Submission No. 012

TULLY SUGAR LIMITED

ABN 92 011 030 256

TULLY SUGAR 中粮 COFCO

Your Ref:

Our Ref: NCS/DH/MF:

20 July 2015

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

Dear Ms Howard

INQUIRY FOR THE *SUGAR INDUSTRY (REAL CHOICE IN MARKETING) AMENDMENT BILL 2015*

BACKGROUND:

About Tully Sugar Limited

Tully Sugar Limited (Tully Sugar) is a wholly owned subsidiary of Chinese agribusiness company COFCO. COFCO acquired Tully Sugar in July 2011. We operate one of the largest sugar mills in Australia. Tully Sugar employs over 200 people on a permanent basis, and more than 100 additional seasonal workers during the crushing season.

Our principal activity is the milling of sugar cane to produce raw sugar of internationally recognised high quality for the export market. Molasses is produced as a by-product of the sugar extraction process and is a valuable cattle feed supplement. The molasses we produce is sold into both the domestic cattle feed and the international markets. Tully Sugar produces electricity which is exported to the Queensland electricity grid.

The Company also owns and operates a number of cane farms, has commercial and residential real estate interests in Tully and is a Registered Training Organisation.

Tully Sugar is supplied by over 240 growers who produce sugar cane on 30,000 hectares of land in the Tully region. The area of cane produced by growers for Tully Sugar has increased by more than 20% since the late 2000's.

About COFCO

Founded in 1949, COFCO has developed from a grains and oilseeds trading company into China's leading service provider of agricultural products and diversified food services. COFCO is committed to creating an agricultural and food company with an integrated value chain that connects farms to households and creates a full-service urban system, and to utilizing sustainable natural resources to provide nutritious, premium-quality products.

From trading and processing of grains and oilseeds, COFCO's value chain has now extended to origination and husbandry, logistics and storage, raw materials processing, biofuels, branded food production and sales, hotels and real estate, financial services, among others. COFCO is committed to building its core competencies in each stage of the value chain and maximising value for our stakeholders, customers and employees, and opportunities for our suppliers.

As a widely recognised global company, COFCO has been awarded as one of the "Fortune 500" companies for 21 consecutive years, the only Chinese agri-food enterprise on the list.

TERMS OF REFERENCE:

On 19 May 2015, Shane Knuth MP, Member for Dalrymple, introduced the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015* as a private members bill into the Queensland Legislative Assembly.

The Bill was referred to the Agriculture and Environment Committee (AEC) for examination, and the AEC is seeking comment on the following matters:

1. Views on the current regulation of the sugar industry with respect to sugar marketing arrangements
2. Benefits and/or impacts arising from the decision to exit the current sugar marketing arrangements (markets outside of QSL)
3. Comments on the proposal outlined in the Bill to provide for:
    a. Proposal for supply contracts that give legal recognition to "grower economic interest" sugar (GEI)
    b. Proposal for growers choice by nomination of marketing entity within supply contracts for GEI
    c. Arbitration of disputed terms in a supply contract
4. Recommendations and/or alternative approaches to address marketing and other industry concerns

SUBMISSIONS:

1. Views on the current regulation of the sugar industry with respect to sugar marketing arrangements

The Queensland sugar industry has been progressively deregulated, culminating in full deregulation in 2006. The changes were necessary to remove inefficient practices and replace them with proper commercial foundations to underpin a modern progressive industry.

One of the major benefits of these reforms was that growers and milling companies alike were able to undertake their own price risk management. As a result, growers can set the sugar price that underpins the price they will receive for their cane using services facilitated by the milling company. This pricing is done using the independent and transparent world market price represented by the Sugar No.11 futures contract.

Since deregulation Tully Sugar has maintained a Raw Sugar Supply Agreement with QSL, and Tully Sugar will continue to be bound by the terms of the current Raw Sugar Supply Agreement until the conclusion of the 2016 season. In fact, Tully Sugar has for many years been a strong supporter of the QSL marketing system and this support continued following the acquisition of Tully Sugar by COFCO.

In March 2012 Tully Sugar and QSL jointly announced the extension of Tully Sugar's Raw Sugar Supply Agreement. Tully Sugar again extended its Raw Sugar Supply agreement in 2013 to the 30 June 2017.

However, following the notice by Wilmar and MSF Sugar of their intention to withdraw from the Raw Sugar Supply Agreement with QSL, Tully Sugar announced on the 30 June 2014 that it would also not extend its Raw Sugar Supply Agreement with QSL beyond 30 June 2017.

Tully Sugar assessed the impact of the withdrawal of the largest suppliers to the QSL export marketing system and determined that the loss of major suppliers would fundamentally change the QSL offering.

In announcing this decision Tully Sugar noted that the withdrawal of Wilmar and MSF Sugar meant that QSL "loses more than seventy per cent of its critical export mass and its competitive marketing advantage. This presents unacceptable risks to our business and our growers".

Since announcing its decision Tully Sugar has been working with its growers to better understand the needs of the Tully sugar industry, and define how Tully Sugar will ensure that the services previously provided to Tully Sugar by QSL will be provided in the future.

Tully Sugar has spoken with many of its suppliers individually and at regular group meetings about the changes that will arise. Tully Sugar has arranged for independent commodity risk advisors to speak at monthly meetings about the services that are commonly available in other industries, and has described how Tully Sugar will seek to replace the services that are currently provided by QSL. The discussion with our grower suppliers is focussing on their commercial requirements, and how those can be met effectively.

A cane supply contract to commence in 2017 is currently being drafted to enshrine the growers' fundamental rights, but it would be fair to say that the prospect, real or perceived, of a legislated outcome is neither helpful nor beneficial to the negotiating process intended to deliver a fair and commercial outcome between the Mill and its growers.

2. Benefits and/or impacts arising from the decision to exit the current sugar marketing arrangements (markets outside of QSL)

Growers already enjoy significant choice in managing their exposure to net sugar price and therefore the price of the cane they produce and sell to mills. We believe in maintaining their fundamental right to access pricing independent of Tully Sugar, and this concept is embodied in the cane payment formula as defined in the cane supply contracts with our growers.

This fundamental right of our Growers will not change under the proposed future marketing arrangements that we are considering.

In addition to the growers' ability to independently link the price payable for their cane to the ICE #11 market, we also recognise that there are additional potential benefits and costs associated with marketing of raw sugar that growers should share in. This is a continuation of the existing arrangements. We have given commitments to our growers that it is not our intention to profit from the provision of services associated with raw sugar marketing, and we have been holding regular meetings with growers to explain how we intend to establish fair and transparent processes to safeguard and protect their interests into the future.

It would therefore be fair to say that we believe that our decision to exit the RSSA with QSL should not result in a detrimental trend on the cane price paid to growers going forward.

3(a) Proposal for supply contracts that give legal recognition to "grower economic interest" sugar (GEI)

"Grower economic interest sugar" is a term that has only been used since the creation of the current Raw Sugar Supply Agreements which came into force at the end of 2013. It does not appear in the current Cane Supply Contract that Tully Sugar signed with its grower suppliers prior to the start of the 2014 crushing season. It is not a term that has been used historically in the Queensland sugar industry.

The link between the price of raw sugar and the payment the grower receives for the cane they deliver to Tully Sugar is set out in the Cane Supply Contract. The grower currently has the ability to manage their price risk independently of Tully Sugar by using forward and in season pricing contracts to set the price of raw sugar, based upon the Sugar No.11 futures contract in Australian dollars, which is then used as the major input into the formula that determines the price the grower receives for the cane they deliver.

We are deeply concerned that the possible introduction of the private members' bill in support of the so called 'grower choice' marketing model will have the effect of:

- expropriating our property rights over more than 60% of the product we manufacture and own (raw sugar) by removing our right to determine how our raw sugar is marketed, and re-establishing QSL as a compulsory default marketing desk for this sugar despite the full deregulation of marketing in 2006; and
- re-introducing compulsory pre-contract dispute arbitration which was abolished in 2004 – abolished with full agreement of government and industry.

These changes in policy are being considered without due regard to the material adverse financial impacts expropriation of our product would have on COFCO's investment in Tully Sugar.

3(b) Proposal for growers choice by nomination of marketing entity within supply contracts for GEI

As outlined above, growers will retain the absolute right to determine the price they receive for cane supplied, thereby retaining control over the principal component of their net cane pay. Tully Sugar will provide or outsource the services necessary to replace those currently provided by QSL, charging these services to growers at cost.

Additional revenue is earned from the Far East Premium which represents Australia's freight advantage in supplying the Asian markets, and its quality advantage relative to some other origins. A further source of revenue is the Polarisation premium, which is a quality parameter common to almost all raw sugar export contracts, based upon the International Polarisation Scale under the Sugar Association of London contract rules.

Costs are incurred in terms of shipping and port logistics, financing, and various marketing charges. Under the current pooling arrangements, these costs are largely offset by the additional revenue from the premiums described above, so that there can be a net positive contribution to the final sugar price used for determining cane payments of up to 5%. This structural situation will not change substantially as a result of the change in the service provider.

Despite the fact that the physical marketing of raw sugar contributes a very small amount to the net price payable to growers, Tully Sugar will have a transparent process for satisfying growers that they are earning FOB premiums from the marketing of raw sugar appropriate to current industry pricing.

Growers have the additional comfort that, as a subsidiary of a foreign-owned company, Tully Sugar is bound under the transfer pricing regulations administered by the Australian Taxation Office to invoice its parent at full market price for its product.

3(c) Arbitration of disputed terms in a supply contract

We also have concerns regarding the re-introduction of compulsory pre-contract dispute arbitration which was abolished in the 2004 sugar industry reforms with the full support of the industry, and state and federal governments. We believe that re-introduction encourages the parties to avoid the responsibility for genuine negotiation on a sound commercial basis.

Our concerns include the uncertainty that placing the fate of commercial arrangements in the hands of a third party with no guiding framework would have a high risk of serious, long term adverse consequences for our industry in Tully. We are unaware of any comparable precedent in the Australian or Queensland business environment that would support the re-introduction of compulsory pre-contract dispute arbitration to the sugar industry.

4. Recommendations and/or alternative approaches to address marketing and other industry concerns

There has been no market failure event described or defined in the Australian sugar industry that would require the introduction of the private members' bill.

The previous decision by Tully Sugar to support the single desk monopoly service provision model will now give way to a model that creates greater competitive tension amongst a range of providers for a number of services. Existing Commonwealth competition and consumer laws are sufficient to regulate the industry and there is no need to make a special case for the Australian sugar industry.

If anything the proposed changes to raw sugar marketing in the Tully sugar industry will allow growers to take greater control over the management of the price they receive for their product. Growers have been able to manage their price risk independently of the mill for a number of years. This will not change, and indeed with Tully Sugar no longer solely relying upon QSL to develop the required price risk management tools, the capacity now exists to access a wider range of services for the growers in the Tully sugar region.

Yours sincerely

N Salter
COMMERCIAL MANAGER