flexible as to ensure that the company is able to respond to a more standard business framework.
6	The Working Group proposes that, subject to taxation and legal advice, the Constitution of QSL has six amendments.
7	It is recommended that rules relating to participation, entry and exit would be determined by the Board of the marketer in consultation with suppliers and incorporated into supply contracts. It is recommended that the goal of the marketer is that suppliers should commit to 100% of bulk raw sugar for export.
8	It is recommended that the initial contract arrangement be finalised no later than 31 December 2005 and that the term of that contract should be three years. Beyond that initial three year period, a rolling two year period could be appropriate.

9	It is recommended that the marketer focus on marketing bulk raw sugar for export under contractual arrangements with suppliers.
10	Initially treasury, risk management and pooling functions would be similar to current arrangements, but the marketer is expected to develop in the transition to standard business practice more innovative arrangements.
11	Bulk sugar terminals and storage operations would continue to be similar to current arrangements. The marketer, in conjunction with STL, will have to develop a third party access protocol prior to the commencement of the 2006/07 season.

Source: Department of Agriculture, Fisheries and Forestry, 2004

The impacts of the recommendations on the sugar industry include:

- QSL no longer compulsorily acquire raw sugar after milling;
- deregulation of bulk sugar export market – suppliers would enter into an initial three year commercially negotiated contractual arrangement with QSL as marketer. Suppliers could opt out after the initial three year period, in accordance with an agreed notice period;
- deregulation of domestic sugar market (statutory price control removed); and
- deregulation of non-bulk sugar for the export market (bags, containers and other forms of sugar).

The Working Group's recommendations were subsequently accepted by industry growers, millers and the Government, and a Memorandum of Understanding was executed between the Queensland Government and Industry (CANEGROWERS and the Australian Sugar Milling Council) to proceed with the proposal of a new marketing system.

The *Sugar Industry Amendment Act 2005* consequently came into operation at the beginning of 2006, deregulating the industry and bringing in the new system of voluntary contract-based marketing arrangements. These voluntary marketing arrangements took the form of raw sugar supply agreements (RSSAs), which have three year terms, between QSL and millers, and provided millers with increased flexibility to sell their miller economic interest (MEI) sugar.

The structure of the industry has evolved since the introduction of the current regulatory framework in 2006. There are now over 4,000 cane farm businesses being serviced by seven companies at 24 mills. This has reflected an increase in concentration of ownership in milling as 12 of the 24 mills are now owned by two companies.

2.5 Industry development

Since 2005, the Queensland sugar industry has seen a number of ownership and structural changes. A majority of the mills have been consolidated with Wilmar becoming the largest miller in Queensland by 2010. In 1997, 12 companies operated 29 sugar mills across Australia (excludes the Tableland Mill which commenced crushing the following year). By 2012, nine companies operated 24 sugar mills[9]. This has since reduced to eight companies operating the 24 sugar mills in Australia[10].

On 21 May 2014, Wilmar served notice, as required under the existing voluntary system, that they will be exiting the current marketing system at the end of the 2016 season. In place of the current marketing system, a joint marketing partnership has been seen by Wilmar to be "*in the best interests of growers and Wilmar*"[11]. However, many growers and growers' collectives are not in favour of this partnership and view it as an impediment in maximising value for GEI sugar. Peak representative body CANEGROWERS has reported that 97% of growers want to be able to choose the marketer of their sugar and 93% said they don't trust their miller to share profit fairly if they are not made to do so[12]. Approximately two thirds of the value of sugar sold by markets is distributed to growers. Hence, they have a strong economic interest in the outcome of their produce and, as such, are requesting the right to say where and how their sugar is marketed. Concerns have been raised regarding the ability of Wilmar to gain better returns than QSL as well as the potential for a lack of transparency across the supply chain.

Under Cane Supply Agreements (CSAs), growers supply the cane, along with explicit legal title of the cane, to mills. These agreements also include the 'cane payment formula', which links the price the growers receive for their cane to the raw sugar price. More specifically, the formula attributes approximately two thirds of the value of the raw sugar to the cane and about one third to the milling process, hence growers have an economic interest for more than half of the raw sugar produced[13]. Although growers do not have an explicit legal title in the cane once it is delivered to the sugar mill for crushing, growers have an intrinsic economic interest sharing in the risks and rewards from the sale of sugar. This is reflected in the current cane payment arrangements.

In order for the industry to operate sustainably, the cane payment formula should reflect the efforts and risks - including investment, inputs and costs - of the growers and millers.

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[9] www.acfa.com.au/sugar-industry/sugar-milling/

[10] asmc.com.au/industry-overview/statistics/

[11] Wilmar media statement, 21 May 2014

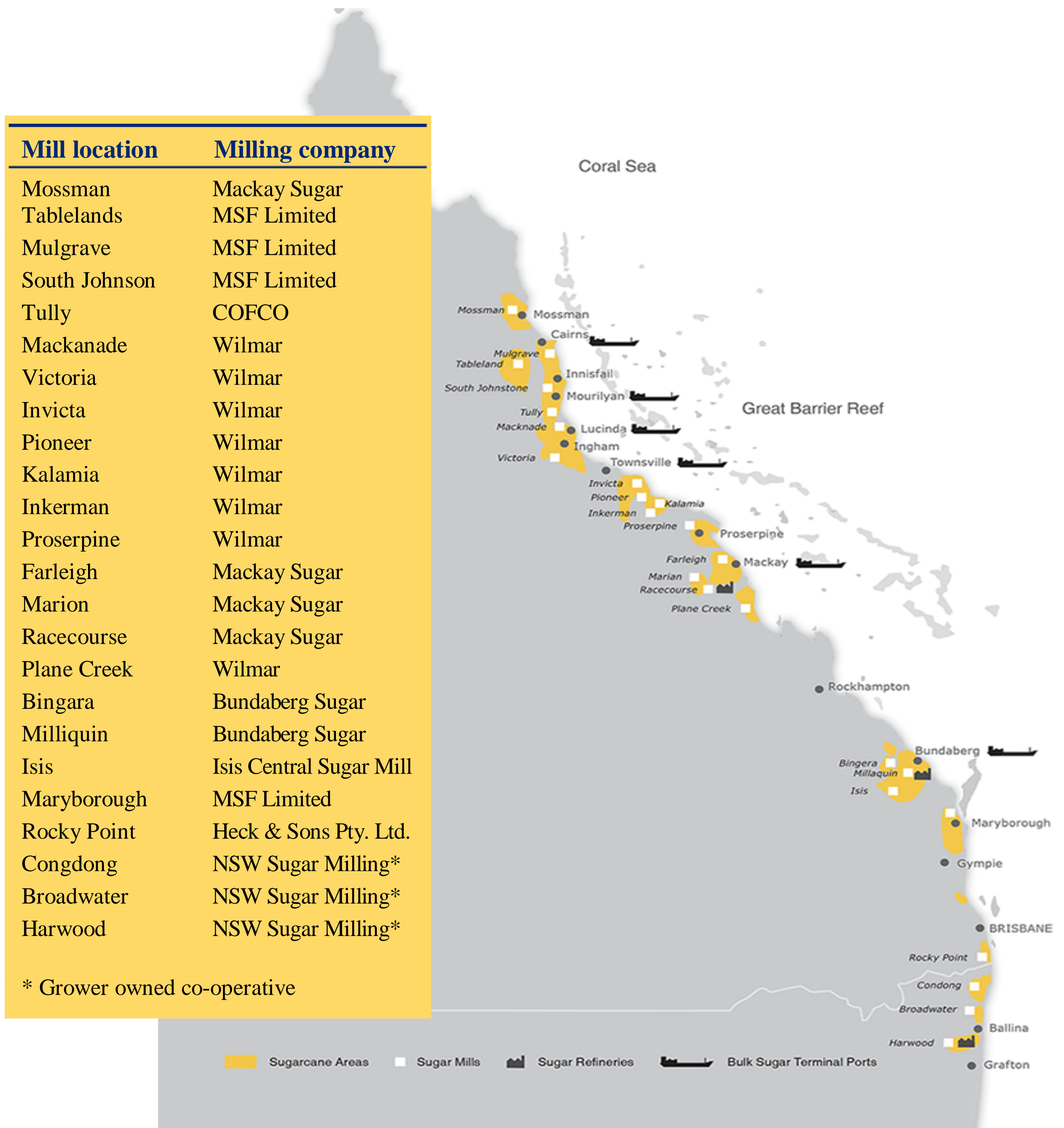
[12] CANEGROWERS media release, 21 January 2015

[13] Queensland Sugar Limited: Paper for the Federal Rural and Regional Affairs & Transport References Committee

Any imbalance of returns provided to millers or growers may have a negative impact on the broader sugar industry, not just on individual growers or millers.

As noted above, the structure of the industry has evolved since the introduction of the current regulatory framework established for the sugar industry. This consolidation has resulted in Wilmar becoming the largest miller in Queensland with eight mills, while MSF Sugar and Mackay Sugar operate four mills each. In New South Wales, there is one grower owned co-operative, NSW Sugar Miling, that operating three mills. Mill ownership is illustrated in Figure 2.3 below.

Figure 2.3: Australian sugar industry map - mill ownership



Mill location	Milling company
Mossman	Mackay Sugar
Tablelands	MSF Limited
Mulgrave	MSF Limited
South Johnson	MSF Limited
Tully	COFCO
Mackanade	Wilmar
Victoria	Wilmar
Invicta	Wilmar
Pioneer	Wilmar
Kalamia	Wilmar
Inkerman	Wilmar
Proserpine	Wilmar
Farleigh	Mackay Sugar
Marion	Mackay Sugar
Racecourse	Mackay Sugar
Plane Creek	Wilmar
Bingara	Bundaberg Sugar
Milliquin	Bundaberg Sugar
Isis	Isis Central Sugar Mill
Maryborough	MSF Limited
Rocky Point	Heck & Sons Pty. Ltd.
Congdong	NSW Sugar Milling*
Broadwater	NSW Sugar Milling*
Harwood	NSW Sugar Milling*

* Grower owned co-operative

2.6 Industry interdependence

The sugar industry features a high degree of interdependence. Growers are highly dependent on millers to process their cane. Conversely, millers rely on growers to supply cane as a necessary input to produce raw sugar. The two parties must necessarily coexist for the industry to survive, let alone to further grow and develop.

Growers are highly dependent on their nearby millers for their financial sustainability. However, because of geographic and infrastructure constraints, most growers have extremely limited choice in which miller they end up supplying. Growers only have a short time to transport cane before processing (approximately 16 hours), so they must choose a mill that is in close proximity. Moreover, the decision as to which mill a grower chooses to supply cane to becomes even more restrictive due to the significant additional cost of transporting cane to the next closest mill. Finally, there are also high costs involved for growers in diversifying to other crops. This means that cane growers are in business only when their local mills are in business.

Millers operate a high fixed cost operation, which means that they require a critical mass of cane production to be financially viable[14]. In fact, the Chief Executive of the Australian Sugar Milling Council, Dominic Nolan, argued, albeit subjectively, at a public Senate Standing Committee meeting that mills are under-capacity and that if the mills were to "*lose 10 to 15% of cane supply, the mills won't be viable*"[15] Hence, the two parties are co-dependent - millers need the cane growers and the cane growers need the millers.

The financial sustainability of the industry is underpinned by the effectiveness and transparency of the pricing for raw sugar, and that marketing arrangements are dictated such that the value of raw sugar is distributed to those parties in the supply chain commensurate with the respective risks and efforts that they have undertaken. The consolidation of milling activity, along with the withdrawal from 'single-desk' marketing arrangements indicated by a number of prominent milling companies, means that at least three quarters of growers will have GEI sugar marketed solely through the nearby miller[16]. Millers will have a higher degree of influence on the financial outcomes of the growers in the future.

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[14] www.aph.gov.au/DocumentStore.ashx?id=778f8849-3146-432d-a43f-6c48692542b9&subId=301314

[15] www.abc.net.au/news/2015-03-13/senate-committee-in-mackay-to-hear-about-sugar-marketing/6305788

[16] www.thefarmsite.com/reports/contents/AustraliaSugar23April2014.pdf

2.7 Recent public deliberations

In September 2014, the Federal Senate moved that the current and future arrangements for the marketing of Australian sugar be referred to the Rural and Regional Affairs and Transport References Committee. The Senate committee established the Sugar Marketing Taskforce, which was charged with investigating ways in which to protect the economic interests of sugar cane growers.

The Senate Committee's Terms of Reference for the Taskforce[17] include focussing on:

1. the impact of proposed changes on the local sugar industry, including the effect on GEI sugar;
2. equitable access to essential infrastructure;
3. foreign ownership levels in the industry and the potential to impact on the interests of the Australian sugar industry;
4. 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; and
5. any related matters.

As a result of deliberations with industry stakeholders and government, considerations have been given to the idea of introducing a code of conduct for sugar marketing arrangements. In December 2014, Senator the Hon Barnaby Joyce, Minister for Agriculture, announced that a Sugar Marketing Code of Conduct Taskforce would be established to investigate a range of issues pertaining to marketing and export arrangements for cane growers.

Chaired by Mr George Christensen MP, the Sugar Marketing Code of Conduct Taskforce is to review the merits of a code of conduct for the sugar industry, which would be included as an amendment to the Australian *Consumer and Competition Act 2010*, to address the imbalance of market power that has manifested after 2006 as a result of the industry's deregulation[18].

The Terms of Reference for the Sugar Marketing Code of Conduct Taskforce[19] are as follows:

1. determine if a code of conduct for the sugar marketing process is needed;
2. determine if such a code should be mandatory;
3. consult with the sugar industry;
4. consider provisions in such a code of conduct to address issues including, but not limited to, the following;

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[17] www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Sugar/Terms_of_Reference

[18] www.abc.net.au/news/2015-02-05/sugar-code-of-conduct-discussions-under-way/6073192

[19] http://www.agricultureminister.gov.au/Pages/Media-Releases/supporting-our-cane-growers.aspx

- negotiation process;
- grower economic interest sugar;
- ability to choose a marketing entity;
- transparency of marketing activities;
- protections from discrimination;
- arbitration where agreement cannot be reached;
- State and Commonwealth Acts relating to the sugar industry and competition;
- Codes of Conduct in other industries; and
- any related matters.

Mr Christensen has signalled that the taskforce believes that there is precedence for a code of conduct to be introduced into the sugar industry[20]. In September 2014 they previously enforced a mandatory code of conduct for the wheat industry regarding port access arrangements[21]. Termed the Mandatory Port Access Code of Conduct for Grain Export Terminals, the legislation's inception ultimately helped farmers and exporters gain access, on a fairer and more transparent basis, to critical port infrastructure that was necessary to sell high-quality Australian wheat to overseas markets [22].

If a code of conduct is to be implemented in the sugar industry, the Taskforce will also have to decide if they believe the industry will act in good faith under a voluntary code, or if they believe that the industry requires a mandatory code. Each type of code carries its own merits – mandatory codes set out a minimum industry standard that are stricter, while voluntary codes tend to be more flexible to market conditions, but are not as tightly enforced as they are self-regulated by industry[23].

The deregulation of sugar marketing arrangements that applied after 2006 meant that millers were no longer mandated to sell their sugar through QSL. Instead, they legally had the option to negotiate commercial contracts for the procurement and supply of sugar cane and raw sugar, respectively, through CSAs and RSSAs, respectively. What has transcended, as a result of the regulatory changes, is that a number of millers have opted out of previously-mandatory marketing arrangements with QSL in favour of what they perceive is best for them. Hence, in the absence of a mandated industry practice, history has showed which decision millers will take. This will likely be a consideration for the Senate, which may have them prefer to adopt a mandatory code of conduct.

The Taskforce has called on industry participants to make submissions as to what they think should be included in a possible sugar marketing code of conduct[24]. Submissions were asked to consider provisions to address issues including, but not limited to, the following:

- the concept that growers have an "economic interest" in the sugar they supply to the mill;

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[20] www.abc.net.au/news/2015-02-05/sugar-code-of-conduct-discussions-under-way/6073192

[21] www.abc.net.au/news/2015-02-05/george-christensen-discusses-sugar-code-of-conduct/6073136

[22] www.agriculture.gov.au/ag-farm-food/crops/wheat/port-access

[23] www.business.gov.au/business-topics/selling-products-and-services/fair-trading/Pages/codes-of-practice.aspx

[24] www.abc.net.au/news/2015-02-05/george-christensen-discusses-sugar-code-of-conduct/6073136

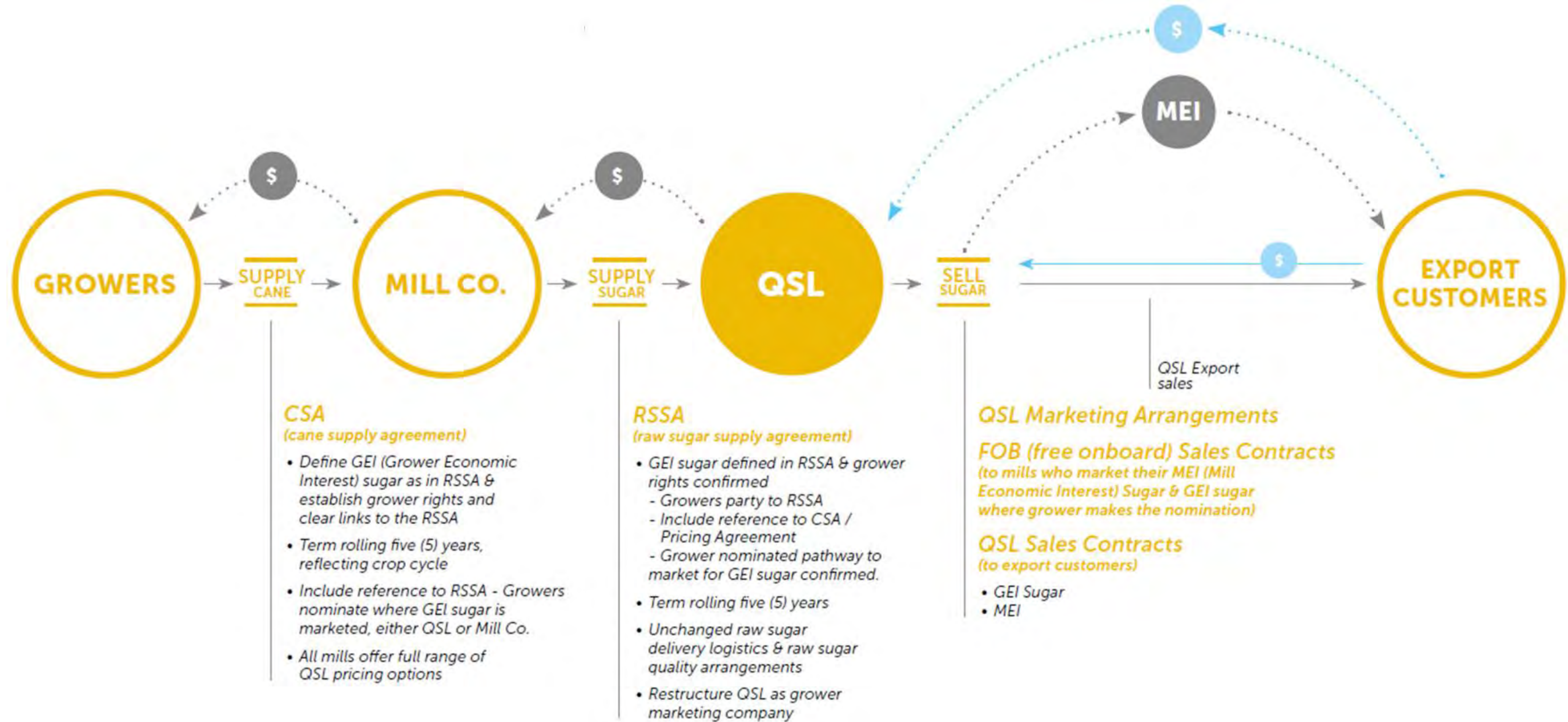
- the growers' ability to independently choose an entity to market GEI sugar;
- transparency of sugar marketing activities;
- the mill supply contract negotiation process;
- protecting growers from discrimination by millers;
- arbitration where agreement cannot be reached as part of a contract negotiation process;
- the encouragement of investment in high-quality mills, milling procedures and marketing arrangements;
- the facilitation of financial returns for growers;
- State and Commonwealth Acts relating to the sugar industry and competition; and
- Codes of Conduct in other industries.

The committee is determined to deliver an outcome before the end of 2015 that will deliver stability and security to cane growers, millers, and sugar marketing entities, as well as the entire sugar industry. Despite this, Mr Christensen has stated that the most effective means of preserving the rights and economic interests of the farmers would be to amend State legislation[25].

The pathways to market for raw sugar under the current raw sugar supply agreements is represented in Figure 2.4.

[25] www.georgechristensen.com.au/sugar-taskforce-process-begins/

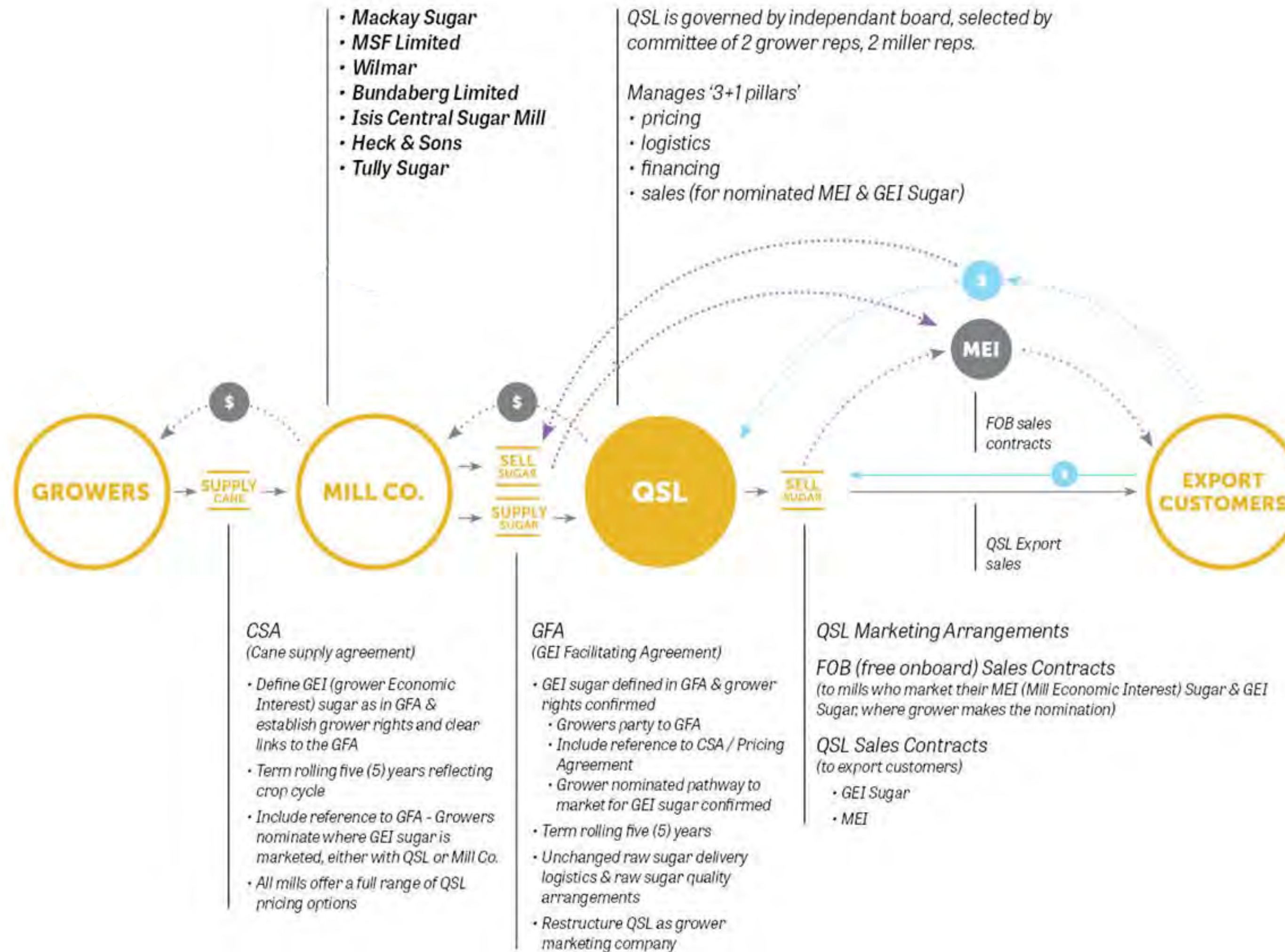
Figure 2.4: Current pathways to market for raw sugar



Source: Pathways to market: Providing choice for GEI Sugar, 11 May 2015

CANEGROWERS and ACFA have also jointly released a proposal for changes to marketing structures that would give growers choice in how GEI sugar is taken to market. Their proposal could be implemented either through changes to the SIA or through a mandatory code of conduct under the federal CCA. A graphical outline of the proposed changes by CANEGROWERS-ACFA can be seen in Figure 2.5.

Figure 2.5: CANEGROWERS and ACFAs proposed pathways to market for GEI sugar



Source: CANEGROWERS marketing model proposal, 28 April 2015[26]

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[26] www.canegrowers.com.au/icms_docs/192553_Pathways_to_Market_GEI_Sugar.pdf

Under this arrangement, GEI sugar would be defined within the CSAs, and linked to a GEI Facilitating Agreement (GFA), which would preserve the rights of growers to elect who markets their sugar – whether through QSL or through a private mill. The terms of the CSA and GFA would set out a five year period. This would be done to align with the investment duration of planting sugar cane crops, which occurs over a five year cycle[27]. Ultimately, this will help reduce the investment risk for growers as well as instil confidence and trust in the long-term relationship between growers and their contracted mill.

[27] www.aph.gov.au/DocumentStore.ashx?id=778f8849-3146-432d-a43f-6c48692542b9&subId=301314

3 Market power

Unchecked, an imbalance of market power between growers, millers and marketers may be detrimental to the future strength and sustainability of the Queensland sugar industry. Allowing growers the ability to elect who markets GEI sugar will be an important factor to maintain the competitiveness of the industry's marketing arrangements.

3.1 Growing

There are over 4,000 cane farm businesses currently operating in Australia[28] that are subject to a number of physical constraints. Mill selection or land use alternatives are two such factors that are that are placing restrictions on cane growers operations and are reducing grower's market power.

Firstly, sugar cane needs to arrive at the sugar mill within 16 hours of it being harvested in order to produce raw sugar[29]. Therefore, this limits both the distance sugar cane can be hauled to a sugar mill for processing as well as the number of mill alternatives for growers.

There is also a high cost associated with hauling sugar cane as it is bulky and generally only produces approximately 140 kilograms of raw sugar per tonne of sugar cane[30]. In most instances, this high cost of transport reduces the feasibility of hauling sugar cane to alternative sugar mills. Moreover, any rail infrastructure established for transporting sugar cane is generally linked to the local sugar mill. In order to deliver sugar cane to an alternative sugar mill, the mode of transport would need to shift (likely from rail to road). This would increase transport costs (including additional capital costs) and result in an underutilisation of existing assets of the sugar industry.

The planting and growing of a sugar cane crop (including re-growth crops) is around a five year investment[31], which is generally longer than the duration of CSAs between growers and millers. This investment mismatch is a risk for growers nor favourable for their market power. The risk of investment mismatch is heightened in instances where there are no economically viable alternative land use options for cane growers.

Where alternative land uses potentially do exist, a significant investment is generally required to establish the alternative uses (e.g. alternative crops) as well as significant investment and effort to establish a market for that alternative use (or crop) and/or investment in alternative infrastructure for production, packaging, manufacturing or other requirements. These factors would prevent most growers from diversifying their crops and, therefore, curtails the ability of growers to exert market power on millers or marketers by withdrawing cane supply.

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[28] www.canegrowers.com.au

[29] www.canegrowers.com.au/page/Industry_Centre/Schools_module/about-australian-sugarcane/

[30] http://asmc.com.au/wp-content/uploads/2013/08/AustralianSugarMilling_AnnualReport_2013-2014_D5_final-101214.pdf

[31] www.canegrowers.com.au/page/Industry_Centre/Schools_module/about-australian-sugarcane/

Urban development options are also not guaranteed even if there is market demand for urban growth. This was evident in the Nambour region where the local mill closed in 2003[32]. For most growers the option of land being rezoned to residential had continued to be blocked by the zoning regulators due to requirements for minimum subdivision size[33].

However, if growers were to engage in alternative land uses and, in doing so, reduce the quantities of sugar cane that they produce, this may provide sufficient incentive for some millers to exit the sugar industry altogether. A miller shutting down could mean that local growers may no longer have a buyer for their cane who is economically viable, as the next closest miller is, in most cases, too far away. Hence, disruption to production levels for either millers or growers could be result in significant economic losses to the other party, as well as for the wider Queensland sugar industry. Ultimately, the two parties must coexist.

[32] www.cse.csiro.au/publications/2006/FutureUseSunshineCoastCaneLands.pdf

[33] www.globalruralproject.wordpress.com/2014/12/03/connecting-global-processes-and-local-outcomes-the-case-of-nambour-and-sugar/

3.2 Milling

Sugar milling entities generally have market power. They are typically the only buyer / producer in a regional market where there are many sellers (i.e. cane growers). In addition to the limited number of options available for cane growers to sell their sugar cane, there are also limited alternative uses for their land.

There are currently 21 sugar mills operated by seven companies in Queensland. Wilmar is the largest miller with eight mills, followed by MSF Sugar and Mackay Sugar who operate four mills each. There are two separate grower owned entities operating five mills in Queensland. The remaining mills are operated by companies with one or two mills[34].

Sugar milling entities tend to hold market power because they are generally the only buyer in the regional market and there are many sellers (i.e. cane growers). As identified previously, there are also a number of barriers for cane growers to cease cane growing activities and find alternative use for their land, which further enhances the miller's relative market power.

A level of vertical integration has been introduced to the Queensland sugar industry through miller decisions to market their own raw sugar. This vertical integration could possibly increase as sugar millers have a greater opportunity to move up the supply chain (i.e. grow sugar cane) than cane growers do to move down the supply chain to become sugar millers. This is due to the high barriers to entry to establish a viable sugar milling operation (including infrastructure development of land, sugar mill and transportation) and market development (i.e. attracting a sufficient number of growers to ensure the mill operation is feasible). This affords sugar millers greater market power than sugar growers, notwithstanding the necessary interdependence between both groups.

Sugar millers (and growers by association) who market their raw sugar through QSL are eligible to be members of QSL. Membership in QSL provides access to low cost financing arrangements for both millers and growers[35]. However, because millers are the sole decision-maker as to where to market their sugar (and growers' GEI sugar), they essentially also decide whether or not growers continue to receive the benefits of QSLs low cost financing arrangements. This is not in the best interests for some growers, as they may be disadvantaged by the loss of access to such existing financing arrangements.

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[34] www.asmc.com.au/industry-overview/statistics/

[35] www.canegrowers.com.au/page/Industry_Centre/About_Us/Statistics_facts_figures/

3.3 Marketing

The shift towards deregulation of the sugar industry was seen as a move to increase competition in the industry, particularly in the marketing sector. However, it is as important to ensure that the right balance is maintained between encouraging competition and upholding confidence, particularly for buyers of sugar, in the Queensland sugar industry into the future.

Under the current marketing agreements with millers, QSL markets a significant proportion of the raw sugar produced by member milling companies (around two thirds) and is responsible for the majority of Queensland's raw sugar exports.

QSL has, in effect, been in operation, in one form or another, as a not-for-profit, industry-owned body since the 1920s. During this time QSL has established a highly favourable reputation internationally for the Queensland raw sugar market. This reputation has been characterised by the quality of the raw sugar as well as the timely and reliable provision of logistics services, and has allowed the industry to draw premium prices[36]. Marketing of raw sugar by entities other than QSL has the potential to alter the perception and reputation of Queensland's highly regarded raw sugar product. This is likely to eventuate if the marketing strategies of new-entrant, private entities differ from that of QSL, as it may cause fragmentation of the Queensland export sugar market. This fragmentation could, in turn, potentially reduce the value of the Queensland sugar industry as export customers may be at risk of experiencing a different quality of raw sugar or a different standard of timeliness or reliability than previously provided by QSL.

QSL currently has relationships with export customers, access arrangements for sugar terminals operated by Sugar Terminals Limited and established logistics arrangements in place to market the majority of Queensland's raw sugar[37]. These relationships and arrangements provide competitive and transparent arrangements for growers and millers, as well as give rise to economies of scale for its marketing functions. A significant reduction in the amount of raw sugar available to QSL may potentially reduce the benefits of scale - previously realised in marketing and logistics operations arrangements. This may negatively impact those smaller sugar millers who do not have sufficient scale or experience to market their raw sugar.

The shift towards deregulation of the sugar industry was seen as a move to increase competition in the industry. It is important that any increase in competition (i.e. as a result of more marketers entering the Queensland industry) does not lead to a detrimental fragmentation of Queensland sugar exports, and decline sugar prices or damage Queensland's reputation of being a supplier of premium quality sugar. To this end, steps may need to be taken to preserve competition in marketing in light of increasing concentration in the milling sector. It is, therefore, necessary that measures be taken to ensure the right balance is maintained between encouraging competition and upholding confidence, particularly for buyers of sugar, in the Queensland sugar industry into the future.

[36] www.qsl.com.au/

[37] www.qsl.com.au/

4 Options

There has been significant consolidation within sugar milling over the last decade. As a result, concerns have been raised by other industry participants as to whether this has led an imbalance of market power held by millers. This has warranted reviews of the current sugar industry regulatory environment to ensure it provides the best outcome for the industry.

4.1 Overview

This section of the report outlines a number of options that could be considered with respect to the market power in milling and marketing outlined earlier in this report. For each option, it considers:

- the objective of the option; and
- the potential positive and negative impacts from any change.

This section outlines a number of options that include:

1. do nothing;
2. establish mediation and/or arbitration framework for negotiating the establishment of contracts and any subsequent disputes;
3. introduction of a Mandatory Code of Conduct for the sugar industry under the *Competition and Consumer Act 2010* ("the CCA");
4. establish declaration mechanism for milling services under the CCA or *Queensland Competition Authority Act 1997* ("the QCA Act");
5. change the SIA to allow growers to choose the marketer for GEI sugar;
6. legislating an annual minimum quantity of sugar to be marketed by QSL; and
7. full re-regulation of sugar milling and marketing through the SIA.

4.2 Analysis of options

1. Do nothing

This option sets out the base case, and should be used as a comparison against the proceeding options.

Potential positive impacts arising from this option include:

- no additional costs to the sugar industry in seeking to change legislation or powers of the national or jurisdictional regulator;
- no perceptions of limiting competition in the marketing of raw sugar; and
- millers can select marketing approach for raw sugar as they see fit.

Potential negative impacts arising from this option include:

- growers have no ability to choose how or by whom GEI sugar is marketed - this decision would be carried out by the mill who has purchased the cane from the grower;
- no greater certainty to marketers or the Queensland sugar industry of the annual quantities of sugar it is able to market; and
- sugar industry participants will have no avenue for arbitration or mediation where negotiations are unsuccessful. This is as a result of the Sugar Industry Reform Bill 2004 that removed mandatory arbitration provisions, as well as the Primary Industries Acts Amendment and Repeal Bill 2007 that removed mediation functions from the Office of SIC.

2. Establish mediation and/or arbitration framework for negotiating the establishment of contracts and any subsequent disputes

The objective of this option is to provide growers with the ability to access independent mediation in the negotiating contracts with millers (and potentially other marketers).

Potential positive impacts arising from this option include:

- commercial negotiations will remain the preferred means of reaching agreement between growers and millers. However, growers and millers can use a dispute resolution process involving mediation and arbitration to resolve any pre- or post-contractual deadlocks. The *Queensland Commercial Arbitration Act 2013* provides a useful mechanism;
- the prospect of mediation or arbitration may incentivise sugar industry participants to act in good faith to avoid regulatory intervention. This could minimise the risk of monopsony misuse of market power by millers;
- may provide greater certainty to growers in choosing their marketing representative; and
- may provide greater certainty to marketers of the annual quantities of sugar they are able to market.

Potential negative impacts arising from this option include:

- establishing the mediation or arbitration framework is likely to involve consultation, time and administrative cost for Government, regulators and the sugar industry;
- mediation and/or arbitration is likely to introduce greater costs and administrative burden for all parties; and
- does not secure the grower's right to elect who markets GEI sugar.

3. Introduction of a Mandatory Code of Conduct for the sugar industry under the CCA

The objective of this option is to reduce the risk of millers misusing market power by applying a light-handed regulatory framework that enables growers' choice in the marketing arrangements for GEI sugar.

Potential positive impacts arising from this option include:

- both millers and growers would be able to select how MEI and GEI sugar is marketed, respectively, which will address concerns over a misuse of market power by millers;
- commercial negotiation would be the preferred means of reaching an agreement between growers and millers. However, mediation and arbitration would form part of the provisions in a Mandatory Code of Conduct to resolve any pre- or post-contractual deadlocks. The *Queensland Commercial Arbitration Act 2013* provides a useful mechanism;
- the prospect of mediation and/or arbitration may incentivise both growers and millers to act in good faith and avoid regulatory intervention. This could also minimise the risk of monopsony misuse of market power by millers;
- provides greater certainty to marketers of the annual quantities of sugar they are able to market; and
- promotes effective competition in the marketing of raw sugar.

Potential negative impacts arising from this option include:

- developing a code of conduct is likely to involve consultation, time and administrative cost for the ACCC, Government and the sugar industry; and
- monitoring compliance of a code of conduct is likely to introduce greater costs and administrative burden for all parties.

4. Establish declaration mechanism for milling services under the CCA or QCA Act

The objective of this option is to reduce the risk of millers misusing market power by strengthening regulatory arrangements as well as promote choice for growers in who markets GEI sugar.

Potential positive impacts arising from this option include:

- commercial negotiations will remain the preferred means of reaching agreement between growers and millers. However, growers and millers can use a dispute resolution process involving mediation and arbitration to resolve any pre- or post-

contractual deadlocks. The *Queensland Commercial Arbitration Act 2013* provides a useful mechanism;

- the prospect of mediation or arbitration may incentivise both sugar industry participants to act in good faith and avoid regulatory intervention. This could minimise the risk of monopsony misuse of market power by millers;
- provides greater certainty to marketers of the annual quantity of sugar they are able to market; and
- promotes effective competition in the marketing of raw sugar.

Potential negative impacts arising from this option include:

- may to be perceived as a move to limit unfettered competition in the marketing of raw sugar;
- mediation and/or arbitration is likely to introduce greater costs and administrative burden for all parties; and
- changing the CCA or QCA Act is likely to involve consultation, time and administrative cost for the ACCC or QCA Act.

5. Change the SIA to allow growers to choose the marketer for GEI sugar

The objective of this option is to allow growers the right to choose who and how GEI sugar is marketed.

Potential positive impacts arising from this option include:

- both millers and growers would be able to select how MEI and GEI sugar is marketed, respectively. This will address concerns over a misuse of market power by millers;
- promotes effective competition in the marketing of raw sugar;
- may give greater certainty to marketers of the annual quantities of sugar they are able to market;
- commercial negotiation would be the preferred means of reaching an agreement between growers and millers. However, mediation and arbitration would form part of the provisions in an amendment to the SIA to resolve any pre- or post-contractual deadlocks. The *Queensland Commercial Arbitration Act 2013* provides a useful mechanism; and
- the prospect of mediation and/or arbitration may incentivise both growers and millers to act in good faith and avoid regulatory intervention. This could also minimise the risk of monopsony misuse of market power by millers.

Potential negative impacts arising from this option include:

- changing the SIA is likely to involve consultation, time and administrative cost for the Queensland Government and the sugar industry; and
- no limitation to the number of marketers could lead to adverse fragmentation of Queensland's sugar exports within the global sugar market.

6. Legislating an annual minimum quantity of sugar to be marketed by QSL

An objective of this option is to ensure to growers that a minimum quantity of sugar is marketed through the industry-owned body, QSL.

Potential positive impacts arising from this option include:

- greater certainty to marketing entities of the annual quantities of sugar that they are able to market; and
- provides a quantity floor amount of GEI sugar that is marketing through QSL, thus giving a level of confidence and transparency of the marketing process to growers, whilst still providing choice and competition in marketing.

Potential negative impacts arising from this option include:

- sugar industry participants currently will not have an avenue for arbitration or mediation where negotiations are unsuccessful. This is as a result of the *Sugar Industry Reform Bill 2004* that removed mandatory arbitration provisions, as well as the *Primary Industries Acts Amendment and Repeal Bill 2007* that removed mediation functions of the Office of the SIC;
- growers have no greater ability to choose how and by whom GEI sugar is marketed, beyond the proposed minimum requirement that is marketed by QSL;
- provides less flexibility for millers and growers, up to the minimum sugar requirement, in who markets sugar;
- likely to be perceived as a move to regulate the sugar industry in Queensland; and
- changing the SIA is likely to involve consultation, time and administrative cost for the Queensland Government and the sugar industry.

7. Full re-regulation of sugar milling and marketing through the SIA

The objective of this option is to reduce the risk of millers misusing market power by re-regulating the sugar milling and marketing activities.

Potential positive impacts arising from this option include:

- may not provide greater certainty to marketers of the annual quantities of sugar they are able to market; and
- limiting the amount of competition in sugar marketing may reduce fragmentation of Queensland's sugar brand within the global market.

Potential negative impacts arising from this option include:

- millers may not be able to select their how MEI raw sugaris marketed;
- growers, millers, marketers and supporting industries will perceive a move to regulate the sugar industry in Queensland as a backward step;
- changing the SIA is likely to involve consultation, time and administrative cost for the Queensland, Government and the sugar industry; and
- no competition for marketing in the industry if there is a return to 'single desk' marketing arrangements.

5 Conclusions

In consideration to the findings in this report, which reviewed the current and potential future sugar industry impacts in light of legislative changes that applied to sugar marketing arrangements from 2006, Deloitte Access Economics makes the following conclusions:

1. future industry changes should address the imbalance of market power between growers and millers and enable growers to elect who markets GEI sugar. This should be done within reasonable boundaries, so as to limit the extent of market fragmentation. This would be pro-competitive for the industry's marketing process;
2. a form of light-handed regulation could be introduced by adopting a federal mandatory code of conduct for the sugar marketing arrangements under the CCA and / or through the enactment of equivalent regulatory structures by amending the Queensland SIA. These changes should seek to codify the minimum standards for timeliness, reliability and transparency that QSL has previously maintained in its marketing arrangements. This would be pro-competitive and mitigate the risk of an imbalance of market power between millers and growers; and
3. commercial negotiation is the preferred method to reach agreement over future cane supply and raw sugar marketing arrangements. However, a commercial dispute resolution process may be required to resolve any pre- or post-contractual deadlocks. The Queensland *Commercial Arbitration Act 2013* provides an appropriate mechanism for this.

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Attachment 3

THE HON IAN CALLINAN AC

Mr Chris Cooper
CJ Cooper & Associates
GPO Box 513
BRISBANE QLD 4001

OPINION
Re: Legislative Power

1. Even before Federation, the sugar industry was of great importance to the economy of Queensland. After Federation, it was of importance both to the State of Queensland and the new Commonwealth. The establishment of a sugar industry in Queensland was the catalyst for the development of much of the State north of Brisbane. Had it not been for the sugar industry, many of the towns and infrastructure which now exist would not have been constructed.

2. All agricultural enterprises have their unique features, but few of those have as many such features as the sugar industry. To be viable, a sugar mill requires an assurance of a substantial and reliable supply of sugar cane. In order to have the incentive to establish a sugar cane farm, growers need an equal assurance that the sugar cane cultivated by them will be received and duly paid for by the miller. Sugar cane once cut deteriorates rapidly. It is essential for its economic exploitation that it be transported quickly, and, ideally, within twelve hours or so of its harvesting. Harvested cane is heavy and voluminous relative to the sugar contained in it. These features necessitate heavy investment by both growers and millers in fixed and mobile infrastructure.

3. The consequences of the matters to which I have referred are that, for all practical purposes, the millers, and growers in proximate fairly clearly defined areas, have little or no practical alternative to dealing with each other.

4. Another historical feature of the sugar industry is that a very high percentage of the sugar produced is exported (currently about 80%). Indeed, until the United Kingdom entered the common market, a substantial proportion was imported by that country under the British Sugar Agreement made between the two nations.

5. It is not surprising, therefore, that the industry was subjected to a high degree of regulation. From at least 1915, State legislation made provision for, among other things, the compulsory supply from proximate designated lands (assignments) to a mill and a reciprocal obligation to accept that supply by the

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particular miller, and the adjudication of the price payable for the sugar cane by the miller by a specially constituted administrative and quasi-judicial body, the Central Sugar Cane Prices Board.

6. Another historical feature of the industry was that most or all of the mills were either cooperatives owned and operated by the growers, or mills owned and operated by Australian corporations. The sugar produced by all of the mills in Queensland was acquired by the Queensland Government and sold effectively from a single desk under State legislation. For a period before 2006 pursuant to State legislation, raw sugar produced in Queensland was acquired and marketed by Queensland Sugar Limited (**QSL**), a corporation constituted for this purpose. QSL was required, however, pursuant to section 102(6) of the *Sugar Industry Act 1999* (Qld) to consult with millers' and growers' industry organisation with respect to the sale of the raw sugar or a substantial portion of it.

7. Something further should be said about QSL. It is a not-for-profit company which is required by its constitution to act in the best interests of the sugar industry (as a whole). Its membership consists of each of the Queensland mill owners and representatives of Queensland canegrowers. The company also operated the six bulk sugar terminals used for storage and handling of all the raw sugar produced in Queensland.

8. Subject to minor variations related to local conditions, cane quality and cleanliness, the price of sugar cane paid to the growers by the millers was such that about 66.66% of the total net revenues achieved for the sale of the complete annual production of sugar was paid to growers. This division of the proceeds was founded upon an acceptance by both sides of the industry that the growers' investment in the assets employed in the industry was about twice that in value of the millers' investment those assets. From time to time there were different 'pools' of sugar attracting different prices, but in substance the system of selling and the method of calculation of prices were as I have described. The growers take the view, therefore, that they have a real and economic interest in 66.66% of the total annual raw sugar production.

9. It will be apparent from what I have set out above that the pricing of sugar, the means by which it was sold, and the growers' entitlement to their share of the proceeds were readily transparent.

10. Over time, however, three radical changes have occurred. Many mills have been acquired by foreign corporations doing business overseas. The new owners of such mills have access to, indeed own, the means of production of sugar from sugar cane grown out of Australia. In large trading organisations of that nature, which engage in related parties sales to refineries they own and numerous swaps and hedging transactions, there would be reduced transparency around the price of sugar achieved from Australian cane. The second radical change was the enactment of competition policy which, relevant to the matters that I am asked to consider, had the capacity to deny growers a role and any effective means of

checking upon the sale of sugar milled in Australia in which they have a real economic interest, especially in the circumstances that the price payable to them is determined by the actual content of sugar in the sugar cane that they supply. The second change was effectively suspended in practice, because the millers voluntarily participated with the rest of the participants in the industry including the growers, in a single desk selling scheme for export sugar or a substantial portion of it. But the third change, the stated intention of one or more mill owners to withdraw from the voluntary single selling desk arrangement, and to sell their own raw sugar, how, where, and for such price as they see fit, once carried into effect, will end the suspension to which I have referred.

11. The *Sugar Industry Act 1999* (Qld) made provision for the making of contracts by a group of growers with a mill owner ('collective contract', section 33). It also, by section 37(3), authorised, for the purposes of both Federal and State competition legislation, the payment of a price for sugar cane by a mill owner to a grower under a collective contract. It also authorised the making of contracts for the acceptance and crushing of cane by a mill at a time fixed for acceptance.

The Question

12. The question that I am asked is, having regard to the matters which I have summarised, whether the Queensland legislature has power to legislate to restore or to enable the Queensland canegrowers to protect their economic interest in the sugar extracted from the sugar cane supplied by them to millers including by giving growers a choice as to the entity which prices and markets their economic interest sugar.

13. The effect of section 3 of the *Constitution of Queensland 2001* (Qld) and section 2 of Attachment 1 (*Constitution Act 1867* (Qld)) is that the Queensland legislature has power to make laws for the peace, welfare and good government of Queensland in all cases whatsoever.

14. The expression "...power to make laws for the peace, welfare and good government of [a colony] in all cases whatsoever" is an expression of the widest possible amplitude. It is an expression which appeared in the *Colonial Laws Validity Act 1865* (Imp) enacted by the Imperial Parliament for the colonies of Australia and has been adopted in Queensland (as elsewhere) for the purposes of, and in the *Constitution of Queensland.*

15. In *Union Steamship Co of Australia Ltd v King*,[1] the High Court held that the power was as ample and plenary as that possessed by the Imperial Parliament, even to the extent of extraterritorial operation.

16. It follows that it is in the power of the Queensland Parliament to enact legislation to enable the Queensland canegrowers to protect their economic interest in the sugar extracted from the sugar cane supplied by them to millers,

[1] (1988) 166 CLR 1.

whether by conferring upon them a legal interest in two-thirds of the total production, or in some other proportion of that production of raw sugar, or to make provision for direct participation by growers or their representative organisations in the sale of the whole or part of the raw sugar produced annually in the State. Legislation could define "economic interest" in such manner and form to achieve these ends and set a mechanism under which growers could choose the entity which prices and markets their economic interest sugar. It could ensure that the price of sugar cane be linked to the price of sugar [transparently negotiated] achieved. It could provide for variations in the proportions of sugar in which each of the parties, millers and growers, are to be regarded as having their respective economic interests. And it could and should make provision for the resolution of disputes about these matters pursuant to the *Commercial Arbitration Act 2013* (Qld), which now applies the UNCITRAL principles widely accepted internationally. It may be that competition authorisation, whether by legislation (including State legislation consistent with s 51(1)(b) of the *Competition and Consumer Act 2010*) or otherwise, under Federal Australian consumer law, might be required. But even that is debatable.[2]

17. The answer to the question I am asked, therefore, is that the Queensland legislature does have power to restore or to enable Queensland canegrowers to protect their economic interests in the sugar extracted from the sugar cane supplied by them to millers, including by giving growers a choice as to the entity which prices and markets their economic interest sugar.

I D F CALLINAN AC

Chambers
21 January 2015

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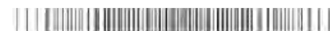
2 The debate (if any) would be whether the Queensland law was inconsistent with Commonwealth law. This would involve the possible application of three tests. 1 – The "simultaneous obedience" test, where it is impossible to obey both laws: *R v Brisbane Licensing Court; Ex parte Daniell* (1920) 28 CLR 23. 2 – The "conferred rights" test, where one law confers a legal right, privilege or entitlement that the other law purports to take away or diminish: *Colvin v Bradley Brothers Pty Ltd* (1943) 68 CLR 151. 3 – The "cover the field" test, where the Commonwealth law intends to cover the field of law in question: *Clyde Engineering Co Ltd v Cowburn* (1926) 37 CLR 466; *Ex parte McLean* (1930) 43 CLR 472. In such a case, there need not be any direct contradiction between the two enactments, and it may even happen that both require the same conduct, or pursue the same legislative purpose. However, if it is imputed by the Commonwealth Parliament that there is a legislative intention that a law shall be all the law there is on that topic, then any state law on that topic may be inconsistent. This will necessarily involve a consideration of three questions: (a) what is the field or subject matter regulated by the Commonwealth act? (b) is the Commonwealth law intended to be exclusive, that is, the only law on the topic? and (c) does the State law operate in the same field as the Commonwealth law? It has to be kept in mind that the fact that the Commonwealth may have power to legislate in a certain field or under a head of power does not mean that it is obliged to or will in fact do so.

Attachment 4



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Advice

To

Steve Kirby
Managing Director
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Level 23, 56 Pitt Street
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Date

11 June 2015

Subject

Advice regarding expropriation claims in relation to draft mandatory industry code for Australian sugar industry

Advice Sought

We refer to and thank you for your email of 26 May 2015 and subsequent correspondence confirming your instructions for us to advise in relation to claims made by Wilmar Sugar Australia that the draft *Competition and Consumer (Cane Sugar Processing Industry Code) Regulation 2015* (**draft mandatory industry code**) amounts to an expropriation of its property in contravention of the Singapore Australia Free Trade Agreement.

You have sought our advice in relation to the following specific issues:

– whether or not the draft mandatory industry code constitutes expropriation within the meaning of the Singapore-Australia FTA;

– if so, whether there are any "escape clauses" that permit the Australian Government to expropriate to pursue competition policy objectives; and

– how investor-State disputes operate under the Singapore-Australian FTA.

Summary of key conclusions

1. There is no legal or factual basis for Wilmar to argue that the draft mandatory industry code amounts to direct expropriation because the code does not involve any transfer of property or title from Wilmar to the Australian Government.

2. It is possible that Wilmar could claim that indirect expropriation has occurred – that is, that the draft mandatory industry code reduces the benefits derived by Wilmar from its investment. However, we consider that Wilmar would be unsuccessful in making a claim of indirect expropriation for the following main reasons, which are based upon publicly available information about past arbitral decisions regarding investor-State disputes involving expropriation claims.

3. First, the draft mandatory industry code could not be construed as

resulting in total or near total deprivation of Wilmar's investment and, therefore, does not constitute indirect expropriation. On the contrary, the draft mandatory industry code merely preserves the status quo as well as help prevent anti-competitive behaviour and promote pro-competitive outcomes in the future.

4. Second, to our knowledge, the Australian Government has not made any direct or indirect representations or commitments to the effect that a measure akin to the draft mandatory industry code would not be implemented. Accordingly, there would be no basis for Wilmar to argue that it had a legitimate expectation that the draft mandatory industry code would not be put in place.

5. Third, it is strongly arguable that the draft mandatory industry code is a bona fide exercise of power by the Australian Government, which is aimed at preventing the misuse by Wilmar of its market power in the market for sugar refining services in (at least) the Burdekin region of Queensland to prevent or limit competition in the market for export of raw sugar. This is a genuine public purpose. Moreover, given that the draft mandatory industry code will preserve the status quo, no or only limited harm will be inflicted on Wilmar and, accordingly, the measure cannot be viewed as disproportionate to the objectives underlying the measure.

6. Given that the draft mandatory industry code applies to both domestic and foreign-owned mills, we consider that it is non-discriminatory.

Contact

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1. Background

1.1 We have based our advice upon the instructions provided to us by Steve Kirby in telephone conferences on 26 May 2015 and a conference with Steve Kirby and others on 29 May 2015.

1.2 We have reviewed Wilmar Sugar Australia Ltd (**Wilmar's**) submission to the Senate Rural and Regional Affairs and Transport References Committee (**the Committee**) dated 14 October 2015, including the paper by Minter Ellison *Australian Sugar: A review of current and future arrangements for the pricing and marketing of Australian Sugar*, which is attachment two to Wilmar's submission.

1.3 We have also reviewed the *SISL Cane Farm Trust* submission to the Committee and the Queensland *Sugar Industry Act* 1999.The Committee's Terms or Reference into the consideration of the Australian Sugar Industry require it to consider, among other things:

> (d) 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.

1.4 In response to this term of reference, we understand that the Committee is likely to make a recommendation that a mandatory industry code be made under Part IVB of the *Competition and Consumer Act* 2015. In this regard, we note that we have seen the recently released draft mandatory industry code.

1.5 Wilmar and Minter Ellison refer to the draft mandatory industry code in their submissions to the Committee as "re-regulation" of the sugar industry and an expropriation of Wilmar's property rights in cut sugar cane and milled raw sugar, which risks contravening Article 11 of Chapter 8 of the Singapore – Australia Free Trade Agreement and equivalent provisions of other free trade agreements to which Australia is a party.

2. Impact of the draft mandatory industry code of conduct

2.1 Controlling possible future anti-competitive behaviour by Wilmar

2.1.1 Wilmar is the largest producer of raw and refined sugar in Australia. It owns and operates eight sugar mills in Queensland, producing about 2Mt of raw sugar for export each year, representing around 55% to 60% of Australia's total raw sugar exports.[1] It owns and operates all of the mills servicing the Burdekin region of Queensland.

2.1.2 Currently and until the end of the 2016 season, Wilmar sells 100% of the raw sugar produced by its mills to Queensland Sugar Ltd (**QSL**), a company entirely owned by sugar growers and millers.[2] QSL marketed and sold the raw sugar for export to global markets, via ports owned by Queensland Sugar Terminals Ltd, but operated by QSL.[3]

2.1.3 Wilmar has given QSL three years' notice of its intention to withdraw from the QSL marketing arrangement with effect from the 2017 season.[4]

2.1.4 Wilmar has proposed the establishment of a Joint Marketing Company (**JMC**) to be responsible for the marketing of 100% of the sugar produced by Wlilmar's mills

[1] Wilmar, 13 October 2014, Submission to Senate Rural and Regional Affairs and Transport References Committee *Current and future arrangements for the marketing of Australian Sugar* (No 10) p. 7.
[2] Ibid, p. 35.
[3] Ibid, p. 24.
[4] Ibid, p. 26.

under an agreement with Wilmar Sugar Trading, which is Wilmar International's sugar trading arm.[5]

2.1.5 Minter Ellison argues that, due to the high fixed costs in operating a sugar mill, it is necessary for a mill owner and operator to ensure a high level of cane throughput each season to obtain a return on its investment in the mill, which is largely sunk.[6]

2.1.6 It argues that, therefore, millers cannot impose unreasonable terms on growers which threaten the growers' viability, without threatening the miller's own profitability. As a result, Minter Ellison argues, it is incorrect to say that millers have an imbalance of power over growers.[7]

2.1.7 In Minter Ellison's view, once competition in the sugar industry is "properly understood", three things become clear:

(a) millers (including Wilmar) do not have a substantial degree of market power in the acquisition of cane or production or marketing of raw sugar;

(b) there is no foundation for any suggestion that Wilmar's proposal to withdraw from the current raw sugar export marketing arrangements with QSL and to substitute a JVC 50% owned by Wilmar, which sells 100% of its output via its wholly owned Wilmar Sugar Trading entity, is aimed at QSL; and

(c) the proposal will not adversely affect competition in which sugar cane is produced or sold; in which raw sugar is sold domestically or for export; for providing sugar handling and storage; or in which "pricing" or "markeing" services are provided.[8]

2.1.8 These arguments may be compelling, if Wilmar had no alternative source of supply for raw sugar other than its Queensland mills.

2.1.9 However, as Wilmar itself makes clear, it is one of the seven major trading firms in the global market for raw sugar, and QSL's current volumes (representing 100% of the Queensland raw sugar export volume) are only half of that traded by Wilmar.[9]

2.1.10 In those circumstances, it is conceivable, even likely, that if Wilmar's upstream offshore trading activities have the potential to create greater profits than maximising throughput of its Queensland mills, it will have a powerful incentive to reduce the price paid to Queensland growers, which overrides any incentive to maximise the profit (or even avoid a loss) from the operation of its Queensland mills.

2.1.11 In those circumstances and where:

(a) under Wilmar's proposal, Wilmar will control the milling, marketing and export of 60% of Australia's raw sugar exports (and 100% of raw sugar exports from the Burdekin region); and

(b) the high fixed and sunk costs in building and operating a sugar mill make it unlikely that any competitor could quickly enter the market to provide additional competitive sugar milling capacity,

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[5] Ibid p. 28; Wilmar, Submission to Senate Rural and Regional Affairs and Transport References Committee *Current and future arrangements for the marketing of Australian Sugar* (No. 51) Attachment 1, Figure 1.
[6] Minter Ellison, 10 October 2014, *Australian Sugar: A review of current and future arrangements for the pricing and marketing of Australian Sugar.*
[7] Ibid.
[8] Ibid pp. 16, 17.
[9] Ibid, p. 14.

Wilmar would be able to reduce price paid to growers free from any constraint.

2.1.12 Such an ability is the classical definition of market power for the purposes of section 46 of the *Competition and Consumer Act* 2010 (**CCA**) which prohibits the misuse of market power.[10]

2.1.13 It is arguable, indeed likely, that Wilmar would have an incentive to take advantage of that market power to:

(a) eliminate QSL from or substantially damage QSL in; and

(b) prevent any other competitor from entering,

the market for the marketing, sale and export of Queensland raw sugar, and potentially other markets, including the operation of export sugar terminals.

2.1.14 Such conduct would amount to a contravention of section 46 of the CCA.

2.1.15 However, by the time any court action was taken by the growers, QSL or a regulator to seek redress for that contravention, QSL, many individual growers and the industry as a whole could have been substantially damaged or destroyed by the conduct.

2.1.16 In those circumstances, we consider that carefully considered and measured regulation by government, such as the draft mandatory industry code, to prevent such an outcome, is an appropriate response and does not amount to re-regulation of the Queensland sugar industry.

2.2 Draft mandatory industry code does not amount to expropriation under the Singapore – Australia Free Trade Agreement

2.2.1 In its submission, Wilmar suggests that the draft mandatory industry code would be "tantamount to the expropriation of Wilmar's property, invoking commitments under Article 11 of Chapter 8 of the [Singapore – Australia Free Trade Agreement (**SAFTA**)]".

2.2.2 For the reasons elaborated in the remainder of our advice, we consider that it is highly unlikely that Wilmar would be able to successfully invoke Article 11 of Chapter 8 of SAFTA on the basis that any draft mandatory industry code would amount to a direct or indirect expropriation of its property prohibited by the SAFTA.

3. Requirements to establish expropriation under Article 11 of Chapter 8 of SAFTA

3.1 Chapter 8 of SAFTA deals with investment by the Parties to SAFTA – namely, Singapore and Australia. Chapter 8 applies to investments that have already been made by an investor of one Party in the territory of the other Party as well as investments that are in the process of being made or are sought to be made.[11]

3.2 Article 11 of Chapter 8 of SAFTA – entitled "Expropriation and Nationalisation" – provides in relevant part that:

> 1. Neither Party shall nationalise, expropriate or subject to measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") the investments of investors of the other Party unless such a measure is taken on a non-discriminatory basis, for a public purpose, in

[10] *Melway Publishing Pty Ltd v Robert Hicks Pty Ltd* [2001] HCA 13 per Gleeson CJ and Callinan J at para. 67.
[11] SAFTA, Chapter 8, Article 2.1(a).

accordance with due process of law, and upon payment of compensation in accordance with this Article.

2. The expropriation shall be accompanied by the payment of prompt, adequate and effective compensation. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation or impending expropriation became public knowledge. Compensation shall carry an appropriate interest, taking into account the length of time from the time of expropriation until the time of payment. Such compensation shall be effectively realisable, freely transferable in accordance with Article 13 (Transfers) and made without delay…

3.3 Article 11.1 clearly prohibits nationalisation and expropriation unless, among other things, compensation is paid in accordance with Article 11.2.

3.4 The draft mandatory industry code clearly does not constitute "nationalisation" within the meaning of Article 11.[12]

3.5 Therefore, the question remains whether it amounts to "expropriation".[13]

3.6 Distinction between direct and indirect expropriation

3.6.1 **Direct expropriation** ordinarily involves a mandatory legal transfer of title to property or its outright physical seizure which benefits the expropriating State. There will usually be a deliberate and unequivocal intent to deprive the owner of property through the transfer of title or outright seizure.[14]

3.6.2 **Indirect expropriation** normally involves total or near total deprivation of an investment, but without a formal transfer of title or outright seizure.[15] In addition, indirect expropriation does not necessarily result in a benefit to the expropriating State.[16]

3.6.3 The classical definition of term "indirect expropriation" is found in the *Starrett Housing* case:

> it is recognized under international law that measures taken by a State can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.[17]

3.6.4 More recently, in *Suez v. Argentina*, the arbitral tribunal analysed whether the measures adopted by Argentina during the economic crisis of 2000–2002 constituted an indirect expropriation. It described indirect expropriation as follows:

> In case of an indirect expropriation, sometimes referred to as a 'regulatory taking,' host States invoke their legislative and regulatory powers to enact measures that reduce the benefits investors derive from their investments

[12] Nationalisation involves the government of one Party taking control of an investment made by an investor of the other Party.

[13] As most arbitral decisions involving investor- State disputes are not publicly available, we have relied upon publicly available information regarding these decisions and associated commentary as the basis for our advice.

[14] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, pp. 6-7.

[15] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 7.

[16] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 12.

[17] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 8 referring to *Starrett Housing v. Iran*, Interlocutory Award No. ITL 32-24-1, 19 December 1983, 4 Iran-United States Claims Tribunal Reports 122, p. 154.

> but without actually changing or cancelling investors' legal title to their assets or diminishing their control over them. [18]

3.6.5 In our view, there is clearly no legal or factual basis for Wilmar to argue that the draft mandatory industry code would amount to **direct expropriation** because the draft mandatory industry code does not involve any transfer of property or title from Wilmar to the Australian Government.

3.6.6 It is possible that Wilmar could claim that **indirect expropriation** has occurred – that is, that the draft mandatory industry code reduces the benefits derived by Wilmar from its investment. However, as explained in the next section of our advice, we consider that Wilmar will be unsuccessful in making such a claim.

3.7 Establishing expropriation in practice

3.8 In determining whether or not indirect expropriation has occurred in practice, the following key questions have been considered by arbitral tribunals in the past:

3.8.1 Is the measure attributable to the respondent State? If so, have they acted in their sovereign capacity?

(a) There is no question that the draft mandatory industry code is a measure that is attributable to the Australian Government, acting in its sovereign capacity.

3.8.2 What is the investment at issue? Is it a property right or other protected legal interest?

(a) Article 1 of Chapter 8 of SAFTA defines "investment" in broad terms to include "every kind of asset, owned or controlled, directly or indirectly, by an investor".[19]

(b) It is clear that the Wilmar's sugar mill and associated capital assets constitute an investment within the meaning of Article 1 of Chapter 8 of SAFTA and, therefore, would be covered by Article 11.

(c) The contracts for the sale of sugar by Wilmar would also constitute an investment covered by Article 11, provided that they were in place at the time of the alleged expropriation and entitle Wilmar to an asset at that time. In this regard, we note that, in *Emmis v Hungary*, the tribunal explained the difference between an asset, which is protected against expropriation, and the contractual source of the ownership of the asset, which is not. The tribunal stated that:

> [T]he loss of a right conferred by contract may be capable of giving rise to a claim of expropriation but only if it gives rise to an asset owned by the claimant to which a monetary value may be ascribed. The claimant must own the asset at the date of the alleged breach. It is the asset itself - the property interest or chose in action - and not its contractual source that is the subject of the expropriation claim.[20]

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[18] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 11 referring to *Suez et al. v. Argentina*, Decision on Liability, 30 July 2010, para. 121.

[19] SAFTA, Chapter 8, Article 1.1(c).

[20] Investor-State Dispute Settlement: Review of Developments in 2014, UNCTAD IIA Issues Note, No. 2 – May 2015, p. 17 referring to *Emmis International Holding, B.V., Emmis Radio Operating, B. V.,* MEM*Magyar Electronic Media Kreeskedelmi és Szolgáltató Kft. v. The Republic of Hungary* (ICSID Case No. ARB/12/2), Award, 16 April 2014, para. 254.

3.8.3 Does the impact of the measure result in total or near total deprivation of the investor's investment and is it permanent?

(a) To be considered an indirect expropriation, past tribunal decisions indicate that the expropriatory measure results in total or near total deprivation of the investor's investment[21] and this effect is permanent or, at least, long-lasting.[22]

(b) The decisions have described "indirect expropriation" as having the following effects:

(i) deprives the owner of fundamental rights of ownership;

(ii) makes rights practically useless;

(iii) deprives, in whole or in significant part, the use or reasonably-to-be-expected economic benefit of the property;

(iv) radically deprives the economical use and enjoyment of an investment, as if the rights related thereto had ceased to exist;

(v) makes any form of exploitation of the property disappear; and

(vi) the property can no longer be put to reasonable use.[23]

(c) Several tribunals have chosen to view the whole business enterprise as an investment, and not its constituent parts. These tribunals have denied the existence of an expropriation in cases where the investor was deprived of some rights, but retained control over the overall investment.[24]

(d) Nevertheless, in other cases, different interests belonging to the same business have been treated separately, each of which may be capable of separate expropriation.[25] It has been suggested that a partial expropriation can be found only if:

(i) the overall investment can be disassembled into a number of discrete rights;

(ii) the State has deprived the investor of a right covered by the investment definition in the applicable treaty – in this case, SAFTA; and

(iii) the right is capable of economic exploitation independently of the remainder of the investment.[26]

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[21] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 65. See also Investor-State Dispute Settlement: Review of Developments in 2014, UNCTAD IIA Issues Note, No. 2 – May 2015, p. 17 referring to *Perenco Ecuador Ltd. v. The Republic of Ecuador and Empresa Estatal Petróleos del Ecuador (Petroecuador)* (ICSID Case No. ARB/08/6), Decision on Remaining Issues of Jurisdiction and Liability, 12 September 2014, para. 672.

[22] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 63

[23] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 64.

[24] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 23.

[25] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 24

[26] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, 25

(e) In our view, the draft mandatory industry code could not be construed as resulting in total or near total deprivation of the investor's investment. On the contrary, the draft mandatory industry code merely preserves the status quo, helps prevent anti-competitive behaviour and will help to promote pro-competitive outcomes in the future.

3.8.4 Did the investor have a legitimate expectation the State would not act in the way they did or propose to do?

(a) For the purposes of expropriation claims, investment tribunals have generally applied a high threshold concerning investor expectations. In particular, in order to demonstrate that legitimate expectations exist, specific representations or commitments made by the State to the investor concerned have been made and these have been relied upon by the investor.[27]

(b) To our knowledge, the Australian Government has not made any direct or indirect representations or commitments to the effect that a measure akin to the draft mandatory industry code would not be implemented. Accordingly, there would be no basis for Wilmar to argue that it had a legitimate expectation that the draft mandatory industry code would not be put in place.

3.8.5 Does the State measure serve a public purpose?

(a) Regulatory measures that have general application will ordinarily enjoy a presumption of validity[28] and immune from a challenge of expropriation.[29]

(b) The regulatory capacity of the State was affirmed in *Methanex v. USA*, where a California ban on a gasoline additive (MTBE) was deemed to be a lawful, non-compensable regulation. The tribunal stated that:

> …as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and which affects, inter alia, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation....[30]

(c) In some instances, a regulatory measure can lead to a significant impairment of businesses.[31] Nevertheless, where a measure is considered to be legitimate regulation, it will not amount to expropriation, and no compensation will be payable.

(d) In order to determine whether measures are legitimate regulation rather than indirect expropriation, tribunals have considered the factors, including:

(i) Does the measure contain characteristics of bona fide exercise of power by the State?

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[27] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 75.
[28] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 92.
[29] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 93.
[30] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 84 referring to *Methanex Corporation v. the United States*, Final Award, 3 August 2005, part IV, chapter D, para. 7.
[31] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 12.

(ii) Is it taken in pursuance of a genuine public purpose, non-discriminatory and in accordance with the law?

(iii) Is there a manifest disproportionality between the aims pursued and the harm inflicted on the investor?

(e) A measure will be considered to be a **bona fide exercise of power** if it genuinely pursues a legitimate public policy objective.[32]

(f) The question of whether "fair competition" regulation **serves a genuine public purpose** has been specifically considered by tribunals. In this regard, it has been noted that:

> although regulatory measures designed to protect the environment, health and safety or **ensure fair competition** frequently impose regulatory and compliance costs on an investment, these will not normally reach the threshold of a substantial deprivation.[33] (**emphasis added**)

(g) In addition, regulation to ensure integrity of markets has also been considered:

> [the State's] role needs to be affirmed as a regulator in order to provide an equitable and stable framework within which **markets can develop in a competitive manner**. The regulatory authority of governments needs to be safeguarded if the State is to continue to fulfil its essential functions to protect the public interest in areas like the environment, health and safety, **market integrity** and social policies.[34] (**emphasis added**)

(h) It is strongly arguable that the draft mandatory industry code is a bona fide exercise of power by the Australian Government, which is aimed at prevention a contravention of section 46 of the CCA. This is genuine public purpose. Moreover, given that the draft mandatory industry code preserves the status quo, no or only limited harm will be inflicted on Wilmar and, accordingly, the measure cannot be viewed as disproportionate to the objectives underlying the measure.

(i) Given that the draft mandatory industry code applies to both domestic and foreign-owned mills, we consider that it is non-discriminatory.

4. Process for initiating an investor-State dispute under SAFTA

4.1 Article 16 of Chapter 8 of SAFTA sets out the process for settlement of investor-State disputes. In summary, Article 16 provides that:

4.1.1 The parties must initially seek to resolve the dispute by consultations and negotiations.

4.1.2 After 6 months from the initiation of the dispute, where the dispute cannot be resolved, the dispute may be submitted to:

(i) the courts or administrative tribunals of the disputing Party;

[32] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 78.
[33] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 64.
[34] Expropriation: UNCTAD Series on Issues in International Investment Agreements II – a Sequel', United Nations, New York and Geneva, 2012, p. 80.

(ii) the International Centre for Settlement of Investment Disputes (**ICSID**); or

(iii) arbitration under the rules of the United Nations Commission on International Trade Law (**UNCITRAL**).

4.1.3 In the 30 year history of this arbitration scheme, Australia has only been the subject of one investor-State dispute challenge, brought by Philip Morris Asia in response to the enactment of the *Tobacco Plain Packaging Act 2011.*[35]

4.2 Notably, Article 16 does not require adjudication by a domestic court or tribunal to be exhausted before arbitration by ICSID or UNCITRAL is sought. Therefore, it is possible that, if Wilmar decides to formally invoke Article 11 of Chapter 8 of SAFTA, it will seek arbitration by ICSID or UNCITRAL before the matter is considered by an Australian or Singaporean court or tribunal.

4.3 However, arbitral tribunals have adopted what is a described as a "cautionary approach" in which, even if a domestic court decision appears to be entirely inconsistent with free trade agreement obligations, an arbitral remedy will be denied until all domestic court remedies have been exhausted.[36]

5. Conclusions on expropriation claim by Wilmar

5.1 Based on the foregoing analysis, our conclusions are as follows:

5.1.1 There is no legal or factual basis for Wilmar to argue that the draft mandatory industry code amounts to **direct expropriation** because our understanding is that the code will not involve any transfer of property or title from Wilmar to the Australian Government.

5.1.2 It is possible that Wilmar will claim that **indirect expropriation** has occurred – that is, that the draft mandatory industry code reduces the benefits derived by Wilmar from its investment. However, we consider that Wilmar will be unsuccessful in making such a claim for the following main reasons:

(a) The draft mandatory industry code could not be construed as resulting in total or near total deprivation of Wilmar's investment and, therefore, does not constitute indirect expropriation. On the contrary, the code will merely preserve the status quo as well as help prevent anti-competitive behaviour and promote pro-competitive outcomes in the future.

(b) To our knowledge, the Australian Government has not made any direct or indirect representations or commitments to the effect that a measure akin to the draft mandatory industry code would not be implemented. Accordingly, there would be no basis for Wilmar to argue that it had a legitimate expectation that the draft mandatory industry code would not be put in place.

(c) It is strongly arguable that the draft mandatory industry code is a bona fide exercise of power by the Australian Government, which is aimed at preventing a misuse of market power. This is genuine public purpose. Moreover, given that the code will preserve the status quo, no or only limited harm will be inflicted on Wilmar and, accordingly, the measure cannot be viewed as disproportionate to the objectives underlying the measure.

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[35] http://www.ag.gov.au/Internationalrelations/InternationalLaw/Pages/Tobaccoplainpackaging.aspx
[36] Chief Justice of Australia Robert French AC, 21 March 2015, *ISDS – Litigating the Judiciary*, Speech to the Chartered Institute of Arbitrators Centenary Conference, p. 14, citing Sir Anthony Mason, Lord Mustill and Judge Abner Mikva in *Loewen Group Inc and Raymond L Loewen v United States of America (Award)* (2005) 7 ICSID Rep 421.

(d) Given that the draft mandatory industry code applies to both domestic and foreign-owned mills, we consider that it is non-discriminatory.