**Submission No. 011**

MSF Sugar

17 July 2015

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

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

Dear Ms Howard

Re: **Inquiry for the Sugar Industry (Real Choice in Marketing) Amendment Bill 2015**

By way of background, MSF Sugar is the largest cane grower, the third largest sugar miller in Australia, is an integrated sugar cane grower, sugar miller, marketer and exporter of raw sugar. MSF Sugar is responding to your invitation to make a submission in response to the Sugar Industry (Real Choice in Marketing) Amendment Bill 2015.

MSF Sugar implores the Agriculture and Environment Committee to rigorously examine the detail of the proposed regulation within an economic, financial and legal framework.

Sadly, much of the current 'sugar marketing regulation debate' lacks an objective focus and substantive examination. This an untenable situation in that it is undermining the international standing of the Australian Sugar Industry and its individual participants, and proposals of regulation at Federal and State Government levels appear to be designed to calm the perpetuators of unsubstantiated rhetoric.

The role for Governments, and elected officials, in a free market economy like Australia, and Queensland, should be to identify, facilitate and promote economic growth and productivity gains, not impair functioning and productive sectors of the economy.

MSF Sugar demonstrably endorses practices and encourages grower choice for pricing and pooling, which is detailed in our submission follows.

Yours faithfully,

**Mike Barry**
Chief Executive Officer


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## OVERVIEW

The Federal and Queensland State Government deregulation of the Australian sugar industry has created an environment to allow for innovation in the growing, milling and marketing sectors of the sugar industry.

MSF Sugar Limited (MSF Sugar) is viewed by some in the sugar industry as a non-conformist as it has taken advantage of the opportunities of the 2006 deregulation of raw sugar marketing to market raw sugar outside of the traditional single desk marketer (QSL).

In the marketing sector a great deal of innovation has occurred, with MSF Sugar leading many of these innovations, while still maintaining the direct link between the price of sugar cane and the international raw sugar price (as defined by the ICE11 raw sugar futures market). This link has maintained the price transparency for the price of sugar cane.

The deregulation of sugar marketing has seen a number of cane pricing mechanisms being developed to allow individual or smaller collective groups of growers to directly price their cane by pricing on the international raw sugar market (ICE11 raw sugar futures market). However growers have also had the choice to remain in a large collective pricing pool if that is their wish (as was the situation in the regulated environment).

Raw sugar produced at the Mulgrave and Maryborough Mills has been successfully directly marketed to raw sugar buyers in Asia since 2006. MSF Sugar physical marketing activities have successfully co-existed with the operations of QSL, with shared access to Bulk Sugar Terminals at Cairns and Bundaberg Ports, accessing ships to transport the raw sugar to market and negotiating raw sugar sales to the large raw sugar refiners in Asia.

MSF Sugar has been demonstrably effective in delivering pricing choice and facilitating better financial outcomes for cane growers. In 2013 and 2014, growers who supplied sugar cane to Mulgrave and Maryborough Mills had the option to either have their cane priced through the MSF Sugar or the QSL marketing systems. More than 90% of independent growers who supply these mills have elected to stay with the MSF Sugar marketing system of which they have been a part of since 2006.

In 2012, MSF Sugar was acquired by the large Thai sugar miller Mitr Phol. Since this purchase Mitr Phol has invested more than $200 million in expanding the sugar industry in the Maryborough and Far North Queensland regions.

It is the view of MSF Sugar and Mitr Phol that the deregulation of the sugar industry has facilitated innovation and made the Australian sugar industry an attractive investment opportunity, while existing competition laws have enabled MSF Sugar to access key industry infrastructure (such as the bulk raw sugar terminals) to market raw sugar outside of the traditional single desk marketer (QSL) and still allow cane price transparency for growers who supply sugar cane to MSF Sugar mills.

### Overall information about MSF Sugar

MSF Sugar is an integrated sugar cane grower, sugar miller, marketer and exporter of raw sugar.

MSF Sugar's assets include four sugar mills, sugar cane farms and shares in STL (the owner of the bulk sugar terminals). The mills are located at Gordonvale, South Johnstone, Atherton Tableland and Maryborough. The company's four sugar mills have a total crushing capacity of 4.7 million tonnes of cane and produce approximately 600,000 tonnes of raw sugar per annum. MSF Sugar is the third largest sugar miller in Australia.

MSF Sugar's cane farms grow approximately 650,000 tonnes of cane, making MSF Sugar the largest cane farmer in Australia.

MSF Sugar employs nearly 650 people of whom 380 are full-time. A total of 630 independent cane growers supply its four sugar mills.

MSF Sugar has sugar cane farms totalling around 13,000 ha, split between the Maryborough, Innisfail and Atherton Tableland regions. These farms are an important source of cane to the company's sugar mills and supplement the sugar cane source from the company's 630 independent cane growers.

MSF Sugar's direct output into the regional Queensland economy is around $275 million per annum – with most of this generated in Far North Queensland.

The company has a 17.56% share ownership in Sugar Terminals Australia (STL), the owner of six major raw sugar export port facilities in Queensland. STL owns bulk raw sugar storage and loading facilities at the Queensland regional ports of Cairns, Mourilyan, Lucinda, Townsville, Mackay and Bundaberg. These facilities can store up to 2 million tonnes of raw sugar, which is around 50% of the raw sugar produced in Queensland in a single year.

The company's future vertical integration strategy is to have an efficient operation from the farm through to the raw sugar buyers in Asia. MSF Sugar is investing throughout this value chain to improve efficiencies, with more than $200 million invested in the past three years and a further $100 million to be invested in the next three years to this aim.

MSF Sugar is also working with Canegrowers Innisfail on a project to unlock opportunities in the Innisfail region to improve farm profitability by standardising farming systems to allow more efficient farming practices. MSF Sugar expects that it will provide financial support to allow the required changes in farming equipment as a result of this project.

MSF Sugar wants, and has, a history of working with growers at the local level to improve the local sugar industry's profitability.

**Recent history of MSF Sugar**

MSF Sugar is the product of the recent merger/acquisition of three sugar milling businesses.

The initial sugar milling business was The Maryborough Sugar Factory, a small listed sugar mill and grower based in Maryborough, Queensland. This mill traditionally made raw sugar for the domestic refiners, with QSL handling the marketing activities.

The deregulation of marketing in 2006 meant that QSL could no longer be involved in domestic marketing activities so The Maryborough Sugar Factory had to develop marketing capabilities and worked with the local growers to develop a cane pricing method. This was the start of the journey.

At the same time Mulgrave Central Mill also decided to market outside of QSL when the deregulation of marketing occurred. At the time Mulgrave Central Mill was a grower-owned cooperative mill. They too worked with their local growers to develop a marketing system.

In 2009 Mulgrave Mill was acquired by The Maryborough Sugar Factory and both marketing efforts were combined.

In 2010, The Maryborough Sugar Factory and Bundaberg Sugar created a milling joint venture from each party contributing their Far North Queensland Mills. The mills involved were Mulgrave, South Johnstone, Tableland and the now closed Babinda mills. The Bundaberg Sugar mills had a raw sugar supply contract with QSL. This contract remained in force with QSL.

In 2011, The Maryborough Sugar Factory changed its name to MSF Sugar and also acquired the Bundaberg Sugar share of the milling joint venture.

MSF Sugar was then in the unique situation of having half of the raw sugar it produced being marketed by itself and half being marketed by QSL (as part of an existing Raw Sugar Supply Agreement). In 2010 and 2011 MSF gave notice to QSL under this Raw Sugar Supply Agreement (RSSA) as it was not practical to continue in this manner.

At the time MSF Sugar was told by some growers that they wanted MSF Sugar to be able to offer a QSL marketing option for the determination of cane price.

MSF Sugar then commenced discussions with QSL and other Queensland millers to negotiate a new RSSA which would enable MSF Sugar not only to have marketing flexibility but also to provide a mechanism for growers to choose a QSL marketing option for the determination of cane price.

Eventually, in December 2013, an RSSA was agreed which gave MSF Sugar a marketing solution. However it was a very slow process, taking nearly 18 months to negotiate.

Subsequently with Wilmar giving notice to cease their RSSA with QSL in April 2014, this significantly changed the QSL financial model as Wilmar provides more than 50% of the raw sugar supply to QSL. MSF Sugar spoke to QSL about the need to explain in detail future arrangements without Wilmar but QSL was unable to give any guarantees. As a result MSF Sugar gave notice to discontinue the RSSA in late June 2014. The RSSA with MSF Sugar will terminate in June 2017.

**1. Whether the *Sugar Industry Act 1999* (current) adequately protects the interests of growers in collective sugar marketing arrangements**

**Adequate protections continue to exist under the auspices of the *Sugar Industry Act 1999* (current), in that:**

a. **Cane producers continue to be paid on the same basis now as they were prior to deregulation and continue to be able to negotiate collectively;**
b. **The cane price formula that determines cane price is unchanged;**
c. **There is a very close symbiotic relationship between cane growers and millers. Each party relies on the other for its survival; and**
d. **Growers have demonstrable alternatives for land use.**

**a. Cane producers are paid on the same basis now as they were prior to deregulation:**

Cane producers continue to be paid for their cane on the same basis that existed prior to deregulation. In fact deregulation has enabled innovation so that individual or collective groups of cane producers are more able to influence the components of the cane price formula on the by taking decisions with regards to the pricing of components of the formula.

By way of background, cane producers have always been paid for **cane,** not sugar. The link between cane price and raw sugar price is to ensure that cane producers are incentivised to deliver the best quality cane and thereby financially rewarded for the quality of that cane.

When the sugar industry was deregulated Growers continued to be able to negotiate collectively, and do so effectively, which constrains potential market power by the mills. The current payment arrangements and the transparency which they provide **continue** to play an important role.

**b. Cane price formula is unchanged:**

The interest of growers continues to be served by a clear and transparent cane price formula that is linked to the sugar price. All existing cane supply arrangements continue to maintain this link, and there is no proposal by any mill to amend this. The integral link between cane producer and miller encourages the miller to facilitate the grower to achieve the highest cane price.

Cane producers have continued to be paid on the same basis for their cane as was the case prior to deregulation. In fact, the deregulation of sugar marketing has seen a number of cane pricing mechanisms being developed to allow individual or smaller collective groups of growers to directly price their cane by pricing on the international raw sugar market (ICE11 raw sugar futures market). However growers have also had the choice to remain in a large collective pricing pool if that is their wish (as was the situation in the regulated environment).

MSF Sugar negotiates a cane supply contract with the growers who supply its four sugar mills. Each mill has its own cane supply contract however the underlying cane price formula is the same at all mills. The basic cane price formula links the tonnes of cane supplied, the sugar content in the cane (called CCS) and the world sugar price.

The basic cane price formula is:

$P_{cane} = P_{sugar} \times (CCS - 4) \times 0.009 + \text{constant}$

Where $P_{sugar}$ is the net sugar price from sales to the world sugar market. More than 95% of the net sugar price is determined from the ICE11 raw sugar futures market.

However each mill's cane supply contract may have some small variations on additional payments which mainly relate to cane logistics issues. This is incorporated in the constant in the cane price formula. This constant is less than $1 per tonne of cane, making up less than 5% of the $P_{cane}$.

The cane price formula in effect splits the revenue from the sale of raw sugar into the revenue to pay for the cane and the revenue the mill needs to operate the sugar mill and to make a profit for its business. The revenue to pay for the cane has recently started to be called 'grower economic interest sugar'. The grower share of the revenue from the sale of raw sugar is in the region of 60 to 65%, depending on the CCS of the sugar cane supplied.

'Grower economic interest sugar' is a constructed term that has emerged in the industry in the past three years during negotiations with QSL on a new Raw Sugar Supply Agreement to allow millers to market (within the QSL system) part of the raw sugar produced by a mill. The reality is that this terminology does not appear in any cane agreement and is a catchphrase invoked throughout the growing side of the sugar industry.

Despite the notional splitting of the revenue described above, the risk on the raw sugar is transferred to the mill when title for the cane is transferred to the miller. This occurs when a grower delivers sugar cane to an agreed rail siding or truck pickup point. From this point the miller takes responsibility for transporting the cane to the mill, the conversion of the sugar cane into raw sugar and the delivery of the raw sugar to the export bulk terminal.

In both the MSF Sugar and QSL marketing systems both the miller and grower share in price risk of the physical sale to the final raw sugar buyer as it will impact on the $P_{sugar}$.

Growers who supply sugar cane to MSF Sugar can either have their $P_{sugar}$ determined by the MSF Sugar marketing system or the QSL marketing system. The arrangements in place by MSF Sugar mill are as follows:

| Milling Region | Marketing System | Comment |
|---|---|---|
| Maryborough | MSF Sugar or QSL | QSL as an option since 2013. MSF Only option 2017 onwards |
| Mulgrave | MSF Sugar or QSL | QSL as an option since 2013. MSF only option 2017 onwards |
| South Johnstone | QSL only | MSF only option 2017 onwards |
| Tableland | QSL Only | MSF only option 2017 onwards |

**c. There is a very close symbiotic relationship between cane growers and millers. Each party relies on the other for its survival**

There is a very close symbiotic relationship between cane growers and millers. Each party relies on the other for its survival.

Sugar cane has:

- Low value per tonne (around $60 per tonne of cane)
    - Therefore must be grown close to a mill to minimise transport costs
    - Ideally the cane will be within 30km of the sugar mill
- Must be converted into raw sugar within 24 hours of harvesting
- Its can only be converted into raw sugar or ethanol

A sugar mill:

- Can only process sugar cane
- Needs a very large volume of sugar cane to cover its fixed costs
- Needs the sugar cane to be harvested in an orderly manner to maintain its quality

Therefore both the sugar cane grower and the sugar mill must work together to:

- Have sufficient cane to mill
- Ensure harvesting of cane proceeds in an orderly manner.

Therefore MSF Sugar cannot afford to treat growers poorly as it will have insufficient cane to profitability operate a sugar mill.

**d. Growers have demonstrable alternatives for land use**

Sugar cane farmers have options on what they do on their land. They are not forced to grow sugar cane and in fact many land owners in the region around a sugar mill use their land for other uses.

The fact is that sugar mill owners are exposed to more risk than individual sugar cane growers. There are several recent instances were sugar mills were forced to close because growers collectively stopped providing enough sugar cane to operate a sugar mill economically. The most recent example was when MSF Sugar closed Babinda mill in 2012 because of inadequate cane supply and rationalised cane supply in the region by transferring this cane to the adjacent Mulgrave and South Johnstone Mills.

Another example is the closure of Moreton Mill (by Bundaberg Sugar) on the Sunshine Coast region of SE Queensland. The closure of this mill (due to inadequate cane supply) has effectively ceased the growing of sugar cane in this region. MSF Sugar is trying to foster a small cane growing industry in this region by working with local growers to truck cane over 100 km to the Maryborough Mill. This haul distance is longer than what is normally considered economic but in this situation both the grower and the mill are working closely together to try and retain sugar cane growing in this region. But it is not easy and to allow it to work it needs innovative solutions, not more regulation.

Should cane growers wish to leave the sector they have options to move from cane farming to alternative farming activities relatively quickly (Table 1), providing adequate protection against perceived adverse decisions by the sugar miller which may be affecting their farming activities.

| Mill Region | Other major activities and risks | Comments |
|---|---|---|
| Maryborough | Cattle and small acre hobby farms | Many cane farms are seen as an ideal size for a large hobby farm |
| South Johnstone | Bananas and Cattle | The region is one of the major banana growing regions in Australia |
| Mulgrave | Urban encroachment | This has seen sugar mills close in the area as the cane land is ideal for urban development |
| Tableland | Bananas, avocados, small crops, macadamia nuts, cattle and dairy | This region due to its number of micro climates is an ideal area for many agriculture activities |

**Table 1 Alternative land uses in the area surrounding the MSF Sugar mills**

Table 2 demonstrates what happened in the Babinda/Innisfail region when the economic return from growing sugar cane is not financial competitive as other land uses.

| Year | Cattle | Bananas | Trees | Real Estate | Abandoned | Tully | Total |
|---|---|---|---|---|---|---|---|
| 2004/05 | 650 | 933 | 327 | - | - | - | **1910** |
| 2006 | 898 | 656 | 639 | - | - | - | **2193** |
| 2007 | 388 | 151 | 497 | 22 | - | - | **1058** |
| 2008 | 588 | 198 | 588 | 90 | - | 1467 | **2931** |
| 2009 | 360 | 267 | 414 | 99 | 361 | 56 | **1557** |
| 2010 | 93 | 74 | - | 27 | 72 | - | **266** |
| 2011 | 19 | - | - | - | - | - | **19** |
| **Total** | **2996** | **2279** | **2465** | **237** | **432** | **1523** | **9932** |

**Table 2 Area in hectares lost to alternative land uses in the period 2004 to 2001 in the Babinda/Innisfail region**

In summary, an owner of a sugar mill is totally reliant on the local land owners to grow sugar cane. Without this supply the mill is uneconomic and will be forced to eventually close. However a land owner on the other hand has many choices of what to do with their land, with the growing of sugar cane being only one option. Therefore it is important for a sugar mill owner to:

- Operate an efficient, reliable mill
- Maintain an appropriate season length
- Ensure sugar is competitive with other uses for the grower's land
- Provide a financial outcome from cane better than alternative uses for the land
- Have a transparent method to determine the price of cane
- Have an equitable method to harvest and deliver sugar cane to the mill for processing over a five-month harvest period

**2. The costs, benefits and impacts on the Queensland sugar industry arising from decisions by some millers to exit the current sugar marketing arrangements (market outside of Queensland Sugar Limited (QSL))**

**a. MSF Sugar has exercised its rights under contract law**
**b. Costs are ongoing and accumulating!**
**c. MSF Sugar has been demonstrably effective in delivering innovation, pricing choice and facilitating better financial outcomes for cane growers**
**d. The deregulated sugar industry attracted much needed capital investment**

### a. MSF Sugar has exercised its contractual rights under law

When Wilmar gave notice to cease their Raw Sugar Supply Agreement with QSL in April 2014, this significantly changed the QSL financial model, as Wilmar represented more than 50% of the raw sugar supply to QSL. QSL is a public company limited by guarantee, of which MSF Sugar is one of the members. The withdrawal of Wilmar potentially changed MSF Sugar's risk exposure to QSL.

MSF Sugar spoke to QSL about the need to detail future arrangements without Wilmar, but QSL was unable to provide any guarantees. As a result MSF Sugar gave notice to discontinue the RSSA in late June 2014. The RSSA with MSF Sugar will terminate in June 2017

In the absence of any guarantee, or substantive financial model, or outlook, from QSL, MSF Sugar acted prudently to protect its business interests and ***exercised its documented rights under its RSSA with QSL and its rights under contract law*****.** MSF Sugar reserves its legal rights to challenge the implementation of any regulation or re-regulation with regards to the sugar industry.

**b. Costs are ongoing and accumulating**

Any costs to the Queensland sugar industry and its participants have not arisen out of deregulation, but from the ongoing uncertainty about potential for re-regulation.

This ongoing uncertainty has undermined and continues to erode confidence. Naively, much of the 'marketing regulation' has been aired publicly in the media and has been noted internationally by customers, investors and competitors alike. It is difficult to quantify the ongoing costs of this uncertainty, but it is important to note the ongoing reputational damage it continues to do.

From an international perspective, one potential cost is the rerating of Australia and/or Queensland in terms of sovereign risk. This and ongoing reputational damage cannot be underestimated.

It is notable that Australian Minister for Foreign Affairs, Ms Julie Bishop, recently commented with regard to speculated sugar industry reregulation:

> "*As you will be aware, the Australian government has established an ambitious economic and trade agenda to support the prosperity of all Australians,*" *Mr Bishop's letter says.*
>
> "*We are pursuing bilateral, regional and global trade agreements that not only open up new markets for Australian exporters, but help build a strong, rules-based architecture for global trade.*
>
> "*Accordingly, it is important that Australia continues to maintain a credible reputation for being an effective and reliable partner with an exceptional record of compliance within the terms of our international trading agreements.*"

**c. MSF Sugar has been demonstrably effective in delivering innovation, pricing choice and facilitating better financial outcomes for cane growers**

In the marketing sector a great deal of innovation has occurred, with MSF Sugar leading many of these innovations, while still maintaining the direct link between the price of sugar cane and the international raw sugar price (as defined by the ICE11 raw sugar futures market). This link has maintained the price transparency for the price of sugar cane.

The deregulation of sugar marketing has seen a number of cane pricing mechanisms being developed to allow individual or smaller collective groups of growers to directly price their cane by pricing on the international raw sugar market (ICE11 raw sugar futures market). However growers have also had the choice to remain in a large collective pricing pool if that is their wish (as was the situation in the regulated environment).

Raw sugar which has been produced at the Mulgrave and Maryborough Mills has been successfully directly marketed to raw sugar buyers in Asia since 2006. MSF Sugar physical marketing activities have successfully co-existed with the operations of QSL, with shared access to Bulk Sugar Terminals at Cairns and Bundaberg Ports, accessing ships to transport the raw sugar to market and negotiating raw sugar sales to the large raw sugar refiners in Asia.

In 2013 and 2014, growers who supplied sugar cane to Mulgrave and Maryborough Mills had the option to either have their cane priced through the MSF Sugar or the QSL marketing system. More than 90% of independent growers who supply these mills have elected to stay with the MSF Sugar marketing system, of which they have been a part of since 2006.

The two milling regions (Mulgrave and Maryborough) where growers have had direct connection to the marketing of raw sugar to the final buyers, the engagement and level of understanding is greater and apprehension is less.

In these two regions growers have been involved at the local level in developing and evolving a cane pricing model.

The initial leader in the industry was Mulgrave Central Mill, a grower-owned cooperative in 2006 when this started (before it was later acquired by MSF Sugar). The approach taken by Mulgrave Central Mill has been continued subsequently by MSF Sugar. The approach is:

- Creation of a grower pricing/reference panel
- This panel has visibility and transparency of all the physical marketing activities undertaken by MSF Sugar. This involves having the activities independently audited.
- This panel is also involved in developing different cane pricing pools for growers:
    - It has evolved from a single grower managed collective pool to a number of pricing options.
    - This includes pools which allow individual decisions, grower collective and grower/miller collective decision pools.
    - This process to create pools is slow but involves the growers at the local mill area and is not imposed. Individual growers then have a choice of pool in which to price their sugar cane.

MSF Sugar has operated as an independent marketer since 2006 and the company believes growers in these regions want to maintain this status. MSF Sugar has managed a successful operation outside of QSL. This is clearly demonstrated by decisions made by sugar cane growers in the Maryborough and Mulgrave mills region where a non-QSL sugar cane price system has been in place since 2006.

For the 2013 and 2014 cane seasons, growers in those regions had a clear choice between the marketing offering from MSF Sugar and QSL. At the end of 2013, Maryborough and Mulgrave region growers were given the choice to nominate either MSF Sugar or QSL raw sugar marketing system to determine the price of their cane.

In the Mulgrave region, 91 per cent of growers elected to remain directly connected to MSF Sugar as their marketing system. In the Maryborough region, 99 per cent of growers made the same decision. In our view, this confirms a clear endorsement by these growers that MSF Sugar provides the sought-after benefits and price results.

For 2014, commitment to remain with MSF Sugar's marketing offer was further demonstrated when only two growers, one of whom is a Board Member of Tableland Canegrowers, moving to the QSL marketing system.

Pivotal to this Submission is the overriding fact that since MSF Sugar commenced marketing of raw sugar in 2006 there has not be any 'proposed change' between the price of cane and the world sugar price. Put simply, the direct link between the world sugar price and the price of cane has and will be maintained.

## d. The deregulated sugar industry attracted much needed capital investment

Historically, between 1999 and 2005, the Australian sugar industry underwent an unrelenting cycle of negative industry returns brought about by a combination of climatic, disease and price-related issues. The Government intervened by providing sustainability grants to the sugar industry as well as putting in place an agreement to further restructure and deregulate the industry.

Following this period, there was a need for significant capital investment particularly in the milling sector to upgrade and boost milling assets and infrastructure so that Australia could continue to compete satisfactorily in an increasingly competitive global marketplace.

In early 2012, in a deregulated market, Mitr Phol, Thailand and Asia's largest sugar and bioenergy producer, purchased MSF Sugar through an off-market takeover offer of the then publicly listed entity. The majority of shareholders at the time of the takeover offer consisted of either cane growers that supplied cane to MSF Sugar or institutional investors of which more than 95 per cent of these shareholders accepted the takeover.

The impact of ownership by Mitr Phol has been positive for MSF Sugar, positive for growers and for the Australian sugar industry.

Over the past two years, the foreign owners of MSF Sugar have invested around $200m of new capital into the Australian operations. At its own operations the investment has been:

- Creation of large efficient cane farms in MSF Sugar's three cane growing regions
  - Purchase of additional farms to create larger farming units
  - Purchase of larger tractors
  - Installation of efficient irrigation systems to improve farm yields
  - Development of underutilised land into cane farms
- Increasing the crushing capacity and efficiencies of sugar mills, primarily the Tableland and South Johnstone Mills
  - $42 million spent at Tableland Mill
  - Year 2 of a four-year $60 million expansion and modernisation of South Johnstone Mill
- Developing and implementing cane pricing options for growers
- Developing and implementing marketing systems to link a raw sugar buyer back to a cane growing region

Mitr Phol through MSF Sugar is also supporting its local independent cane suppliers to improve their businesses. This has been by:

- Planting loans to growers in the Innisfail and Babinda regions to replant after Cyclone Yasi.
- Planting loans to growers who plant cane to expand supply to the company's sugar mills.
- Leasing land to growers to expand their farming business to realise better economies of scale.
- Loaning money to growers in the Maryborough region to install efficient irrigation systems to drought proof their farms and to improve farm profitability.

The above investment made by Mitr Phol in the Australian sugar industry was made possible because it was deregulated which has allowed investment decisions to be made at the local level.

Prior to the investment by Mitr Phol in the growing sector in the Innisfail region the area under cane was falling. This has turned around over during the past three years as MSF Sugar has supported and incentivised local growers to grow more sugar cane.

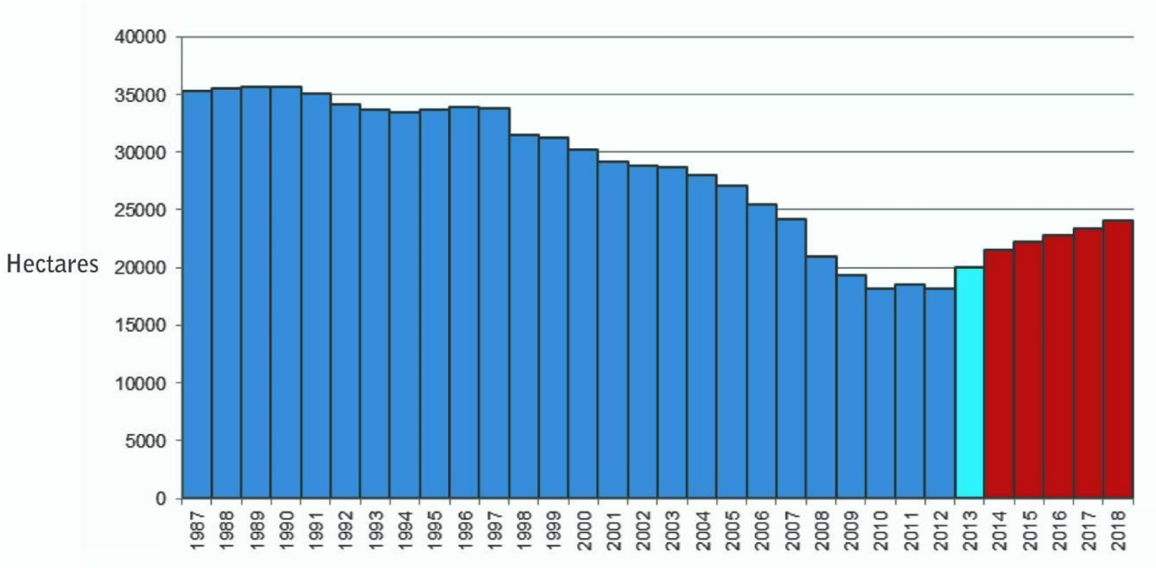



**Chart 3 Area under cane in the Innisfail-Babinda supply area**

3. **Whether provisions in the Bill are viable and will achieve their stated objective:**
   a. **Supply contracts that give legal recognition to 'grower economic interest' sugar (GEI)**
   b. **Growers' choice by nomination of marketing entities within supply contracts for GEI**
   c. **Arbitration of disputed terms in a supply contract**

**a. Supply contracts that give legal recognition to 'grower economic interest' sugar (GEI)**

It seems somewhat presumptuous to assume that supply contracts should give rise to 'grower economic interest' without testing the implications of so doing.

'Grower economic interest sugar' (GEI) is a term that has emerged in the industry in the past three years during negotiations with QSL on a new Raw Sugar Supply Agreement to allow millers to market (within the QSL system) part of the raw sugar produced by a mill. The reality is that this terminology does not appear in any cane supply agreement and is a catchphrase or construct invoked throughout the growing side of the sugar industry to infer that growers have legal title to sugar.

Despite the notional splitting of the revenue described above, the risk on the raw sugar is transferred to the mill when title for the cane is transferred to the miller. This occurs when a grower delivers sugar cane to an agreed rail siding or truck pickup point. From this point the miller takes responsibility, assumes all risks and pays all costs for transporting the cane to the mill, the conversion of the sugar cane into raw sugar and the delivery of the raw sugar to the export bulk terminal.

The delivery of cane by the grower to the rail siding or trucking point is analogous to an FAS or FOB sale, in international trade, under the International Chamber of Commerce's INCOTERMS below:

> *"Free Alongside Ship" means that the seller delivers when the goods are placed alongside the vessel (e.g., on a quay or a barge) nominated by the buyer at the named port of shipment. The risk of loss of or damage to the goods passes when the goods are alongside the ship, and the buyer bears all costs from that moment onwards.*

*“Free On Board” means that the seller delivers the goods on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards.*

If title to raw sugar is ascribed to growers, which effectively prescribes sugar mills to toll crushing status, this opens a Pandora’s box of retrospective costs to be recouped by sugar mills from growers. If sugar mills had had the opportunity historically to negotiate a toll crushing arrangement, that tolling fee would have been set based on return on investment, and sugar mills have been deprived of that opportunity. Similarly as mills have borne the risks and costs associated with transport utilising their assets, these costs should be recouped retrospectively.

If this is the intention of the legislation that sugar mills are to become toll crushers of cane, then the Bill should clearly state that. The Government should then buy the sugar mills and associated assets and free the capital invested by sugar mill owners to pursue business in unregulated industries.

Who provides compensation to sugar millers if Grower Equity interest ascribes title to growers is potentially a complex legal minefield.

Aside from the direct financial costs, there are significant future costs to the sugar industry, Queensland and Australia. The Katter Party, and the Government, have raised the issue of a Queensland ethanol industry and the ascription of grower title to raw sugar is the antithesis to any such proposal. The prospect of future development of other products from sugar cane or a mill’s sugar stream are similarly, naively constrained.

**b. Growers’ choice by nomination of marketing entities within supply contracts for GEI**

There remains a considerable misunderstanding by a significant number of growers about the link between the world sugar price and the price of cane. Many growers do not understand how the numbers are achieved and, as an industry, there is a lack of understanding about what happens to raw sugar once it leaves a mill.

It seems that the central tenet to ongoing speculation and proposals for regulation is a widely held misunderstanding of how raw sugar is ‘marketed’, the distinction between physical sales and futures pricing and where value lies. Further, it is apparent that few growers understand that over the past 5 years, the ICE11 price component made up 99% of the net sugar price and that net physical premiums (physical premiums +/- marketing costs) made up <1%.

**Sugar Price Make-up**

The typical make-up of the $P_{sugar}$ is:

| Component | Value |
|---|---|
| ICE11 raw sugar price | $450 |
| C&F Premium | $55 |
| Freight cost | -$30 |
| Storage and Port costs | -$20 |
| Finance and Marketing costs | -$5 |
| **$P_{sugar}$** | **$450** |

**Table 3 Build-up of the $P_{sugar}$ starting with the ICE11 raw sugar price**

The C&F Premium is the negotiated premium paid by the bulk raw sugar buyer in Asia and will fluctuate year to year depending on Asian supply and demand. Year on year the difference between the ICE11 raw sugar price and $P_{sugar}$ will be plus/minus $5 per tonne of raw sugar.

The concern voiced by some sectors of the cane growing community is that the best C&F premium will only be achieved by having a single desk seller of raw sugar. However the change to Australian marketing arrangements will not change the supply/demand situation in Asia. MSF Sugar and its growers are not in competition when selling raw sugar into the international market as both seeks to achieve the highest possible price. Both the miller and the grower are aligned in a desire to get the highest $P_{sugar}$.

Table 4 demonstrates that the net premium delivered (physical sales premiums minus marketing, freight, finance, storage & handling costs) range from 1.1% to -1.97% on average across all pricing pools for Maryborough and Mulgrave pools until 2014 when QSL pools and pricing were included for former Bundaberg North mills. Net premium is essentially the "physical' marketing component of raw sugar that is the issue in dispute.

**Table 4**

| Season | Net Premium as % Of ICE 11 Returns |
|---|---|
| 2009 | 0.57% |
| 2010 | -0.50% |
| 2011 | 1.10% |
| 2012 | -0.72% |
| 2013 | 0.06% |
| 2014 | -1.97%* |

*includes costs of QSL shared pool

The physical sales premium is essentially the freight differential between the delivered costs of Queensland sugar and the next competitive origin. When freight differentials are historically cheap, influenced by low commodity prices and demand and low oil prices, net premium can be negative.

Discussion with growers leads MSF Sugar to believe that many, and probably most, growers misunderstand where the vast amount of revenue is derived. This lack of understanding in turn impedes any acceptance of arrangements that may seem new or different.

***The reality is that MSF Sugar has a demonstrably effective and inclusive system that provides growers with choice, and auditable transparency.***

In these two regions growers have been involved at the local level in developing and evolving a cane pricing model.

The initial leader in the industry was Mulgrave Central Mill, a grower-owned cooperative in 2006 when this started (before it was later acquired by MSF Sugar). The approach taken by Mulgrave Central Mill has been continued subsequently by MSF Sugar. The approach is:

- Creation of a grower pricing/reference panel
- This panel has visibility and transparency of all the physical marketing activities undertaken by MSF Sugar. This involves having the activities independently audited.
- This panel is also involved in developing different cane pricing pools for growers:
  - It has evolved from a single grower managed collective pool to a number of pricing options.
  - This includes pools which allow individual decisions, grower collective and grower/miller collective decision pools.

- o This process to create pools is slow but involves the growers at the local mill area and is not imposed. Individual growers then have a choice of pool in which to price their sugar cane.

**c. Arbitration of disputed terms in a supply contract, and**

MSF Sugar endorses the view advanced by the Australian Sugar Milling Council in their recent submission to the Federal Sugar Marketing Code of Conduct Taskforce that: "***a move to arbitration would be an uneconomic and retrograde step for the industry"*** which we have repeated for ease of reference.

***1. Arbitration***

*Including pre-contractual arbitration in a code of conduct for the sugar industry would be a strong move back to regulation. Deregulation of the sugar industry was crucial in improving productivity along the supply chain and providing an industry with the commercial flexibility to be internationally competitive. It is described in detail in the ASMC submission to the Senate Inquiry into the current and future arrangements for the marketing of Australian sugar. The deregulation process included many inquiries, reviews and task force reports, industry assistance packages and legislative changes to federal and state laws. A prominent component of the deregulation was that compulsory mechanisms for dispute resolution and mediation with 'final offer' arbitration where mediation failed to find an agreement. The reviews in the lead up to deregulation found that arbitration was blocking productivity gains and were a deterrent to normal / healthy commercial competitiveness, resulting in Australian sugar not being able to compete globally.*

*The Hildebrand Review in 2002 commented that 'Arbitration is an issue' resulting in a lack of genuine negotiations and the use of 'final offer arbitration' as a default situation leading to 'an inferior outcome'.*

*The CIE Report in 2002 found that the arbitration provisions prevented normal competitive processes, supporting the status quo and restricting the more progressive growers. Arbitration also prevented supply chain optimisation, while being unnecessary, due to other general dispute resolution mechanisms being available.*

*The ASMC does not support a return to a less innovative and less productive sugar industry, through compulsory pre-contractual arbitration.*

*There is only one example of pre-contractual arbitration in agribusiness in Australia currently. It applies to the grain exporters negotiating access to bulk grain port terminals and is part of the mandatory Port Terminal Access (Bulk Wheat) Code of Conduct. The Code applies to bulk grain port terminal operators to ensure that exporters of bulk wheat have 'fair and transparent access' to port terminal services.*

*Arbitration in the Wheat Port Code deals specifically with infrastructure access disputes. There is no Industry Code in Australian agribusiness that prescribes arbitration as a measure to establish contracts between a supplier and processor, manufacturer, merchant or other receiver of goods. There is no case of market failure that would support the introduction of such heavy handed regulatory intervention in the Australian sugar industry.*

## 4. Alternative ways to improve sugar marketing outcomes for growers and millers.

***MSF Sugar has a demonstrably effective and inclusive system that provides growers with choice, and auditable transparency.***

Since 2006, MSF Sugar has operated as an independent marketer and the company believes growers in these regions want to maintain this status. MSF Sugar has managed a successful operation outside of QSL. This is clearly demonstrated by decisions made by sugar cane growers in the Maryborough and Mulgrave mills region where a non-QSL sugar cane price system has been in place since 2006.

The frameworks established by MSF Sugar in conjunction with the Maryborough & Mulgrave growing community are:

- Creation of a grower pricing/reference panel
- This panel has visibility and transparency of all the physical marketing activities undertaken by MSF Sugar. This involves having the activities independently audited.
- This panel is also involved in developing different cane pricing pools for growers:
    - It has evolved from a single grower managed collective pool to a number of pricing options.
    - This includes pools which allow individual decisions, grower collective and grower/miller collective decision pools.
    - This process to create pools is slow but involves the growers at the local mill area and is not imposed. Individual growers then have a choice of pool in which to price their sugar cane.

In addition, a Charter was developed for the Grower Reference Panel and is inserted as follows. This Charter is designed to be able to evolve to meet the needs of the GRP and some amendments are currently being discussed.

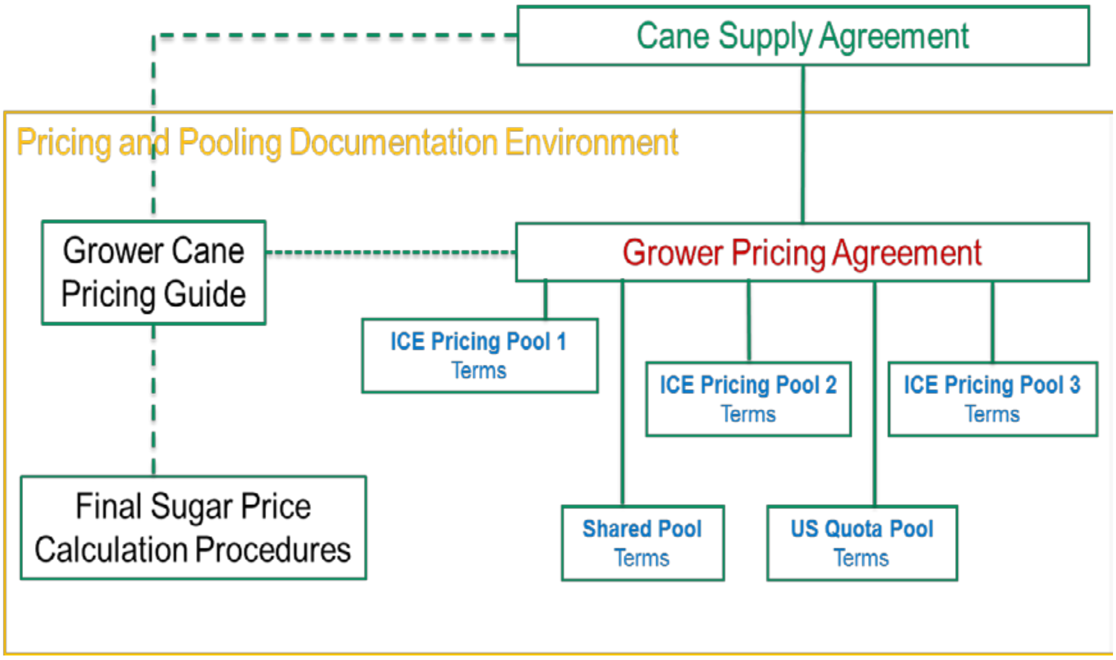
Establishment of Grower Pricing Panel (GRP)

- Growers from each mill area plus Canegrowers representatives
- Meets quarterly – detailed updates on pool returns & export programs
- ICE 11 Grower Collectives & Individual Pricing – Forward Season
- Each mill area has established a Target Pricing Committee that sets price targets for committed tonnages in regional Collective Forward Pricing Pools
- Growers have the ability to individually set price targets in increments of 50.8 t

Growers are able to negotiate collectively, and do so effectively, which constrains potential market power by the mills. The current payment arrangements and the transparency which they provide also play an important part.

MSF Sugar negotiates a cane supply contract with the growers who supply its four sugar mills. Each mill has its own cane supply contract however the underlying cane price formula is the same at all mills. The basic cane price formula links the tonnes of cane supplied, the sugar content in the cane (called CCS) and the world sugar price.

In addition, MSF Sugar has developed an Improved Pricing and Pooling Model as below, which is designed to give Growers choice in managing their financial outcomes.




By entering into a Cane Supply Agreement, a grower is able to elect to enter into a Grower Pricing Agreement which enables growers to participate in a number of pricing pools.

The Grower Pricing Agreement

- Provides the opportunity for MSF to improve the pricing pools offered to growers
- Introduce new pools
- Remove unsupported pools
- Modify existing pools
- Give growers confidence
- To take advantage of the system (i.e. manage cane price risk)
- System is understood and not intimidating (over-complicated)
- The arrangements are equitable, fair and transparent
- Key Final Sugar Price calculation principles and methodologies are documented up-front and can form the basis of an audit scope
- The process for Grower Reference Panel (GRP) and Target Price Committee membership is documented
- The provisions for quarterly Marketing Plan Review and Preview meetings are documented

Furthermore:

- All pools open to audit.
- GRP has direct input into the scope of audit
- Scope is open to change on an annual basis if necessary
- Input into the choice of auditor
- Cost of the audit is a shared cost
- GRP sign a confidentiality agreement and is able to view sales premiums, freight, question sales timing, sales customer choice and futures allocation