Submission No. 008

17 July 2015

The Chairman
Agriculture and Environment Committee
Parliament House
George Street
BRISBANE QLD 4000

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

Dear Sir

SISL Cane Farm Trust submission to
Queensland Agriculture and Environment Committee

Sugar Industry (Real Choice in Marketing) Amendment Bill 2015 ("Bill")

Executive summary

SISL is a funds management business specialising in agribusiness investment. In the past 10 years, SISL has invested over $35m acquiring and developing approximately 4,000 acres of sugar cane farms in the Burdekin region near Ayr. SISL has a deep understanding of the sugar sector both globally and in Australia. Our Advisory Board includes past CEO's, Directors and Chairmen of CSR, Sugar Australia and C. Czarnikow.

SISL welcomes the introduction of the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015.* In particular we make the point that the fundamental intention and effect of the Bill is to create a pro-competitive outcome that properly and fully completes the de-regulation process that started in 2006.

Thus the Bill is not "re-regulation". Rather, the Bill sets out the rules for a "level playing field" for all participants in the Australian sugar industry, cane growers and millers alike. The Bill therefore delivers the kind of modern, market based "fair-play" outcome that Australia rightly stands for.

SISL fully supports the detailed submission made by Canegrowers and ACFA in relation to the Bill.

SISL notes that the Committee specifically invited views and comments in relation to four topics. In summary these topics are:

1. The current sugar marketing arrangements;
2. Impacts arising from the decision by millers to exit the current sugar marketing arrangements;
3. The Bill's provision for Grower Economic Sugar, Grower Choice and contract arbitration procedures; and
4. Possible alternative approaches to raw sugar marketing.

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In relation to topics 1 and 4 it is SISL's view that the current sugar marketing arrangements are the bench-mark standard to which the rest of the sugar world aspires to. The attempt by the mills to monopolise the marketing of export raw sugar therefore represents a backward step. In our view the changes proposed by Canegrowers / ACFA represent a step forward and are an extremely positive step for the industry. Opening the provision of marketing services up to a contestable process improves the transparency of the supply chain.

SISL's submission therefore focuses on topics 2 and 3 and expands on five key points:

A. Grower Choice
B. Grower Economic Interest Sugar ("GEI Sugar")
C. Best Alternative To a Negotiated Agreement ("BATNA")
D. Future investment in the Queensland sugar sector
E. "No worse off" test for the economic sharing of raw sugar value

Points A, B and C above, specifically address the content of the Bill (topic 3) and support the provisions of the Bill.

Point D addresses the issue of the damage that will be done to investment in Queensland's sugar industry by the Wilmar proposal (topic 2), as well as the long-term social impact of the Wilmar proposal on the economic vitality of regional communities.

Finally, at point E, SISL has suggested a small improvement to the arbitration procedure to ensure that a form of "no worse off" test applies to any dispute in relation to the cane price formula that underlies the entire economic relationship between growers and their mill.

A Grower Choice

There has been a concerted effort by some of the raw sugar mill owners to present the sugar cane growers objections to proposed changes to the current arrangements (these arrangements being the way the supply chain operates from cane grower to raw sugar buyer) as somehow "re-regulation" or a desire for a "single desk".

This is not true and SISL wishes to set the record straight on this point.

It is in fact the raw sugar mills – specifically, Wilmar in the Burdekin (and COFCO and MitrPohl in their respective regions) - in their attempt to gain total control of the export marketing of raw sugar that represent an effort to create a "single desk" in each grower region, and thus a de-facto re-regulation of the industry.

If the mills are successful in their attempt to exert their monopoly power over the cane growers, Australia will have effectively re-regulated its sugar industry by monopolising miller control of the raw sugar.

The terms of S. 33B of the Bill are in line with the "Grower Choice" model proposed by Canegrowers / ACFA. The introduction of these provisions will finish the job of properly de-regulating the sugar industry, and set the industry on a sound footing for the future.

Grower Choice is not a rejection of millers participating in the export marketing of Australia's sugar. A miller is as entitled as anyone to bid for each grower's GEI Sugar, but they have to do so on an open and contestable basis. If a grower elects to have a miller (or any other

agent) manage the marketing of his GEI Sugar in a given year (or years) that is entirely and properly up to the grower.

Grower choice represents the purest expression of the economic marketplace as imagined by the great philosopher and economist Adam Smith in 1776. Smith explained that the free-market economic system relied on each of the many actors making their own individual decisions based on their own interests. Every day in Australia, each of us gets to make our own decisions (good or bad) about how we conduct our economic activities. To deny this opportunity to Australia's sugar cane growers would seem a perverse interpretation of "free-market" and anathema in Australia's rules based economy.

B Grower Economic Interest Sugar ("GEI Sugar")

Australian sugar cane growers participate alongside the millers in a market facing system for the raw sugar derived from their sugar cane. The current system recognises that the symbiotic relationship between grower and miller does not give rise to a "true market" at the farm-gate. It recognises that a natural monopoly exists between a large buyer and many small suppliers. The revenues of both growers and millers are therefore based on the price achieved for the sale of the raw sugar in the "true market" - the international raw sugar export market. This enlightened economic outcome has resulted in a sharing of the economic benefits between grower and miller with an approximately 2:1 split between growers and millers respectively.

If one reads the above paragraph without prejudice it is clear that growers are just as much entitled as the millers are to have a say in how the raw sugar price is determined (and thus how the raw sugar is marketed). Their economic revenue stream is entirely dependent on the net export raw sugar price (which is a combination of many factors). Grower economic interest is not necessarily title to a specific batch of raw sugar but it is nevertheless patently a "property right". It is a right to deal with a specified tonnage of co-mingled raw sugar - in the same way we all have a right to a specific number of co-mingled dollars in a bank account.

To avoid the expropriation of this property right by the raw sugar millers in their attempt to take over the marketing of all Queensland's raw sugar, it is necessary for the economic interest that growers have in the raw sugar to be formally and permanently recognised. The legal title to raw sugar, arising under the current cane supply agreement ("CSA"), is not carte-blanche for a mill to expropriate the property rights of every sugar cane grower.

The terms of S.33B are very clear in recognising the concept of "Grower Economic Interest" and will ensure that each and every sugar cane grower retains control of their property rights to exercise as they see fit.

C Best Alternative To a Negotiated Agreement ("BATNA")

In any commercial arms length negotiation all parties have an alternative to reaching agreement - they can walk away.

Cane growers do not have this option. For underlying biological reasons their cane must be delivered to the mill within 24 hours of harvest. Even if growers were able to extend this time period, transport costs over long distances to an alternative mill are prohibitive (cane is a high-volume-low-value product).

It is therefore imperative that the Queensland State Government implement the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015* to ensure that in accordance with S. 33A sugar cane growers are not forced into a take-it-or-leave-it contract by the monopoly power of the raw sugar mill.

SISL does note however, that it is important that the Bill include a provision such that in the absence of an agreement on the economic formula under S. 33B, the economic formula prevailing today in 2014 must be the fall-back. This underlying economic arrangement has served the industry well for 100 years and with this condition in place, the growers and millers both have an incentive to "stay at the table" in order to reach a deal. In the absence of such a minimum, the miller can put a "take-it-or-leave-it" deal on the table in the knowledge that growers have no BATNA.

D Future investment in the Queensland sugar sector

There has been much made of the potential negative effect on investment in the sugar sector if either a Federal or State based solution is imposed on the industry. This is something to which SISL is firmly qualified to speak on. It is SISL's view that in fact the risk to investment lies in *not* implementing a pro-competitive solution.

SISL does not intend to invest any further in the sector until there is certainty that our property rights will be protected. In fact, if the raw sugar mills succeed in enforcing their monopoly power it is likely that SISL will seek to divest its interests in sugar cane farms and deploy this capital in other agricultural pursuits where there is free and fair access to the global market.

Further, it is difficult to imagine any new entrant (whether domestic or foreign) looking favourably at an investment in sugar cane farms where the revenue stream is effectively a "farm gate" price that can be dictated or manipulated by the activities of a monopoly buyer.

If this is the case, and in the opinion of CFT's Board and investors it clearly is, then there is a looming social disaster unfolding in northern Queensland. The average age of the approximately 9,000 sugar cane farmers in Australia is over 60. In most cases the vast bulk of their retirement wealth is held in the form of the farm they own. Whilst in past generations they may have relied upon a child taking over the farm, in today's world their children have typically moved away from the family cane farm. The inevitable outcome of this is a need for third party capital investment to (a) liberate the retirement savings of many cane farmers, and (b) ensure the future productive use of the land for sugar cane or other crops.

If third party capital is not available in the volume necessary to maintain and improve the value in cane farms then, not only are the existing farmers likely to suffer reduced asset values and incomes, but the mills will be able to acquire these farms at prices well below their fair value under the current system. Such an outcome represents a massive expropriation of wealth from a cohort of hard working Australians.

It should be noted that the capital invested in the sugar sector is disproportionately held by cane farmers. Cane farmers have more than $12bn of capital at risk, whilst Wilmar (for example) has only invested around $2bn which sum includes a variety of refining and other assets not related to milling. Thus, for a small proportion of the total invested capital value of the Australian sugar industry, the mills are seeking to use their "bottleneck" to force an unequal bargain on the major investors in the industry - Australian cane growers.

E No Worse Off Test

The Bill is silent on the exact nature of the economic sharing of raw sugar proceeds between miller and grower. This is as it should be - a commercial negotiation between parties of equal capacity is the proper solution. However, as has been made clear, and accepted by, the Federal Senate Inquiry, the Federal Government Task-Force and numerous submissions from the industry, the millers and growers are not of equal capacity.

The mills are able to exert monopoly power and therefore the simplest and least intrusive way of protecting the growers is to include a provision in the Bill such that in the absence of agreement by the grower to a change in the cane price formula – and thus the economic sharing of raw sugar proceeds – the formula shall be as contained in the Cane Supply Agreement for 2014. In other words a provision to ensure that the economic basis of a grower's contract cannot be changed to leave them "worse off" without their express consent.

Conclusion

De-regulation should not result in the elimination of one "mandatory single desk" only to see the creation of a de-facto mandatory single desk - which the proposal by Wilmar to control the marketing of raw sugar effectively results in - with each miller acting as a monopoly buyer.

In order to give effect to true de-regulation, each player in the industry must have control over their property rights, the ability to choose how to deal with them and the right to "walk away" from negotiations.

Legislating the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015,* will properly complete the de-regulation of the sugar industry in Queensland and Australia. SISL suggests that the Bill would be further improved were it to also include a "no-worse-off test" that ensures that the economic formula in use today is the fail-safe formula to be used in the absence of any agreement by a grower to change it.

Please feel free to contact SISL at any time should you wish to discuss any aspect of this submission.

Yours sincerely

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Chairman

Steven G Kirby

Managing Director