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Agriculture and Environment Committee
Parliament House
George Street
Brisbane QLD 4000

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

RE: Submission on *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015*

Dear Committee Members

Please see attached Wilmar Sugar Australia's (Wilmar) submission on the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015*. We thank the Committee for the opportunity to provide a submission, noting the Private Members Bill was drafted and tabled without any consultation with the companies that manufacturer Queensland's export raw sugar.

Wilmar is one of Queensland's largest manufacturing employers, employing more than 2000 full time and seasonal employees. Legislative restructuring of the sugar industry absent any consultation or regulatory impact assessment process places significant risks on the future viability of our milling business and our 2000 employees.

We note the very unusual circumstances of the Bill being presented and explained to the Committee with the support of Mr Stephen Ryan, General Manager of Australian Cane Farmers Association (ACFA). The Committee should be aware that ACFA only represent approximately 2% of Wilmar growers and has no direct involvement in the manufacturing of Queensland's raw sugar or in the global trade and sale of raw sugar, which are the specific sections of the industry's supply chain this Bill is proposing to fundamentally restructure.

Wilmar is the largest manufacturer of raw sugar in Australia and one of the world's leading global traders of raw sugar. We would welcome the opportunity to provide a briefing to the Committee on Queensland's sugar industry supply chain and our economic analysis of better cane farm and sugar mill returns that could result from improved sugar marketing arrangements in Queensland.

In particular, we would like to brief the Committee on the contractual pricing and supply chain protections Wilmar is offering to its farmers. Wilmar has developed a draft supply contract proposal that provides unprecedented contractual protections for cane farmers, making redundant any need for Government to consider heavy-handed industry-wide re-regulation that expropriates the raw sugar we manufacture in our sugar mills.

We look forward to your consideration of this request and commend the attached submission to the Members of the Committee.

Yours sincerely,

S. W. Rutherford

Shayne Rutherford
Executive General Manager Strategy and Business Development
Wilmar Sugar Australia

Wilmar Sugar Australia

Submission to the Agriculture and Environment Committee

20 July 2015

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1. Executive summary

Below is a summary of Wilmar's primary concerns with the *Sugar Industry Amendment Bill 2015* (the Bill).

Wilmar does not believe that the Bill is needed as Wilmar has guaranteed that growers will continue to receive the full economic benefit from Australian sugar sales under a comprehensively documented suite of grower transparency and protection measures. Furthermore, introduction of the Bill will create significant unintended adverse consequences for the industry. The primary concerns are:

Growers do not have, and have never had, title to manufactured raw sugar

At no stage in the history of the Queensland sugar industry, have cane growers had title to processed raw sugar. The title to manufactured raw sugar unambiguously lies with the miller who makes it. There is no such thing as a "sugar grower", "sugar farmer" or "grower-owned sugar". Queensland's sugar industry supply chain consists of cane farmers who grow and sell cane and mill companies that manufacture raw sugar. Sugar millers buy sugar cane and then use their sugar mill infrastructure to process and transform the cane into a new product, raw sugar, which is owned by the mill, in much the same way as a flour mill buys wheat grain and makes flour.

To provide raw material suppliers (in this instance cane growers) with ownership rights to determine how and where to sell a manufacturer's processed produced (raw sugar) is an expropriation of a property right. This Bill would be an unprecedented interference with manufacturer's rights, with implications under existing trade agreements and significant impacts on Queensland's international reputation as a place to invest. There is no demonstrated economic or commercial basis for a cane grower to seek ownership rights over the raw sugar manufactured by millers.

To make, own and sell raw sugar you need to own a sugar mill

Wilmar has invested more than $2 billion in Queensland to buy sugar milling assets so it has the capability and infrastructure to manufacture raw sugar. There is no basis on which to suggest sugar cane farmers should control the sale of another company's manufactured raw sugar. This would be akin to suggesting wheat farmers should be able to control flour sales.

An appropriate case study for the Committee to consider regarding sugar ownership, is the recent history of the Proserpine Mill. Proserpine Mill was previously grower-owned. As owners of the mill, the cane grower suppliers of the mill owned the raw sugar the mill manufactured at the mill. As such, the grower owners made decisions about how and where to sell their manufactured raw sugar. In 2011, the Proserpine Mill was placed in voluntary administration jeopardising mill jobs and the cane farms that supplied the mill. Wilmar purchased the mill from voluntary administration for $120 million and invested significantly in capital expenditure to upgrade the mill so it was more efficient and financially sustainable. Wilmar now employs 250 mill employees at Proserpine and rightly, Wilmar owns the sugar the mill manufactures. This Bill proposes that despite Wilmar's investment and rescuing of the Proserpine Mill from administration, growers should still be able to control the sale of sugar manufactured by the Proserpine Mill.

Cane pricing is not changing

Wilmar is not seeking to change how growers are paid for cane. The 100 year old Cane Price Formula, which links the price paid for cane to the price achieved for raw sugar, is guaranteed to stay under Wilmar's raw sugar marketing proposal. As a result of the Cane Price Formula, cane growers do not receive a farm gate price like in other agriculture sectors.

Growers make choices affecting 99% of the net sugar price, independent of the miller

Cane growers have an economic exposure to the 'net sugar price' achieved for raw sugar as the price of cane is linked to the sugar price via the Cane Price Formula. The physical marketing of sugar, net of costs, represents about 1% of the 'net sugar price' used in the Cane Price Formula to determine the price paid for

cane. The remaining 99% of the 'net sugar price' is determined through the individual pricing and pooling options chosen by the cane grower. This includes the ability under Wilmar's proposed arrangements for growers to forward price cane by using Queensland Sugar Limited (QSL) as a pricing manager (for 99% of the net sugar price).

The Bill will restructure the Queensland sugar industry for 1% of net sugar price

The Bill is in effect proposing to entirely restructure ownership rights in the Queensland raw sugar supply chain, in relation to perceived concerns about transparency and equity in relation to growers' exposure to the 1% of the net sugar price that they cannot independently manage. Wilmar believes the 1% of net sugar price is important, indeed increasing that 1% for the benefit of Wilmar and the growers who supply its mills, is the primary reason Wilmar is exiting the voluntary raw sugar marketing arrangements with QSL. Wilmar has guaranteed to provide, and has comprehensively documented, a full suite of contractual transparency and protection measures to ensure growers receive the full economic benefit from all physical sugar sales. Forcibly removing a miller's ability to market and sell the product it makes, in relation to perceived, but unfounded concerns about 1% of the net sugar price, is an extreme proposal which would have significant financial impact on Wilmar's business, risking the future viability of our mills and the employment of 2,000 people in Queensland.

The Queensland sugar industry was de-regulated in 2006 at great cost to Queensland and Federal Governments

This draft legislation disregards the Queensland Government's $33 million commitment and the Federal Government's $444 million, which was provided to the sugar industry to assist with de-regulation in the early 2000's. In addition, raw sugar marketing was de-regulated in 2006 with the express intention that sugar millers would be able to determine how to market the product they make. In fact, several mills have operated successfully outside the QSL system in the 9 years since de-regulation, and found they can achieve better returns by doing so. Indeed today, there are significant numbers of growers who are supportive and fully engaged with their mill directly marketing their sugar production.

Pre-contract arbitration removed with the agreement of all industry stakeholders

Compulsory pre-contract arbitration was removed from the sugar industry as part of the 2004 reforms, based on expert economic analysis of the cost of arbitration and the adverse impact it had on the industry. Wilmar's existing and proposed cane supply contracts already provide a process of discussion and mediation administered by the Australian Commercial Disputes Centre, and final and binding in-contract arbitration subject to the *Commercial Arbitration Act 2013* (Qld). Had the Katter Australia Party consulted with Wilmar sugar, this could have been clarified before the Bill included this potentially damaging and costly measure.

No consultation with the companies that make sugar

It is deeply concerning that a private members bill to re-regulate the Queensland sugar industry has been tabled without any consultation with the companies that make export sugar. At no stage was Wilmar consulted on the draft Bill or afforded the opportunity to provide input to the preparation of the Bill. The development of legislation without any fundamental public policy development process is very concerning.

No evidence of market power or anti-competitive behaviour

Despite emotive language, there is no economic or commercial incentive for a sugar miller to reduce cane growers' returns. In fact, in Wilmar's case a 5% reduction in cane volume results in a more than 20% reduction in earnings before interest and tax (EBIT). Wilmar has a clear incentive to increase the throughput of cane in its mills, and the best way to do this is to increase returns for growers.

The pricing structure of the Queensland sugar industry, which Wilmar is not seeking to change, means that by using its marketing expertise and leveraging its global network, Wilmar can generate better returns for its raw sugar, which flows back to growers through the Cane Price Formula.

In addition, under the *Sugar Industry Act 1999* cane growers are authorised to collectively bargain with

millers, and are required to have a cane supply agreement in place. Developed over 100 years of negotiation and collective bargaining, these agreements are comprehensive, detailed contractual guarantees for growers over the pricing and payment of their product.

Wilmar is invested in the Queensland sugar industry, and is invested for the long-term.

Wilmar International commenced its sugar operations in Australia in 2010 with its $1.75 billion acquisition of Sucrogen (formerly CSR sugar). In 2011, Wilmar also acquired the Proserpine Mill, which was in voluntary administration, for $120 million. Currently Wilmar employs more than 2,000 people in Queensland, including seasonal staff. In 2015, Wilmar has budgeted to invest approximately $9 million in research and development and on-farm extension and productivity programs, and more than $78 million is budgeted for capital expenditure. The Bill proposes to re-regulate the sugar industry, with significant effects on future investment and employment in Queensland, without any public cost benefit analysis or process.

The alternative to re-regulation is commercial negotiation that delivers a fair and balanced supply chain and appropriate farmer protections

Wilmar fundamentally agrees that cane farmers should be afforded strong and appropriate supply chain protections. Wilmar would encourage the Committee and the Member for Dalrymple to undertake an independent review of Wilmar's draft cane supply agreement proposal.

Wilmar is proposing contractual protections for farmers which set a new benchmark for supply chain fairness and transparency, exceeding what is available to farmers under the Federal Government's regulated Horticulture and Grocery Codes of Conduct.

Wilmar has been entirely open about its proposed contractual agreements, providing copies to the Australian Competition and Consumer Commission (ACCC), and State and Federal Departments of Agriculture in December 2014. No department has notified Wilmar of any concerns regarding its offer or draft agreements. Grower collectives have also been offered financial support to undertake their own independent legal and marketing expert reviews of the draft agreements. Some growers and their collectives have taken up this offer with reviews currently underway.

In Section 6.3 of our submission we have compared the farmer supply chain protections being offered by Wilmar, with other agriculture sectors.

In an Australian first, Wilmar is also proposing to invite its growers to participate on a Grower Transparency Committee to oversee Australia sugar sales. Growers will get access to confidential financial sales data and be able to see where Wilmar's Australian sugar is being sold, the date of the sale, the shipping and handling costs for each ship, and the net sugar price achieved for farmers. The new Transparency Committee will be nominated by growers, for growers. This provides our farmers with unprecedented access to overseas sales data. It is the equivalent of a cattle farmer being able to track the final downstream sale price of the steaks from their cattle that are sold in China.

Commercial negotiation is appropriate for a mature and commercially-focused sugar industry. Unfortunately, while government re-regulation and particularly the promise of providing growers with ownership rights over a mill's manufactured product are being promoted; commercial negotiations have been, and will continue to be, stymied.

2. Response to the Committee's specific areas of interest

Wilmar's views on each of the discussion topics outlined in the Committee's invitation for public submissions are provided below.

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

Current regulation is appropriate and effective

The Australian sugar industry has transitioned from one of the most heavily regulated sectors in Australia to one which has a much more appropriate and effective regulatory regime that encourages a more globally-focused and competitive industry.

In particular, the most recent reforms introduced in 2004 and 2006 occurred after many years of review, consultation and discussion involving all industry participants, following a raft of investigations into whether the sugar industry's excessive regulation hindered its responsiveness to global market developments.

Raw sugar marketing was deregulated after a series of reviews including a report commissioned by the Queensland Government in 2005 that recognised the compulsory vesting of sugar to the single-desk was holding the industry back, and freeing-up compulsory vesting was overwhelmingly in the public interest.[1] Following deregulation in 2006, some mills (Maryborough, Mossman and Mulgrave) chose to independently market their own sugar. The majority of mills, including Wilmar (formerly CSR sugar), entered into voluntary agreements with Queensland Sugar Limited (QSL) to market their export raw sugar. These were rolling three year agreements.

Marketing deregulation has fostered significant innovation, including forward pricing, which was introduced in 2008. Today, growers are able to undertake price risk management independently from the price risk management decisions of their miller, via a range of individual and pooled pricing options, through forward pricing. For the 2015 season, 71% of Wilmar's growers participate in forward pricing. Through price risk management, growers exercise choice that determines approximately 99% of the Net Sugar Price used to calculate the price of their cane.

Today, several millers, including Wilmar, market a portion of their sugar outside the QSL system, and achieve better returns by doing so. Wilmar's recent decision to leave the QSL arrangement from the 2017 season was motivated by a desire to achieve better returns for itself and its growers for all the raw sugar it produces. Wilmar's decision is entirely consistent with the principles of the 2006 deregulation of sugar marketing; is permitted under the *Sugar Industry Act 1999*, and is in full compliance with the company's legal and contractual obligations to growers and QSL. No processor should be forced to receive lower returns, particularly when the price received by its suppliers, is linked to the returns achieved for the manufactured product.

The *Sugar Industry Act 1999* requires that mills and growers enter into formal cane supply agreements as a precondition of a miller crushing a grower's cane. The Act also authorises grower collective bargaining for the purpose of negotiating these Cane Supply Agreements.

Cane Supply Agreements have evolved over almost 100 years of statutory and collective bargaining to become comprehensive commercial agreements documenting in great detail all aspects of the commercial

[1] The CIE, 'Unshackling Queensland Sugar' June 2005

arrangements between millers and growers. Wilmar must now negotiate amendments to these agreements with its growers and their representatives, to reflect new marketing arrangements that are agreed for the 2017 season.

In the context of Cane Supply Agreement negotiations, it is important to understand the impact of the structural co-dependence of mills and growers. The sugar industry has, by and large, a default co-dependent, monopsony supply chain. Mills can only receive cane from specific farming regions located near the mill and for the most part, farmers have only one mill to sell their cane to. Mill profitability is highly leveraged to cane volume throughput, and to maintain profitability mills need to ensure a sustainable cane supply matched to available milling capacity. Mills are therefore strongly incentivised to ensure that commercial outcomes of cane supply negotiations provide for the economic sustainability of their grower suppliers.

In Wilmar's case it is estimated that a 5% decrease in cane volume translates to a reduction in earnings before interest and tax (EBIT) of more than 20%. The total installed capacity of Wilmar's mills is sufficient to crush over 17 million tonnes of cane if it were available, but Wilmar currently receives only 15 million tonnes of cane. Wilmar has a significant incentive to increase the volume of cane throughput. The best way to increase the amount of cane coming into a sugar mill is to increase the returns the cane grower receives.

Wilmar contends that the co-dependent nature of the relationship between growers and mills, the high sensitivity of mill returns to cane supply volumes and the existence of grower collective bargaining, are all factors which ensure an appropriate balance of market power between millers and growers. These factors also led the Industry Commission in 1992 in its review of the Australian sugar industry to state:

> *'.. in the past there may have been some potential for mills to exploit market power. However, growers have now formed strong organisations to negotiate on a collective basis. In some regions, growers have purchased their local mill. Growers also have far greater access to information to allow them to assess whether terms offered by a mill are reasonable. The development of trade practices legislation also provides some protection for growers against the misuse of market power by mills. While the Act limits collusive agreements to reduce competition between suppliers, an exemption may be provided if 50 or more parties are involved. These developments, coupled with millers' dependence on growers to supply sufficient cane to allow the mill to operate at satisfactory levels of capacity, **raise the possibility that it is growers rather than millers who possess the greater market power.'*** *(Industry Commission, The Australian Sugar Industry, 6 March 1992, Report No. 19, p.42, emphasis added)*

In addition to the Sugar Industry Act, commercial dealings of sugar industry participants are subject to other state and commonwealth regulation which provide adequate countervailing forces to ensure appropriate conduct of the parties. In particular, the *Competition and Consumer Act 2010* (CCA) (Cth) prohibits anti-competitive conduct, and prohibits unfair business practices. In addition, the Australian Competition and Consumer Commission (ACCC) has significant powers to enforce the CCA. The *Queensland Competition Authority Act 1995* (Qld) includes similar provisions to those of the CCA, giving added regulatory oversight to ensure open access to bulk sugar terminals.

2. Benefits and/or impacts arising from the decision by some millers to exit the current sugar marketing arrangements

Why Wilmar is exiting the voluntary sugar marketing arrangements with QSL

Wilmar and other millers have been marketing a portion of their sugar outside the QSL system for several years, and achieved better financial returns by doing this.

The primary purpose for Wilmar seeking to market 100% of the raw sugar it makes and owns, is to increase

returns for Wilmar and the cane growers who supply its mills, by leveraging its international network and significant trading expertise to maximise the net sugar price received on the sale of its Australian sugar. Wilmar has committed to retain the existing cane price formula, which links the cane price received by a grower to the net sugar price, and maintain or enhance all existing grower pricing, pooling and advance payment options.

Wilmar has proven it can generate better returns than QSL. Averaged over the 2012 and 2013 seasons, Wilmar's net sugar price, including marketing premiums, was $45 per tonne higher than growers received on average under the QSL system. Wilmar's marketing premiums were approximately 60% higher than QSL returned over the same period, about $11 better per tonne of sugar. At the Wilmar sugar price, growers would have received on average more than $4 extra for each tonne of cane. This would have increased growers' average farm margins by more than 50%. For a grower producing 10,000 tonnes of cane this would have delivered, on average, $40,000 a year in extra farm income. In the current financial environment, any opportunity to increase returns for cane growers, should be considered.

What are the Benefits and Impacts

Wilmar conservatively estimates the benefit of Wilmar's proposed marketing arrangements to be over $46 million per annum to Wilmar and its cane grower suppliers (please refer to Appendix A for further detail regarding this estimate). Of this, $36 million would be expected to flow to Wilmar's growers. In addition to this significant financial opportunity that Wilmar is offering through the proposed marketing arrangements, our proposal includes transparency measures that surpass what is offered in any other agriculture sector in Australia.

In an Australian-first for farmers, cane farmers or their representatives would be part of a Grower Transparency Committee and given sale details for every shipment of Australian sugar sold by Wilmar. Every grower would receive monthly reports providing transparency over marketing premiums net of costs, and the forecast price outcomes for pools including results from third party managers where applicable. Growers would also have the choice of forward pricing their cane with Wilmar, QSL or other suitably qualified third party pricing managers, subject to pricing limits that are used to manage production risk.

3a. Comments on the proposal outlined in the Bill to provide for supply contracts that give legal recognition to 'grower economic interest' sugar (GEI)

Wilmar has already agreed to recognise the principle of "grower economic interest"

Wilmar recognises that growers have an interest in sugar price outcomes as the price paid for cane is a function of sugar price. The supply contracts proposed under Wilmar's pricing and marketing arrangements include a defined term and formula which recognise the principle of grower economic interest ("GEI").

The introduction of forward pricing for growers in 2008 was underpinned by the recognition and quantification of a grower's exposure to sugar price under the Cane Price Formula. The quantification of a grower's exposure to sugar price (termed "Nominal Sugar Exposure" by Wilmar and "Grower Economic Interest" in the existing raw sugar supply agreement between mills and QSL) has formed an integral part of the operation of all grower pricing and pooling since 2008. The mathematical formula for Nominal Sugar Exposure and "GEI" are identical. However, it is important to note that a grower's exposure to sugar price or "grower economic interest" in no way implies grower ownership rights in a miller's manufactured raw sugar.

Wilmar farmers will have the choice of forward pricing their "GEI" with Wilmar, QSL or other suitably qualified third party pricing managers, subject to pricing limits that are used to manage production risk as is current industry practice. Wilmar is also proposing to increase the limit on forward pricing to a maximum of 70%, which is an increase of 10% on the current level.

3b. Comments on the proposal outlined in the Bill to provide for growers' choice by nomination of marketing entity within supply contracts for GEI

"Growers' choice" as provided for in the Bill transfers ownership rights over a mills' manufactured sugar to growers and is an expropriation of property.

The title to raw sugar produced at a mill resides with the miller, not because of any agreement with any other person, but by virtue of the fact that the miller created the product. Wilmar sought legal advice from Minter Ellison regarding the issue of raw sugar title, and the impact of the measures proposed in the Bill. Minter Ellison's advice, provided as Appendix B, confirms that raw sugar is owned by the mills, and enabling growers to determine who physically markets the sugar, is an expropriation:

> *Accordingly, while cane growers have an exposure, under a CSA, to prices for raw sugar, they have no proprietary interest in any part of the raw sugar itself. Understanding this point is crucial to analysing a proposed law which would give growers 'choice' as to how raw sugar is to be marketed. Such a law would give cane growers the power to determine how a product that is produced and owned by another person (the mill owner) is to be sold to third parties*.

The advice goes on to outline that depriving a mill of the rights that it would otherwise enjoy to market the sugar it makes, is an expropriation:

> *There is, in our opinion, a strong argument that the Bill would, if enacted, be a measure that has an effect equivalent to the expropriation of the 'grower economic interest sugar' produced by Wilmar, as the Bill would deprive Wilmar of virtually all of the benefits of the ownership of that property.*

Expropriating a manufactured product, by giving a raw material supplier ownership rights over the processed raw sugar, would set an extreme precedent for Australian agriculture.

There is no precedent is Australian agriculture for Government to expropriate a downstream processed product and give a supplier property rights over a processed product that has been entirely transformed through a manufacturing process. To do so would be an extreme and unjustified regulatory intervention. It would also represent a significant sovereign risk to Queensland's reputation as a place to invest and do business.

"Growers' choice" as provided for in the Bill would be financially damaging for Wilmar and the growers who supply its mills

'Grower choice' has the effect of forcing Wilmar to sell the majority of its manufactured product to its international trading competitors (on terms determined by its raw material suppliers) and then competing against these parties in marketing the remainder of its production to end customers. An expropriation of Wilmar's raw sugar property rights under 'grower choice' would be financially damaging for Wilmar and our growers, risking the future viability of our mills and the employment of our 2,000 employees. 'Grower choice' would have the effect of stripping Wilmar of its rights to determine the terms of sale and counterparties for more than 60% of its manufactured product. Mills have a direct economic interest in 100% of the sugar that they manufacture and are not financially indifferent as to whether they sell all, or only a portion, of the product that they manufacture.

Wilmar conservatively estimates the opportunity cost of implementing a 'grower choice' model to be over $46 million per annum to Wilmar and its cane grower suppliers, assuming QSL markets 100% of "GEI" (refer Appendix A). This estimate of cost impact takes no account of the fact that grower returns are likely to be further reduced because other international traders are highly unlikely to return to growers the full economic benefit of the sale of Wilmar's sugar production. Put simply, international traders that have no capital invested in Australian sugar milling assets will seek to make profits from buying and on-selling sugar and have no vested interest to maximise returns for growers as Wilmar does. In comparison, Wilmar has committed to deliver 100% of net marketing premiums to growers, on a dollar per tonne basis, and has a vested interest in doing so – to increase cane volume for its mills.

3c. Comments on the proposal outlined in the Bill to provide for arbitration of disputed terms in a supply contract

Wilmar's supply contracts provide for commercial arbitration for resolution of disputes

Wilmar's existing and proposed cane supply contracts already provide a process of discussion and mediation administered by the Australian Commercial Disputes Centre, and final and binding arbitration subject to the *Commercial Arbitration Act 2013* (Qld). However, the proposed Bill provides for compulsory pre-contract arbitration, i.e. arbitration used to determine the terms of supply contracts between millers and growers at the point of contract negotiation and establishment.

Compulsory pre-contract arbitration was abolished with the agreement of industry because it was widely accepted as being a prime impediment to industry efficiency, change and innovation.

Compulsory pre-contract arbitration was removed from the sugar industry as part of the 2004 reforms, based on expert economic analysis of the cost of arbitration and the adverse impact it had on industry change and innovation.

Under the proposed Bill, where a grower is in the process of negotiating a supply contract, that 'intended' supply contract would be subject to arbitration. Pre-contract arbitration would create a costly and protracted process as there is no limit on the terms to be agreed and no guiding framework as a basis for decisions – in effect a party could request the arbitrator to determine any or all the terms of the proposed agreement on which the parties would then be forced to deal with each other.

The Commercial Arbitration Act was not established for arbitrations of this nature. The Commercial Arbitration Act is premised on there being an existing agreement in place between the parties and a dispute between the parties as to the interpretation or performance of the agreement. Given the complexity and intricacy of the cane pricing and sugar marketing systems that exist in the Queensland sugar industry; it is likely only people with extensive industry knowledge could be considered appropriate arbitrators. The practical implementation of this model of arbitration would therefore likely require the establishment of a specialist sugar industry commission which would add additional cost and bureaucracy.

Pre-contract arbitration would push the industry back to a framework that was found to impede increased competition, efficiency and innovation; and add significant cost for millers and growers. The risk of the introduction of unintended perverse and adverse industry outcomes would also be significantly increased.

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

The solution is supply chain transparency and grower protections that surpass what is available in any other agriculture sector.

The fundamentals of the sugar industry supply chain are that cane farmers grow and sell cane to millers who manufacture and sell raw sugar. Both mills and growers are exposed to sugar price. Mills are exposed to sugar price as they own and sell their manufactured raw sugar. Growers have an exposure to sugar price as under the cane price formula, the price of cane is linked to the net sugar price received by mills.

The industry already recognises that growers have an exposure to sugar price and marketing deregulation has provided growers access to a range of pricing and pooling options which enable them to independently make the decisions that determine 99% of the net sugar price. Net marketing premiums which are associated with the physical sale of sugar make up the remaining 1% of the net sugar price. Wilmar believes mills are in the best position to determine how to undertake the marketing and physical sale of their manufactured product, to maximise the net sugar price for the mutual benefit of mills and growers. Wilmar also appreciates that growers want transparency to ensure that the full economic benefit of sugar sales is

fairly reflected in the net sugar price, and all relevant transactions are undertaken on a commercial arms-length basis.

In order to ensure transparency in relation to sugar price, Wilmar will establish an independent Grower Transparency Committee to give farmers access to full details of Wilmar's Australian sugar sales. In an Australian-first for farmers, cane growers or their representatives would be part of a Grower Transparency Committee and given sale details for every shipment of Australian sugar sold by Wilmar. Wilmar is not aware of any other farmers in Australia, including beef, dairy, seafood, horticulture and pork farmers, getting access to this level of market sensitive overseas sales performance data. In addition, every individual grower will receive comprehensive reporting which is significantly more transparent than the information currently provided to millers or growers by QSL. Wilmar's proposal also includes audit rights and guaranteed dispute resolution measures, which will ensure farmers have continuing access to in-contract arbitration under the Commercial Arbitration Act. This already gives cane farmers the equivalent access to contract dispute mechanisms as farmers are offered by the Federal Government's Horticulture Code of Conduct and Grocery Code of Conduct. Additional regulation is not required to ensure dispute resolution measures.

Giving ownership rights over a mill's raw sugar to cane growers is an extreme approach to achieving supply chain fairness and transparency.

3. Pathway to deregulation

Many of the current practices and principles underpinning the marketing of Australian raw sugar exports have been shaped by the industry's evolution from one characterised by extensive regulation and government intervention through to an increasingly deregulated and global market-oriented industry.

The road to deregulation has involved extensive consultation over many years with all industry participants, including Federal and Queensland Governments, growers and millers. There has been significant expenditure of taxpayer funds to assist the sugar industry to make the transition to deregulation, including the Commonwealth's commitment of $440 million, and the Queensland Government's $33 million which accompanied the most recent reforms of 2004 and 2006.

The deregulation of sugar marketing in Queensland on 1 January 2006 was the final step in the process of broader deregulation of the Australian sugar industry, and was undertaken with full agreement of government and industry. It was a significant milestone in the transition to a more innovative, commercially-focused and globally competitive Australian industry.

3.1 Regulated, and regularly reviewed

Between 1979 and 1996, there were nine reviews undertaken of the industry's structure and regulatory arrangements. Governments progressively took up recommendations for reform to the industry with a view to developing a more internationally competitive, export-focused industry that better aligned with the principles of National Competition Policy and the broader public interest.

The *Sugar Industry Act 1999* gave effect to many of the recommendations arising from a comprehensive industry review carried out by the Sugar Industry Review Working Party in the mid-1990s. The new legislation took effect in 2000 and was due to be reviewed in 2006. Its main provisions related to the negotiation of cane supply contracts between growers and millers, sustainable resource management, and the marketing of raw sugar.

The Act continued the practice introduced in 1915 of vesting all manufactured sugar in QSL, which was the successor to previous statutory bodies such as the Sugar Board and the Queensland Sugar Corporation. Through the Act, QSL was responsible for marketing the vested sugar on domestic and export markets, and returning proceeds to millers under agreements negotiated with the millers who were legally entitled to be paid for the sugar.

The Act did not define a statutory relationship between the payments made by QSL to millers for the sugar, and the payments by a miller to growers who provided the cane. As noted in the Queensland Government 2003 policy statement, Sugar: The Way Forward:

> *There is a common belief (which could be termed a tradition or custom) in the industry that sugar payments from the marketer should be apportioned two-thirds to growers and one-third to the mill, but this has no legal foundation in the present legislation. Payments from QSL to a mill for sugar and payments from the mill to its grower-suppliers for cane are* ***two different and legally unrelated matters****. (p.56)*

The cane price formula that is used today to pay growers for their product is discussed in detail below, but it is important to note that it has never been legislated, and the concept that growers have some form of legal entitlement to two-thirds of sugar manufactured by the miller has never had any legislative or legal basis.

3.2 Sugar industry reform

The Australian sugar industry was coming under intense pressure in the early 2000s on a number of fronts. Challenges included declining global market share; the oversupply of raw sugar on the world market; Brazil's ascendancy as a producer; and, the downward trend in average prices. Overall industry earnings had declined in a relatively short period of time. Without structural change, the Australian industry faced further

and potentially irreversible decline.

Around this time, there were a number of studies into the causes of and remedies for the industry's decline. Between 2000 and deregulation in 2006, there were several reviews, reports, legislative amendments, memorandums of understanding or heads of agreement signed between government, growers and millers. All identified the need for further reform, in particular the removal of legislative obstacles to productivity improvements that could be achieved throughout the different stages of the value chain.

There was extensive consultation with industry and growers by the Commonwealth and State Governments, and the introduction of various industry reform measures and assistance packages. The Commonwealth Government provided $444 million for the Sugar Industry Reform Program (SIRP), which was announced in 2004 to drive industry restructuring and provide assistance to individual farmers and communities affected by the changes.

The Queensland Government was also active, proposing a number of legislative reforms to support a more productive and competitive industry. It contributed $33 million to the reform program. The 2004 Sugar Industry Reform Bill was introduced with the objective of implementing the government and industry's commitment to further reform amid a fundamentally changed market outlook.

The 1999 Act was seen as hindering the industry from making the necessary changes to boost its competitiveness in the global market. As noted in the Explanatory Notes to the 2004 reform Bill:

> *Both the Australian Sugar Milling Council (ASMC) and the Queensland Cane Growers Organisation Limited (CANEGROWERS) formally recognised on 1 March 2004 that the future cannot simply be an extension of the past and that previous assumptions driving production and structural arrangements need to be changed. They also committed to the transformational change required to achieve sustainability.*
>
> *The commitment of all parties to the comprehensive reform and restructure of the sugar industry, including the* ***establishment of a working group to develop voluntary marketing arrangements as soon as possible.***

An agreement in March 2004 between the Queensland sugar industry and the Queensland Government reaffirmed the commitment of all parties to the comprehensive reform and restructure of the sugar industry, including the establishment of a working group to develop voluntary marketing arrangements as soon as possible. It noted the likely future cessation of the compulsory acquisition for sugar, although envisaged a role for QSL in the transition from regulated to commercial operations.

Following the presentation of the working group report, the Queensland Government undertook to prepare amending legislation to remove compulsory vesting and to allow the new arrangements to operate prior to the commencement of the crushing season in 2006. The progress to voluntary marketing was agreed by industry participants, including Canegrowers, the Australian Sugar Milling Council and the Queensland Government in a memorandum of understanding signed in October 2005.

3.3 Deregulation of raw sugar marketing in 2006

The *Sugar Industry Amendment Act 2005* introduced changes to marketing arrangements, principally the introduction of new voluntary marketing arrangements that would see commercially negotiated contractual arrangements between participating mill owners and QSL for the export of bulk raw sugar for an initial period of three years. The new arrangements were to take effect from the commencement of the crushing season in 2006.

Following deregulation, some mills (Maryborough, Mossman and Mulgrave) chose to independently market their own sugar. The majority of mills, including Wilmar (CSR Sugar), entered into voluntary agreements with QSL to market their export raw sugar.

In a more commercially open and competitive environment, sugar millers and growers were able to influence

change and innovation in sugar marketing. More sugar pricing options emerged compared to the single price pool that had been previously available through QSL. Millers can now elect to allocate their raw sugar to a variety of QSL-managed pools and can forward price a proportion of their sugar production independently from QSL. Each pool has different pricing and risk management strategies.

Through the cane supply agreements, growers also now have more options to choose different pricing and risk exposure/management options. None of these options were previously available to growers with all prices and costs being pooled across all sales. The introduction of forward pricing in 2008 by Wilmar (CSR Sugar) has provided growers with more choice about how their cane is priced up to three years ahead. This option was not previously available under the QSL single pool price.

In keeping with the terms agreed for the future of deregulated sugar marketing under the 2006 reforms, Wilmar, MSF and Tully Sugar have decided to market all their sugar independently of QSL from the end of the 2016 season. Wilmar's decision is based on the objective to achieve greater flexibility, innovation and improved marketing outcomes (higher sugar prices) for Wilmar and its grower suppliers.

3.4 Deregulation has been successful

Deregulation of sugar marketing was not an 'accident' of the industry reform process; it was the intended end goal of the reform process. Of the more than 20 reviews, reports and inquiries into the sugar industry from 1983 to deregulation in 2006, the landmark Hildebrand Report was delivered to the Honourable Warren Truss MP, then Minister for Agriculture in 2002. The Hildebrand Report was the driving rationale behind the Federal Coalition Government's commitment to the $444 million taxpayer funded transition package to assist the sugar industry move to a deregulated structure. The report stated:

> *The Assessment concluded that the industry's best chance to survive and flourish is largely up to itself; on its willingness to change the way it organises itself in Queensland; on learning to cooperate and take up good ideas of which there are many; on its willingness to support the best, most energetic and most able talent to lead for the good of each mill area or region.*

The principles behind deregulation of marketing that were supported by Government and industry in 2006 continue to be relevant today. The drivers of deregulation a decade ago anticipated many of the features of the contemporary global market. Today, Australian sugar makes up less than 25 per cent of sugar imports into the Asian region, and this market share is diminishing steadily as supply from other countries continues to increase (i.e. from Brazil and Thailand). As noted in a report completed by The CIE in 2014, the single desk is no longer required for Australian producers to capture regional marketing premiums (The CIE, 'Current and future arrangements for the marketing of Australian sugar: Senate Inquiry', October 2014, p.19).

Australian agriculture is reliant on foreign investment for growth. The sugar industry has been a prime case study of the ability for foreign investment to recapitalise and improve the long-term viability of the sector, which has benefited Queensland cane growers. As an example, when Wilmar purchased Sucrogen in 2010, mill efficiency was suffering as a result of significant underinvestment. Wilmar's capital reinvestment in the milling business doubled from what was occurring under CSR in the early to mid-2000s, to $78 million in 2015 alone.

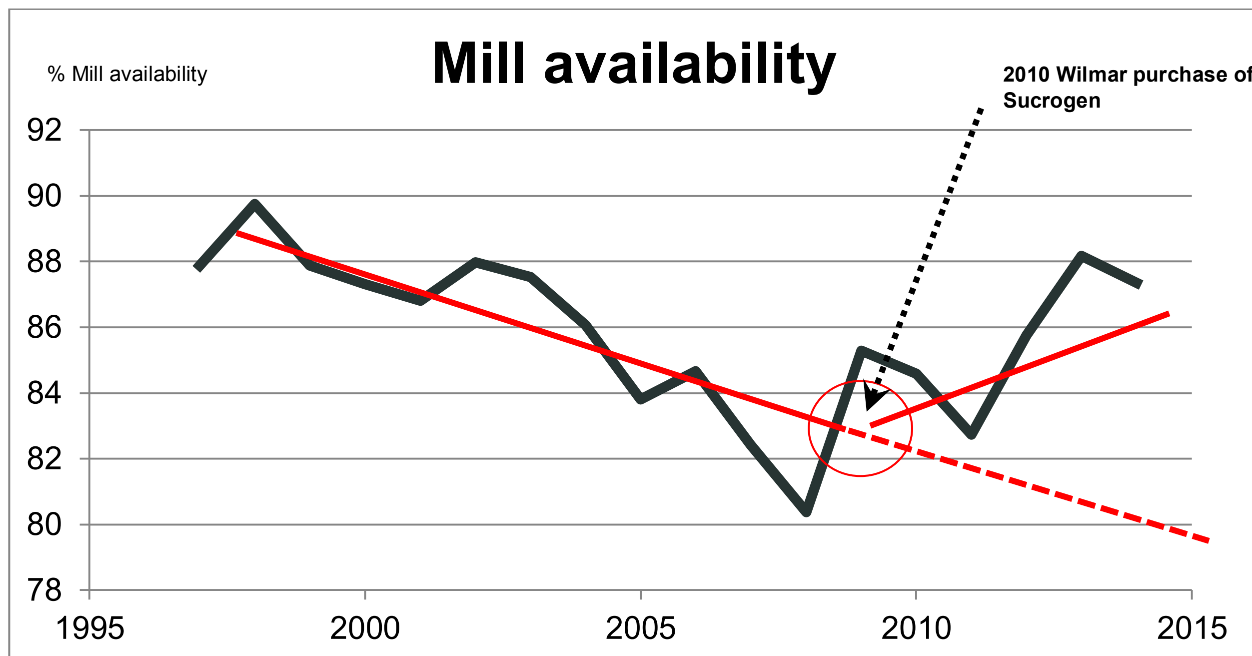

Figure 1: Mill availability showing the impact of reinvestment

Wilmar has invested over $300 million in capital expenditure in the mills since 2010, and a similar amount in maintenance expenditure. In 2011, Wilmar also acquired the Proserpine Mill, which was in voluntary administration, for $120 million.

The jobs of approximately 250 people, including seasonal staff, in the Proserpine region were protected through Wilmar's purchase and reinvestment in the mill. The purpose of marketing 100% of the sugar manufactured at Wilmar's eight sugar mills is to increase the returns to the company and its grower suppliers, and protect the employment of its Queensland workforce of about 2,000 people. Wilmar Sugar Australia employs 525 people in the Herbert region, 965 in the Burdekin, and 74 people in Mackay; with additional staff in Brisbane and Townsville offices.

As outlined above, with deregulation and a more open environment, forward pricing was introduced which allowed growers to choose different pricing and risk exposure options.

In 2008, grower forward pricing was offered by Wilmar (CSR Sugar) for the first time and progressively, an increasing array of pricing methods and pools were made available to cane growers. Today, growers are able to undertake their sugar price risk management independently from the price risk management decisions of their miller via a range of individual and pooled pricing options. Queensland cane growers enjoy the benefits of price risk management arrangements which are unique in the global sugar industry.

For the 2015 season, 71% of Wilmar's grower suppliers participated in forward pricing by nominating at least some of their pricing exposure to specific pools or pricing methods. In the Proserpine region, over 90% of Wilmar growers participated in forward pricing. This is a prime example of the innovation that de-regulation has fostered, and in only 8 years has been taken up by a majority of Wilmar growers.

4. Industry structure characterised by co-dependence

The sugar industry has, by and large, a default co-dependent, monopsony supply chain. Mills can only receive cane from specific farming regions located near the mill and for the most part, farmers have only one mill to sell their cane to. It is estimated in Wilmar's case that a 5% decrease in cane volume translates to a reduction in earnings before interest and tax (EBIT) of more than 20%. Mills are strongly strategically and financially incentivised to ensure farming operations remain profitable as mill viability is highly dependent on the sustainability of an adequate level of cane supply.

Wilmar fully acknowledges the co-dependent, monopsony nature that is inherent in the structure of the industry we operate within, and the responsibilities this places on millers and growers to work together for the mutual benefit of both parties. Wilmar also fully acknowledges that growers and millers should operate under a commercial and legislative framework whereby their standards of conduct, commercial agreements and practices are open, transparent and fair.

4.1 Collective bargaining

Cane growers supply cane to mills under Cane Supply Agreements (CSA), which have **evolved over almost 100 years of statutory bargaining and commercial negotiation.** The terms of payment, including the cane price formula and net sugar price are defined in these comprehensive commercial agreements between millers and growers.

The perceived economic power of mills has historically been promoted by some industry participants as a justification for the retention of regulation in the sugar industry. The issue has been extensively canvassed, including by the Industry Commission in 1992 in its review of the Australian sugar industry which found that in fact it was possible that growers rather than millers possessed the greater market power. It noted:

> *.. in the past there may have been some potential for mills to exploit market power. However, growers have now formed strong organisations to negotiate on a collective basis. In some regions, growers have purchased their local mill. Growers also have far greater access to information to allow them to assess whether terms offered by a mill are reasonable. The development of trade practices legislation also provides some protection for growers against the misuse of market power by mills. While the Act limits collusive agreements to reduce competition between suppliers, an exemption may be provided if 50 or more parties are involved. These developments, coupled with millers' dependence on growers to supply sufficient cane to allow the mill to operate at satisfactory levels of capacity, raise the possibility that it is growers rather than millers who possess the greater market power. (Industry Commission, The Australian Sugar Industry, 6 March 1992, Report No. 19, p.42)*

Several agricultural industries are characterised by a single available processor being supplied by many producers, but in the Queensland sugar industry's case, growers have an authorised collective bargaining system in place. One of the strongest features of the Australian sugar industry is the existence of well defined, commercial CSAs which set the terms of the supply of cane to mills. For instance, the CSAs currently in place between Wilmar and its growers include the following features:

- Crushing season start and end date and associated consultation with growers and their representatives regarding crushing schedule
- Cane supply obligations for growers and acceptance obligations for Wilmar including independent audit of the weighing, sampling and analysis of Cane by a Cane Auditor
- Harvesting and transportation obligations including bin allotments, harvest rosters, delivery schedules, workplace health and safety requirements
- Calculation of and payment for cane, including details of interest, payment advices and GST
- Dispute resolution including provision for mediation administered by the Australian Commercial Disputes Centre, and potential for final and binding arbitration in accordance with and subject to the *Commercial Arbitration Act 2013* (Qld)

4.2 Price makers, not price takers

Cane growers are not price takers like diary, cattle, horticulture, wool, pork and other farmers. Mills do not pay cane growers a farm gate price for cane.

Cane growers are their own price makers (subject to prices in the global sugar market). The price of cane is based on the sugar price and cane growers have the ability to forward price a portion of their own crop up to three years in advance.

The Cane Price Formula is completely transparent and provides pricing protection for growers. The formula was introduced in the early 1900's, and despite significant changes in the industry the formula has had only minimal adjustment and is still in use for most Queensland mills. One of the reasons for this is that the formula cleverly incentivised the parties to improve the performance of their respective segments of the industry supply chain. If growers' grew sweeter cane they would keep the value of any additional CCS above 12, and if the mills were to invest in better equipment and technology they would keep efficiency gains.

The cane price formula, which links cane price to sugar price, underpins the operation of today's grower price risk management choices and avoids growers and millers having a win/lose relationship which is evident in other agriculture sectors.

The Cane Price Formula is:

Cane Price = 0.009 x (CCS – 4) x Net Sugar Price + Constant

Under the cane price formula, the price of cane is a function of:

1) The sugar content of the cane termed the Commercial Cane Sugar (CCS) content;
2) The Net Sugar Price received by millers (see below); and
3) A constant which varies from region to region and is approximately $0.60

Net Sugar Price can be expressed as:

Net Sugar Price = ICE#11 Price + Marketing Premiums – Marketing Costs

Where:

ICE#11 Price = globally traded Intercontinental Exchange No. 11 raw sugar futures contract price, converted to an A$ equivalent

Marketing Premiums = additional components of price negotiated between parties to a sugar sales contract over and above the ICE#11 price converted to an A$ equivalent

Marketing Costs = the A$ costs associated with storing and handling sugar in the bulk sugar terminals, financing the industry advance payment scheme, administration of pricing and physical sales

Because of the Cane Price Formula, growers and mills thrive or fall together depending on how much cane is supplied, how much sugar is produced and the global sugar price.

4.3 Growers make the decisions that determine approximately 99% of the net sugar price

Based on the average of the last five years of data from QSL and using the QSL Harvest Pool as the reference:

1) The ICE#11 price represents approximately 99% of the Net Sugar Price
2) Marketing Premiums represent approximately 8% of the Net Sugar Price
3) Marketing Costs represent approximately 7% of the Net Sugar Price

As a practical example, Farmer A is a cane grower who grows 25,000 tonnes of cane. The income Farmer A receives for the cane is decided by:

- **CCS:** The relative CCS for Farmer A is 14.9.
- **ICE#11** = $465.00 (assumed outcome of Farmer A's forward pricing and pooling decisions)
- **Net Marketing Premium** which for this example, is the Marketing Premium of $35.00 less the Marketing Cost of $33.50 = $1.50
- **Net Sugar Price** which is calculated as ICE #11 plus Net Marketing Premium ($465.00 + $1.50 = $466.50)
- **Constant** = varies by District, but in Farmer A's case it is $0.64

Farmer A's income = 0.009 x (14.9 – 4) x $466.50 + $0.64 = $46.40 per tonne of cane

Of the farmer's income of $46.40 per tonne of cane:

- $0.14/tonne cane is due to the Net Marketing Premium;
- $0.64/tonne cane is due to the constant; and
- $45.60/tonne cane is due to the ICE#11 sugar price

Most importantly Farmer A has management control over his CCS, and his decisions regarding forward pricing and pooling. The ICE#11 component is approximately 99% of the net sugar price. Therefore, via grower price risk management, growers exercise choice that determines approximately 99% of the Net Sugar Price used to calculate the price of their cane.

This gives Farmer A management control over approximately 99% of the price received for his cane, where Farmer A exercises his forward pricing and pooling discretion. This pricing outcome for a primary producer is unique to Australia's agriculture sector.

4.4 Fundamental feature is mutual dependence

Wilmar's success as a company within Australia is closely aligned to the success of its growers, because Wilmar's sugar milling and trading business is heavily reliant on a strong and sustainable cane supply. The total installed milling capacity of Wilmar's mills is sufficient to crush over 17 million tonnes of cane if it were available. Current crop sizes of approximately 15 million tonnes represent a significant shortfall in cane throughput versus milling capacity, and Wilmar therefore has a very strong represent a vested interest in increasing the volume of cane throughput to improve its return on investment. The best way to increase the amount of cane coming into a sugar mill is to increase the returns the cane grower receives so that growers are incentivised to grow more cane.

A mill has little value without a cane supply, whereas the capital value of cane farm would be substantially retained, reflecting the value of its alternate use for other crops or purposes or the value of water rights. The sensitivity of mill viability to cane supply and the significant capital losses associated with the closure of a mill are such as to strongly motivate mill owners to ensure that growers remain profitable and therefore continue to be incentivised to grow cane and supply a mill.

Wilmar's ability to attract better prices and premiums for Australian sugar will benefit growers through increased payments to growers under the cane payment formula, which includes as one of its components the price of the sugar. A better result for Wilmar translates to better returns for growers.

As one of the world's leading sugar traders Wilmar can generate greater value for its growers through its superior market intelligence, global scale and international presence. Wilmar's international sugar marketing resources include trading and research teams in Paris, Singapore and Sao Paulo. Wilmar traded around 5 Mt of raw sugar in 2013. In comparison, QSL operates from Queensland and in 2013 sold 2.3 Mt of raw sugar.

Both Wilmar and growers benefit directly from higher sugar prices and Wilmar's proposal aims to ensure cane farming businesses are profitable and sustainable as this underpins the viability of Wilmar's raw sugar milling business. At a time when growers' input costs are ever-increasing, it is important any opportunities to increase returns are captured.

5. Impacts of proposed regulation

The *Sugar Industry Amendment Bill 2015* has potentially significant adverse financial impacts for Wilmar and the growers who supply its mills. In addition, the Bill would result in a fundamental restructure of the industry, by giving raw material suppliers ownership rights in determining who would market the raw sugar produced by a manufacturer. It is an extreme approach to a purported (rather than real) problem that has been emotively represented as some form of 'market failure'.

5.1 No clear objective of what the bill seeks to achieve

The reason cited as rationale for the *Sugar Industry Amendment Bill 2015* as stated in the Explanatory Notes, is 'anti-competitive' actions of mills in exiting the current voluntary marketing arrangements. As outlined above, deregulation of raw sugar marketing in 2006 was agreed to by all of industry, including grower collectives and specifically provided for mills to determine how best to market their sugar including potentially exiting voluntary marketing arrangements with QSL in lieu of other more preferred arrangements.

The principles behind deregulation of marketing that were supported by the industry in 2006 continue to be relevant today. Wilmar's decision to leave the QSL arrangement is entirely consistent with the principles of the 2006 deregulation of sugar marketing; is permitted under the *Sugar Industry Act 1999*, and is in full compliance with the company's legal and contractual obligations to growers and QSL.

Proponents of the Bill and 'grower choice' have not provided any objective argument or evidence to support their claims that the actions of mills in exercising their right to market their own manufactured product in full compliance with existing industry regulation and state and commonwealth laws are 'anti-competitive'.

The *Competition and Consumer Act 2010* (Cth) prohibits misuse of market power and precludes unconscionable conduct, and is enforced by the ACCC's considerable powers. Legal safeguards against 'anti-competitive' behaviour are in place at a Federal Government level, and as outlined above several agriculture sectors are characterised by several suppliers to one available processor. Collective bargaining was introduced to the sugar industry to address any potential misuse of market power, of which there has been no evidence provided.

5.2 No consultation with millers

As the Explanatory Notes to the Bill confirm, sugar millers were not consulted in the development of the draft regulation, which is very disappointing considering the significant impact re-regulation of the sugar industry would have on all participants.

The Bill appears to have been introduced in response to concerns by some growers and grower representatives about future marketing arrangements proposed by mills that have given notice to exit the QSL voluntary marketing arrangements in 2017, but it is unclear what these specific concerns are. Wilmar has developed a detailed set of draft agreements and invited all grower representatives to review and discuss these agreements with Wilmar in December 2014. Copies of the draft agreements were also given to state and commonwealth departments of agriculture and the ACCC at this time. Wilmar could have outlined the core elements of its proposed marketing arrangements to the KAP if consultation had taken place. MSF Ltd has also been successfully operating a pricing and marketing system outside QSL with its growers for a number of years. The MSF marketing arrangements are similar in concept to Wilmar's proposal.

Suggestions of market power imbalance in the industry are demonstrably incorrect, and could have been outlined to the KAP if consultation had taken place. Cane growers have legislated protections including collective bargaining, which has enabled the development of detailed commercial agreements covering all aspects of the supplier relationship between growers and millers. The 'Reasons for the Bill' seems to be based on a notion that perceived supply chain power imbalances and lack of a competitive market for cane supply and other undeclared concerns about future marketing arrangements may be rectified by:

- Giving growers control over who sells a mill's downstream manufactured sugar; and
- Replacing commercial negotiation with an effective statutory bargaining regime

Forcibly removing Wilmar's ownership rights over its manufactured raw sugar would have a financially damaging impact on Wilmar and the growers that supply its mills. Re-instating arbitration would result in protracted, expensive and inefficient negotiation processes for millers and grower collectives and significantly increase the risk of unintended perverse and adverse consequences.

5.3 Achievement of policy objectives

The Explanatory Notes outline several issues in the 'Achievement of Policy Objectives' section, including that the Bill acknowledges a need to 'provide growers with the ability to be proactively involved in the marketing of their own sugar'. Growers have an exposure to and therefore an economic interest in the price received for raw sugar, which the price they receive for their cane is linked to. This economic interest, however, in no way confers property or ownership rights over the manufactured raw sugar produced by a mill.

Cane growers have never had title to sugar. Under the existing marketing arrangements millers voluntarily choose to market their sugar with QSL, and millers are paid a Net Sugar Price for sugar supplied to QSL based on the ICE#11 price outcome under each relevant pricing pool/mechanism (as selected by millers and/or growers) and the applicable marketing premiums and costs achieved by QSL. In turn, millers base the price of cane supplied by individual growers on the price paid to them by QSL in respect of the price risk management decisions (e.g. pool selection or grower forward pricing) undertaken by individual growers.

Under Wilmar's proposed marketing arrangements, growers will continue to be able to have access to a full range of pricing and pooling options, including those managed by growers, Wilmar or a third party pool manager, including QSL. Wilmar will also establish a Grower Transparency Committee to facilitate communication and transparency between growers and Wilmar. It would be made up of growers or grower-nominated third parties, and will receive comprehensive market sensitive information on a confidential basis in respect of sales of individual sugar shipments and pricing and marketing reports. This would provide growers will the ability to be proactively engaged in raw sugar marketing, without unintended financially detrimental outcomes.

The Bill is correct in identifying that millers and growers have an economic interest in the price of sugar, however as clearly outlined above, an economic interest is in no way equated to ownership or property rights. Further, Wilmar has a financial incentive to increase the price it receives for its sugar, and has guaranteed in its draft legal agreements to provide 100% of the net marketing premiums to its growers as is the case under the QSL system.

The Explanatory Notes outline that there is no legislative or regulatory framework to ensure that millers act in the best interest of cane farmers. Regulation is not required to achieve this outcome, as the return on a millers' investment is highly sensitive to and dependent on cane volumes. If mills were to seek to reduce payments to growers, mill cane supply would decline and mill profitability would also decline. To do so would be completely self-defeating for a mill.

5.4 Costly for the industry

The statement in the Explanatory Notes to the Bill that there will be “minimal to no cost to Government” from implementing this draft legislation disregards the $33 million the Queensland Government has already provided to the sugar industry to assist with de-regulation and the flow-on effects of the significant negative financial impacts on the sugar industry and loss of future investment opportunities that would result from loss of investor confidence. In addition, there has been no consideration of the magnitude of potential compensation claims that may be brought against the commonwealth government by foreign owned milling companies under free trade agreements.

To date the proposed re-regulation of the sugar industry and proposals such as raw sugar title expropriation

have not been supported by any economic or market benefit analysis. The Regulatory Impact Statement System Guidelines published by the Queensland Government describe the required procedure for developing regulation for Queensland Government agencies under the Regulatory Impact Statement (RIS) system. The Guidelines require a thorough analysis and assessment of the wider costs, benefits and other impacts of proposed regulation.

Wilmar estimates there will be a significant opportunity cost for millers and growers should this draft legislation be implemented, in the order of $10 million per year for Wilmar and $36 million for its growers (based on QSL marketing all “GEI”). While Wilmar does not consider there is even sufficient prima facie evidence to suggest re-regulation of the sugar industry is required, if the Bill was to be considered further a thorough cost/benefit analysis should be completed.

5.5 Expropriation of millers’ property rights

Growers do not own raw sugar. Growers grow and are paid for sugar cane. Wilmar has received legal advice from law firm Minter Ellison, provided as Attachment A, which confirms that the title to raw sugar produced at a mill resides with the miller, by virtue of the fact that they made it.

> *"When raw sugar is first brought into existence in a sugar mill, the title to the sugar will, absent any agreement to the contrary, reside with the miller that produced it."*

The implication of a ‘Grower Choice’ model, as contemplated by the Bill, giving growers the ability to determine who markets raw sugar produced at a mill, is expropriation of a property right. Minter Ellison's advice states:

> *From 1923 until the deregulation of sugar marketing in 2006, raw sugar was vested automatically in QSL (and its predecessors) following its manufacture by millers. QSL had, by virtue of State legislation regulating the sugar industry, a monopoly on the export of raw sugar. However, even prior to marketing deregulation in 2006 it was the mill owner, not the growers, who initially owned the sugar it produced. Vesting was the statutory device by which the mill owner's title was transferred to QSL. But for this legislation, title would have remained with the mill owner, where it resides today.*
>
> *Accordingly, while cane growers have an exposure, under a CSA, to prices for raw sugar, they have no proprietary interest in any part of the raw sugar itself. Understanding this point is crucial to analysing a proposed law which would give growers 'choice' as to how raw sugar is to be marketed. Such a law would give cane growers the power to determine how a product that is produced and owned by another person (the mill owner) is to be sold to third parties*.

The advice goes on to outline that depriving a mill of the rights that it would otherwise enjoy to market the sugar it makes, and to enjoy the monetary benefit of that activity, leaves the miller with an ‘empty husk’ of those ownership rights:

> *There is, in our opinion, a strong argument that the Bill would, if enacted, be a measure that has an effect equivalent to the expropriation of the 'grower economic interest sugar' produced by Wilmar, as the Bill would deprive Wilmar of virtually all of the benefits of the ownership of that property.*

There is no precedent in Australian agriculture for Government to expropriate a downstream processed product and give a supplier property rights over a processed product that has been entirely transformed through a manufacturing process. To do so would be financially damaging to Wilmar and the 1,500 growers who supply our mills with cane.

5.6 Implications under current trade agreements

Government re-regulation and particularly the expropriation of a processed product, as proposed in the *Sugar Industry Amendment Bill 2015* would set a disturbing precedent for future investment in Australian agriculture and other processing and manufacturing sectors.

Measures that could seriously interfere with Wilmar's use of its mills or expropriate its property, may invoke the commitments under Article 11 of Chapter 8 of the Singapore-Australia Free Trade Agreement (SAFTA). The terms of this agreement outline a series of commitments Australia has made to promote and protect foreign investment, including commitments to guard against the expropriation of Singaporean-owned property in Australia except on a non-discriminatory basis, for a public purpose, in accordance with due process of law, and with prompt, adequate and effective compensation.

The measures included in the Bill are not concerned with the interests of the public as a whole, but rather with the regulation of the supply chain in a specific industry, creating economic benefits for one group of private interests at the expense of another.

Minter Ellison examined the potential implications of the Bill under the SAFTA, and the advice states:

> *A law enacted by the Queensland Parliament is a 'measure' that is subject to Chapter 8 of the Treaty, just as much as a law enacted by the authority of the Australian Parliament.*

Article 11.2 of SAFTA requires that:

(a) expropriation shall be accompanied by the payment of prompt, adequate and effective compensation;

(b) compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation or impending expropriation became public knowledge; and

(c) compensation shall carry an appropriate interest.

As such, re-regulation of the Queensland sugar industry affecting the ownership rights of millers over their manufactured product, could result in a need for effective and adequate compensation under the terms of SAFTA.

5.7 Compulsory arbitration in place of commercial negotiation

Historically, compulsory arbitration in forming agreements (awards and then collective contracts) was part of a package of regulated measures including:

- Sugar manufacture, marketing and sugar pricing controls; and
- Cane production, processing and cane pricing controls.

In 1996 the Sugar Industry Amendment Act introduced a Final Offer Arbitration process, where each party was required to submit a final offer to resolve the dispute and then the arbitrator was bound to accept one of the two final offers. The intention of this process was to make it so unattractive that the parties would seek to avoid it by resolving their issues.

Numerous subsequent reviews of the sugar industry found that compulsory arbitration was holding the industry back, and for these reasons arbitration measures were removed. For example:

- The 2002 Memorandum of Understanding between the Federal and Queensland Governments, 'The Commonwealth and Queensland Working Together for the Sugar Industry and Communities', concluded that the statutory bargaining system and associated compulsory arbitration system "impede increased competitiveness and efficiency, and are detrimental to cultural change and innovation."

- The 2002 report by Clive Hildebrand to the Hon. Warren Truss MP Minister for Agriculture, Fisheries and Forestry Report said, "Arbitration is an issue. It is not desirable that arbitration becomes a customary way to avoid the responsibility that should accompany local leadership in genuine negotiation at the mill area level, for the good of participants in that mill area."

The process by which cane supply agreements are negotiated is not changing as a result of millers deciding to exit the voluntary marketing arrangements with QSL, and growers will continue to be able to collectively negotiate with millers.

Arbitration may have serious, long-term and unintended consequences on the Australian sugar industry, by putting the fate of commercial arrangements in the hands of a third party. In addition, the Commercial Arbitration Act is premised on there being an agreement in place between the parties, so regulating pre-contract arbitration could lead to costly and protracted arbitration processes and significantly increase the risk of unintended perverse or adverse consequences.

As outlined above, the in-contract dispute resolution measures that are included in Wilmar's draft legal agreements include access to arbitration under the Commercial Arbitration Act. This gives cane farmers access to measures equivalent to those offered by the Federal Government's Horticulture and Grocery Codes of Conduct.

It is Wilmar's view that a mature and commercially-focused sugar industry has no need to rely on third parties to determine the commercial basis upon which industry participants deal with each other. Statutory bargaining between millers and growers has provided comprehensive commercial contracts that determine the terms of cane supply and payment. As outlined in the Minter Ellison legal advice:

> *In a best case scenario, it is reasonable to expect that an arbitration relating to a wide range of terms for inclusion in a supply contract would take several months. It is not inconceivable that such an exercise could take more than a year. The proposition that such an arbitration would necessarily be quick and inexpensive is fanciful.*

6. Alternative to re-regulation

In announcing its decision to market its own sugar production from 2017, Wilmar determined that it was no longer in its interest or that of its growers to continue to seek to make slow incremental gains within the constraints of the QSL system. Wilmar has a strong financial incentive to increase cane throughput and the best way to do this is increase growers' returns, which is what its proposed marketing model aims to achieve.

Mills being able to choose the best way to market their raw sugar (including by marketing it themselves) was an intended end goal of the deregulation and reform process. In a global and fiercely competitive market, marketers with a global networks, international expertise and direct understanding of and exposure to the production and sale of raw sugar are far better placed to achieve the best possible returns. Wilmar has direct understanding of market dynamics through its international operations and sugar mills in Queensland, and a vested interest in achieving better returns which will flow to the company and its grower suppliers.

It is Wilmar's submission that it would be more beneficial to the industry for the Queensland Government to focus on ensuring that in negotiating new pricing and marketing arrangements with growers, mills maintained the basis of the existing cane payment formula; retained and enhanced existing grower pricing, pooling and payment options; and offered growers commercial and contractual fairness provisions, and transparency measures, to ensure marketing premium revenues are delivered without dilution to growers.

6.1 Wilmar's proposed marketing arrangements

Wilmar has developed a set of agreements for negotiation which together form the basis of a proposed new marketing model commencing with the 2017 season, and will also enable continued grower forward pricing from July 2015 should growers wish.

Importantly, the proposal Wilmar has put forward provides supply chain protections and transparency measures that surpass what is available to farmers in other Australian agriculture sectors. In particular, the proposed model offers:

- **In an Australian-first for farmers, cane farmers or their representatives would be part of a Grower Transparency Committee and given sale details for every shipment of Australian sugar sold by Wilmar.** Farmers will be able to see where Wilmar's Australian sugar is being sold, the date of the sale, the shipping and handling costs for the sugar cargo, and a breakdown of the components of the net sugar price premiums achieved. Wilmar is not aware of any other farmers in Australia, including beef, dairy, seafood, horticulture and pork farmers, getting access to this level of market sensitive overseas sales performance data. It is also significantly more transparent than the information currently provided to growers and millers by QSL.
- **Reports will be made available to every grower, every month**, showing forecast price outcomes for all pools, including third party managed pools.
- **Growers will be able to continue using QSL** or other suitably qualified third party pricing managers to forward price their cane, subject to pricing limits that are used to manage production risk.
- **The Cane Price Formula will not change**, and growers cane prices will continue to be linked to sugar price.
- **100% of net marketing premiums will be delivered to growers on a dollars per tonne basis.** These premiums would be allocated to pricing pools in the same manner as is currently the case with QSL, so growers will receive exactly the same net premium as Wilmar on a per tonne of sugar exposure basis.
- **In addition to provision of 100% of net marketing premiums, growers will also receive 50% of any arbitrage benefits involving Wilmar Sugar Australia sugar and other-origin sugar.** Arbitrage Premiums are those which are captured through the unique synergy that Wilmar can bring through having a significant 'book' of non-Australian sugar as well as its 'book' of Australian sugar.

The Arbitrage Premiums are therefore a benefit available to growers that are over and above the returns derived from 100 per cent of the marketing premiums.

- **At the end of each season, Wilmar will engage an accounting firm to review and audit its marketing outcomes for the season.** The Certification Statement from this audit will be made available to all growers and the Certification Report will be provided to the Grower Transparency Committee along with an opportunity to discuss the report and findings with the auditor.
- **In addition to the annual audit outlined above, a grower or grower collective can request a further audit of any matters in the scope of the Certification Audit**. Any underpayments identified by the certification auditor or the grower audit will be repaid to growers with interest.
- **Guaranteed dispute resolution measures, which will ensure farmers have continuing access to in-contract arbitration under the Commercial Arbitration Act.** This gives cane farmers the equivalent access to contract dispute mechanisms as farmers are offered by the Federal Government's Horticulture Code of Conduct and Grocery Code of Conduct.

When combined, the farm income transparency and protection measures offered by Wilmar to its growers are better than any other farming sector in Australia.

Examples of the reports that will be provided to the Transparency Committee and all Wilmar growers, are available below.

Table 1: Example of the report that will be provided to every grower, every month

Monthly Net Pool Price Report - 2017 Season **31 July 2017**

Net Pool Prices	Quantity	Quantity	Gross Pool Price	Allocation Account Amount	Net Pool Price
Pricing Mechanisms:	Tonnes Actual	Tonnes IPS	AUD/Tonne IPS	AUD/Tonne IPS	AUD/Tonne IPS
US Quota Pool	40,000	41,480	560.00	(91.67)	468.33
Production Risk Pool	350,000	362,950	430.00	3.79	433.79
WSA Managed Pool 1	300,000	311,100	467.07	3.79	470.86
WSA Managed Pool 2	180,000	186,660	435.00	3.79	438.79
Third Party Managed Pool	80,000	82,960	440.00	3.79	443.79
Call & Target Pricing Mechanisms (Average)	450,000	466,650	Not applicable	0.90	Not applicable
Total	**1,400,000**	**1,451,800**			

Notes:
IPS Conversion Factor: 1.037 (estimate)
Gross and Net Pool Prices for Call and Target Pricing Mechanisms are not shown because these pricing mechanisms relate to an individual grower

wilmar

Table 2: Example of one of the reports that will be provided to the Grower Transparency Committee every month

Monthly Premium Report - 2017 Season

All financial amounts are in US$ per metric tonne

Sugar sales from WSA to WST

Purchase Reference #	Vessel Name	Shipment Date	Tonnes	Brand	ICE Contract Month	Net Premium	Arbitrage Premium
1	Vessel 1	03-Jul-17	35,000	Br1	Jul-17	30.46	2.78
2	Vessel 2	05-Aug-17	43,000	Br1	Jul-17	30.46	2.78
3	Vessel 3	10-Aug-17	38,000	Br1	Jul-17	30.46	2.78
4	Vessel 4	14-Sep-17	25,000	JA	Jul-17	30.46	2.78
5	Vessel 5	10-Oct-17	40,000	Br1	Oct-17	30.46	2.78
6	Vessel 6	25-Oct-17	50,000	Br1	Oct-17	30.46	2.78
7	Vessel 7	03-Nov-17	45,000	Br1	Oct-17	30.46	2.78
8	Vessel 8	15-Dec-17	28,000	JA	Oct-17	30.46	2.78
9	Vessel 9	29-Apr-18	40,000	Br1	Mar-18	30.46	2.78
Total/Average			**344,000**			**30.46**	**2.78**

Sales of WSA Sugar from WST to end customers

Sale Reference #	Vessel Name	Shipment Date	Tonnes	Related Party (Yes/No)	Destination	Sale type	ICE Contract type	ICE Contract Month	Total Contract Price	ICE AA or Fixed Price Component	Net Premium Components							Arbitrage Premium
											Physical Premium	Polarisation Premium	Freight Charge	Freight Cost	Permitted Deductibles excl. Freight	Spread Gain (Loss)	**Total**	
1	Vessel 1	03-Jul-17	35,000	No	Malaysia	CNF	ICE 11	Jul-17	478.83	420.00	17.64	16.19	25.00	(24.00)	(6.61)	-	**28.22**	7.00
2	Vessel 2	05-Aug-17	43,000	No	Korea	CIF	ICE 11	Jul-17	498.44	431.50	18.30	16.64	32.00	(30.00)	(6.11)	-	**30.83**	-
3	Vessel 3	10-Aug-17	38,000	Yes	Indonesia	CIF	ICE 11	Oct-17	516.40	450.00	18.08	17.32	31.00	(31.00)	(7.40)	5.00	**33.00**	-
4	Vessel 4	14-Sep-17	25,000	No	Japan	CNF	ICE 11	Jul-17	508.33	438.50	16.98	16.85	36.00	(36.50)	(5.89)	-	**27.44**	4.00
5	Vessel 5	10-Oct-17	40,000	No	Indonesia	Fixed Price	ICE 11	Oct-17	487.34	423.00	16.09	16.25	32.00	(33.00)	(7.18)	-	**24.16**	8.00
6	Vessel 6	25-Oct-17	50,000	No	Korea	CIF	ICE 11	Mar-18	528.84	458.00	19.18	17.66	34.00	(32.00)	(6.55)	6.00	**38.29**	-
7	Vessel 7	03-Nov-17	45,000	No	Korea	CIF	ICE 16	Oct-17	471.71	392.00	18.52	15.19	46.00	(47.00)	(6.92)	-	**25.79**	2.00
8	Vessel 8	15-Dec-17	28,000	No	Japan	CNF	ICE 11	Oct-17	515.93	442.00	19.84	17.09	37.00	(36.50)	(6.30)	-	**31.13**	-
9	Vessel 9	29-Apr-18	40,000	No	Malaysia	CNF	ICE 11	May-18	477.98	418.00	17.86	16.13	26.00	(24.00)	(6.20)	3.00	**32.78**	5.00
Total/Average			**344,000**						**497.82**	**429.86**	**18.09**	**16.57**	**33.30**	**(32.67)**	**(6.61)**	**1.77**	**30.46**	**2.78**

6.2 Benefits Wilmar's proposal offers

Grower collectives, Wilmar and the government all agree that growers require the best possible returns for their product. Growers' margins are increasingly under pressure with steadily increasing input costs and challenges with cane productivity. For example, Wilmar estimates that a 100 hectare farm in the Burdekin region, producing about 10,000 tonnes of cane would have a farm margin of approximately $58,200, delivering a return on investment of only 2.6% (refer Figure 2 below).

Mills have a direct economic interest in 100% of the sugar that they manufacture, and an incentive to increase the returns for the mill and the growers who supply the mill, in order to increase cane throughput. Wilmar has proven it can generate better returns than QSL for its sugar.

Over the past two years, Wilmar has marketed a total of approximately 900,000 tonnes of Australian sugar outside of the QSL marketing system. Wilmar has compared the actual returns received by its growers under the QSL system in the 2012 and 2013 seasons, with the returns Wilmar achieved on the sugar it marketed in the same period. Wilmar's marketing premiums were approximately 60% higher than QSL returned, about $11 better per tonne of sugar. At the Wilmar sugar price, growers would have received on average more than $4 extra for each tonne of cane. This would have increased growers' average farm margins by more than 50%. For a grower producing 10,000 tonnes of cane this would have delivered, on average, $40,000 a year in extra farm income. Based on the assumed farm margin above, and return on investment of 2.6%, this would increase the return on investment to 4.3%.

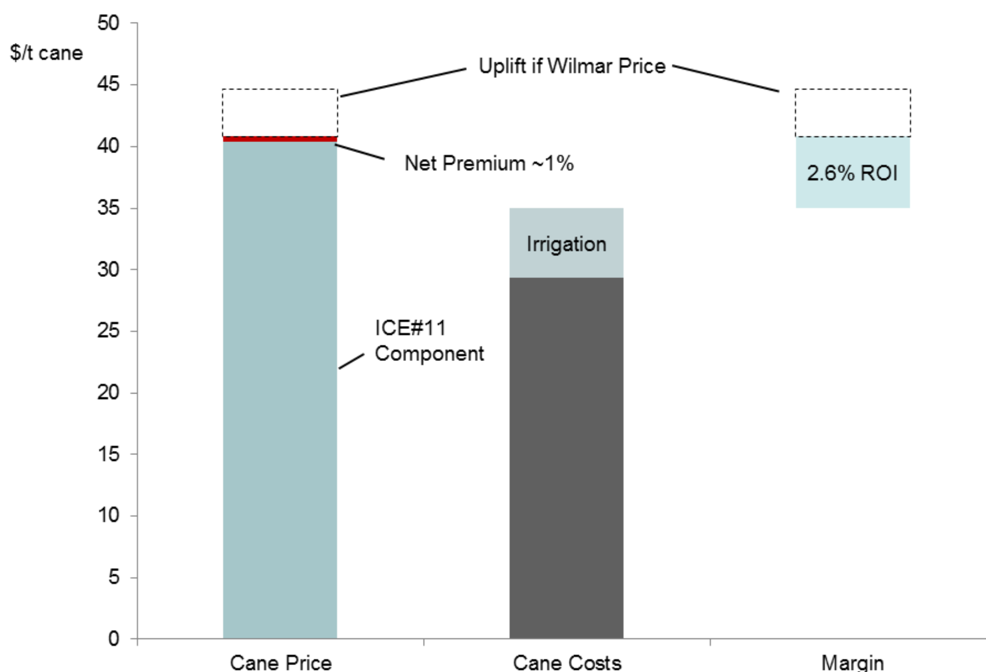

Figure 2: Potential profit increase for a Burdekin region cane farm producing 10,000 tonnes of cane

Analysis based on 2012 and 2013 season. Source material - QSL pool reports and Wilmar records. 2013 season results are as at 31 May 2014 with forecasts for season completion. Cane price and farm margins based on simple annual average of volume weighted regional cane prices and farm margins. Regional cane prices and farm margins based on regional sugar price, CCS and Wilmar estimate of regional farm cost of production including overheads, levies and depreciation. Regional Sugar price in AUD/t IPS based on simple annual average of volume weighted sugar prices of all Wilmar growers in BKN Region. Margin/Profit equals profit before interest and tax. ROI based on Land Value of $17,500/ha; Land harvested % Total Land of 80%; Plant and Equipment Value: $24/t cane; Working Capital not included; Cane Yield of 110t/ha

6.3 Wilmar's proposal compared with other industries

The table below demonstrates that the commercial arrangements proposed by Wilmar's marketing arrangements already surpass what is available in other agriculture sectors.

Table 3: Comparison of the commercial arrangements that exist between grower and miller in the sugar industry with the commercial arrangements that exist in other industries.

Transparency provisions in Wilmar supply contracts and comparisons to other agriculture supply contracts	Wilmar's offer / proposal	QSL current	Horticulture contracts	Grocery supply contracts	Cattle industry contracts
Market information for farmers to consider market prices, trends and benchmarks	✓	✓	✓	✓	✓
Ability to forward price crop / product sales	✓	✓	✗	✗	✗
Transparent supplier payment system (that links farm payments to the sale outcome of the downstream processed / manufactured product)	✓	✓	✗	✗	✗
Price reports for farmers showing what price the downstream product was sold for.	✓	✗	✓ 1	✗	✗
Sale report for farmers showing when the product was sold, where/who it was sold to, how much was sold and at what price	✓	✗	✗	✗	✗
Seasonal audit of all sugar sales to deliver absolute transparency for farmers. Conducted by 'Big4' firm. Farmers get to review audit with auditor.	✓	✗	✗	✗	✗

2. The Horticulture Code provides a specific price report provision for agents selling horticulture produce on behalf of suppliers. This section applies only to contracts where an agent is selling a supplier's produce on the supplier's behalf. This is an entirely different product ownership scenario (the supplier still owns his or her produce) to a miller selling its wholly-owned processed raw sugar. The Horticulture Code does not require price reports to have any comparative pricing information.

6.4 Status of negotiations

Following on from extensive consultation with all industry stakeholders immediately post Wilmar's announcement to exit QSL, Wilmar initiated a commercial engagement program with grower collectives in November 2014. Wilmar invited collectives to participate in an independently facilitated engagement program to negotiate a future model for pricing and marketing arrangements. To assist the engagement process, Wilmar proposed to appoint an independent facilitator to chair the meetings, facilitate constructive negotiations and to deliver transparency of the process to growers through reporting outcomes of the meetings. The facilitator's meeting reports would be made publicly available to both growers and government stakeholders.

As part of Wilmar's commitment to a constructive engagement process, Wilmar offered to fund independent expert legal and marketing reviews of its draft agreements. To foster transparency in the negotiation process Wilmar also proposed to invite the Department of Agriculture, Fisheries and Forestry to send an observer to attend engagement meetings between Wilmar and grower collectives.

Wilmar is pleased to advise that at the time of writing, three meetings have been held with the Canegrowers'

regional collectives, two with the Burdekin District Cane Grower organisation, and several meetings have been held with a number of independent collectives and individual growers who are not part of any grower collective. In addition, independent collectives and individual growers have initiated their independent legal and marketing expert reviews of Wilmar's draft agreements.

However, it is important to note that while regulatory intervention is being promoted, particularly regulation that would provide growers with ownership rights over millers' manufactured raw sugar, progress through commercial negotiation has been constrained. While ever the government is offering effective ‘grower sugar title’ and compulsory pre-contract arbitration, progress in commercial discussions will continue to be stymied.

7. Conclusion

Deregulation of the sugar industry in 2006 occurred after 20 years of reviews by State and Federal Governments, with almost $500 million of government assistance to support the transition to a deregulated environment.

The Bill does not provide any pricing certainty for cane growers, but would have a significant negative financial impact on millers and cane growers, raise sovereign risk issues for foreign investment and potentially conflict with Australia’s obligations under existing trade agreements.

Wilmar has proposed a cane pricing and sugar marketing framework that offers supply chain protections and transparency measures that surpass what is available to farmers in all other Australian agriculture sectors.

If potential re-regulation was taken off the table, it is Wilmar’s firm belief that negotiations with grower collectives would advance far more readily than they have to date. While the potential of effective ‘grower title to sugar’ and compulsory pre-contract arbitration are being touted as a possible outcome of government deliberations, grower collectives have little incentive to fully engage with millers.

8. Appendix A. Estimated opportunity cost associated with a marketing model that transfers ownership rights over manufactured raw sugar to growers

Table 4: Indicative annual opportunity cost impacts from a 'grower choice' model assuming all "GEI" is marketed by QSL

Source	Wilmar	Growers	Total
Arbitrage[1]	$4.0 m	$4.0 m	$8.0 m
Volume leverage[2]	$6.1 m	$12.1 m	$18.2 m
Marketing Expertise[3]	N/A[4]	$20.2 m	$20.2 m
Total	$10.1 m	$36.3 m	$46.4 m

Analysis based on assumed 2.2 mt Wilmar sugar production, AUD/USD 0.8 and assumes grower nominal sugar exposure is 67% of Wilmar production.

1. Arbitrage benefit assumed 20 pts shared 50/50 with WST and WSA per Wilmar marketing proposal. Wilmar benefit is incremental compared to current situation.

2. Additional 30 pts premium assumed on 2.2 mt sugar from volume effect of Wilmar marketing 100% of sugar production rather than total less grower nominal sugar exposure.

3. Additional 50 pts premium assumed on grower nominal sugar exposure volume due to Wilmar superior marketing performance relative to QSL per Wilmar Better Returns, Grower Update #4 based on average of 2012 and 2103 season actual relative performance.

4. No additional contribution as under current QSL RSSA, Wilmar permitted to market total sugar production less grower nominal sugar exposure and already captures assumed higher premiums

9. Appendix B. Minter Ellison legal advice

Wilmar Sugar Australia

Sugar Industry (Real Choice in Marketing) Amendment Bill 2015

Advice on Legal Issues

July 2015

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1. Introduction

The *Sugar Industry (Real Choice in Marketing) Amendment Bill* is a private member's bill introduced into the Queensland Parliament on 19 May 2015. The Bill contains amendments to the *Sugar Industry Act 1999* (Qld) which are intended to provide for:

(a) cane growers to be able to initiate arbitration in accordance with the provisions of the *Commercial Arbitration Act 2013* (Qld) if they are unable to reach agreement with a mill owner on the terms of cane supply agreements; and

(b) a model described as 'grower choice', being an arrangement under which cane growers:

(i) would be exposed to the sale price for raw sugar with respect to a proportion of the raw sugar output of a mill (described as 'grower economic interest sugar'); and

(ii) have the ability to designate the entity that will market the 'grower economic interest sugar'.

We explain these provisions in more detail below.

The Bill has been referred to the Agriculture and Environment Committee of the Queensland Parliament for consideration.

2. Background

The production and marketing of raw sugar in Queensland was largely deregulated by the passage of the *Sugar Industry Reform Act 2004*. Under the Sugar Industry Act as now in force:

(a) a grower may supply cane to a mill for crushing in a season only if the grower and mill owner are party to a *'supply contract'* (also described in the industry as a 'cane supply agreement' or 'CSA');

(b) growers in a region may negotiate collectively with a mill owner and enter into a collective CSA;

(c) the CSA must contain provisions for the resolution of disputes arising out of the contract, but there is no provision for dispute resolution where the parties cannot agree on what the terms of the supply contact will be; and

(d) cane growers are authorised, for the purpose of the *Competition and Consumer Act 2010* (Cth) (**CCA**) to negotiate collectively with respect to pricing and scheduling under a proposed CSA.

In 2013, Wilmar Sugar Australia announced that it would cease selling its raw sugar to QSL and would commence marketing (ie. pricing and selling) its own sugar from the 2017 season. Several other mill owners have since announced their intention to withdraw from marketing arrangements with QSL.

It is against this background that the Bill has been introduced into the Queensland Parliament.

3. An overview of the legal issues arising out of the Bill

While the Bill lacks clarity in certain places, and leaves a number of important questions unanswered, there are two critical concerns that emerge from the Bill and the outcomes it aims to achieve. We have focussed, in this paper, on these critical issues.

The first is the proposal for compulsory arbitration of disputes relating to the terms of a CSA. As outlined below, recourse to compulsory arbitration of a proposed agreement, in circumstances where both sides have strong incentives to reach a negotiated outcome, creates a risk of lengthy delay and disruption in the sugar industry.

The second relates to the implications of a 'grower choice' model for the property rights of mill owners. This proposal will see mill owners deprived of the right to market a sizable proportion of the raw sugar produced in their mills without compensation. This measure could result in a contravention by Australia of the Singapore-Australia Free Trade Agreement.

We outline these concerns in further detail below.

4. Arbitration is ill-suited to setting the terms of a cane supply agreement

4.1 Background

Commercial arbitration is a process of alternative dispute resolution provided for under Commonwealth, State and Territory legislation. In essence, where parties in an existing legal relationship (usually, but not necessarily, one of contract) have a dispute, they may agree to refer the dispute to arbitration. Where these conditions are met the arbitration is to be conducted in accordance with the terms of the Commercial Arbitration Act.

An arbitration under the Commercial Arbitration Act requires the parties to have entered into an 'arbitration agreement', being an agreement to submit to arbitration disputes that have arisen or may arise out of a defined legal relationship (whether contractual or not).[1] An arbitration agreement may take the form of an existing contract (with provisions that make provision for arbitration) or an agreement reached between parties after a dispute has arisen.

The important point is that a commercial arbitration can generally only arise where the parties to the arbitration are in an existing legal relationship and have agreed to the arbitration taking place. Commercial arbitration is not normally available in a situation where parties are negotiating the terms and conditions of a legal relationship which has not yet come into existence and there are no contractual terms or other principles to guide the arbitrator as to the resolution of the dispute.

There are a small number of statutory regimes that provide for arbitration as a means of resolving disputes about the terms on which one party will deal with another. For example:

(a) Under the *National Electricity Law* if there is a dispute relating to the terms and conditions upon which a service applicant seeks to acquire a service from a network service provider, the dispute is to be resolved by a specialist regulator (the Australian Energy Regulator). Similar provisions exist in relation to access to gas pipelines under the *National Gas Law*.

(b) Under the third party access regimes in Parts IIIA and XIC of the CCA, or Part 5 of the *Queensland Competition Authority Act 1997* (Qld), where an access seeker and a service provider are unable to reach agreement in relation to access to a declared service, either party may notify an access dispute, which can be resolved through arbitration by a specialist regulator (either the ACCC or the Queensland Competition Authority).

4.2 Concerns with proposals for compulsory arbitration

In our opinion, neither commercial arbitration, nor some form of statutory arbitration, is suitable for the negotiation of a CSA.

It is apparent that the scope and complexity of an arbitration relating to the terms of a CSA is likely to be extremely wide. All terms of a CSA (not just those referred to in the Bill) are potentially the subject of negotiation and arbitration.

The length and cost of the dispute resolution process that is contemplated by the Bill is exacerbated by the fact that *commercial* arbitration is the mechanism proposed. In a normal commercial arbitration, the arbitrator is guided by the terms of the arbitration agreement or the contract under which the dispute has arisen. Under the Bill, the arbitrator is given no guidance as to how he or she should fix the terms and conditions to apply under a CSA.

In a best case scenario, it is reasonable to expect that an arbitration relating to a wide range of terms for inclusion in a supply contract would take several months. It is not inconceivable that such an exercise could take more than a year. The proposition that such an arbitration would necessarily be quick and inexpensive is fanciful.

Nor is a statutory arbitration regime necessarily appropriate.

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[1] UNCITRAL Model Law on International Commercial Arbitration, Article 7.

A statutory regime for pre-contract arbitration intrudes upon the property rights of investors, by forcing them to deal with access seekers on terms and conditions to be determined through the access regime. As Ergas[2] wrote in 2009 (commenting on the facilities access regime in Part IIIA of the CCA):

> *'the ownership of property brings with it a concomitant bundle of rights which include the freedom to exclude others from the property, to derive benefit from the property, to retain possession, and obtain legal redress for violations of that possession. Of course, property rights have never been unqualified, and are often abrogated for a public or private purpose.*
>
> *Part IIIA of the TPA is just such an intrusion into the property rights of firms. ... Part IIIA provides for mandated access to the facilities of a firm where that access would meet a number of conditions and, in particular, promote competition in a relevant market. That is, in broad terms, where competition in a market is dependent upon access to a 'bottleneck' or 'essential facility', the Part allows for imposing a right of third-party access to that facility by means of 'declaration' of the service provided by that facility.'*

Sugar mills are not essential infrastructure facilities of the type that might be regulated under Part IIIA of the CCA or some other species of access regime. This is because:

(a) sugar mills are often duplicated, indicating that they lack the natural monopoly characteristic which is a precondition for declaration under Part IIIA; and

(b) the use of a sugar mill would almost certainly involve the use of a 'production process', which would preclude declaration under Part IIIA.

Compulsory arbitration to set contract terms is used sparingly in State and Commonwealth legislation, reflecting the care that should be taken before imposing such a measure on a market where parties have an incentive to produce commercial terms through negotiation.

The National Competition Council, in a submission to the Productivity Commission inquiry into the telecommunications access regime in 2001, highlighted the risk that the existence of arbitration can in fact discourage negotiated outcomes if the parties have different expectations about the results of the arbitration process, making them less willing to compromise because of the belief that a better outcome can be achieved through arbitration.[3]

Arbitration also has the potential to cause severe disruption in a market where there are multiple arbitrations to be conducted with different growers or grower groups, potentially producing different outcomes in the same industry or the same geographic area, or binding individual growers to outcomes they do not support and may not have had any involvement with.

While arbitration may be a necessary feature of a facilities access regime, being concerned with access to essential infrastructure that generally exhibits natural monopoly characteristics, growers and millers in the sugar industry are forced by their circumstances to negotiate. Neither can refuse to deal with the other without undermining their own profitability and, ultimately, their own survival. In such an environment, compulsory arbitration is likely to produce poorer, more costly and more protracted outcomes. Where commercial terms are dictated to one party through arbitration, there is a risk of weakening that party's motivation to cooperate in fostering the commercial relationship. A party in this situation may even be moved to disrupt the relationship to the extent it can.

In May 2005, the Australian Government commissioned a review of Australia's export infrastructure by a taskforce led by Dr Brian Fisher. In its report, the taskforce stated that:

> *'In our view, there should be a presumption that issues associated with export oriented infrastructure will be resolved by commercial negotiation between the infrastructure*

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[2] H Ergas, *An excess of access: An examination of Part IIIA of the Australian Trade Practices Act*, published in *Agenda* (Vol 16, No. 4), ANU, 2009.

[3] NCC, *Legislation Review of Clause 6 of the Competition Principles Agreement and Part IIIA of the Trade Practices Act 1974: Submission to the Productivity Commission*, January 2001, pages 44-45.

provider and users. We accept that this will often be imperfect, at times significantly so, but it is still likely to be preferable to the intrusive regulation that has become widespread.' [4]

Given the potential costs associated with arbitration, imposed on a market where both growers and millers have strong incentives to negotiate, there is a case for applying the same principle to the supply of sugar cane to mills.

5. 'Grower choice' deprives mill owners of property rights with respect to raw sugar produced in their mills

5.1 Mill owners own the raw sugar they produce in their mills

When raw sugar is first brought into existence in a sugar mill, the title to the sugar will, absent any agreement to the contrary, reside with the miller that produced it.

The miller owns the sugar not by virtue of any agreement with a cane grower or any other person, but by virtue of the fact that the miller created the product. A contract (such as a CSA) can modify a miller's property rights over the sugar created in its mill, *but it is not the source of those rights*.[5] The proposition that the ownership of the sugar is unsettled until a CSA is signed is incorrect. In the absence of any contract term to the contrary (or indeed any contract at all) the raw sugar will belong to the mill owner that creates it, no matter who supplies the cane that is used to create it.

It is uncontroversial that a cane grower, absent any agreement to the contrary, takes ownership of the sugar cane grown on their land. Under a CSA, a cane grower then supplies that cane to a miller. The mill owner then crushes the cane to produce raw sugar. As a result of this process, the asset sold by the grower (the sugar cane) ceases to exist, and a new product (the raw sugar) is created by the miller.

In *Borden (UK) Ltd v Scottish Timber Products*, [6] the UK Court of Appeal considered a case where a firm supplied resin to a chipboard manufacturer. The supplier sought to rely on a 'retention of title' clause in the supply contract to claim an interest in the chipboard. However the Court of Appeal held that the process of manufacture resulted in the creation, by an irreversible process, of a new product, the chipboard. The resin ceased to exist, along with the supplier's title in that resin. Absent any contractual term to the contrary, the supplier had no proprietary interest in the chipboard. As Buckley LJ stated (at p 974):

'It was impossible for the sellers to reserve any property in the manufactured chipboard, because they never had any property in it; the property in that product originates in the buyers when the chipboard is manufactured.'

The same reasoning, in our opinion, leads to the conclusion that a cane grower's title in their cane ceases to exist, along with the cane itself, once the cane is crushed. The property in the raw sugar resides with the miller that produces the sugar, not by virtue of any agreement with the supplier of the cane, but by reason of the fact that the miller manufactured the product.[7]

From 1923 until the deregulation of sugar marketing in 2006, raw sugar was vested automatically in QSL (and its predecessors) following its manufacture by millers. QSL had, by virtue of State legislation regulating the sugar industry, a monopoly on the export of raw sugar. However, even prior to marketing deregulation in 2006 it was the mill owner, not the growers, who initially owned the sugar it produced. Vesting was the statutory device by which the mill owner's title was transferred to QSL. But for this legislation, title would have remained with the mill owner, where it resides today.

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[4] *Australia's Export Infrastructure: Report to the Prime Minister by the Exports and Infrastructure Taskforce*, May 2005, page 3.

[5] Also see Ergas, *op cit*, at note 2 above.

[6] [1979] 3 All ER 961.

[7] Also see *Associated Alloys v Metropolitan Engineering and Fabrication* [1998] NSWSC 442; and *Clough Mill v Martin* [1984] 3 All ER 982 at 989, where Goff LJ stated, *'it is no doubt true that, where A's material is lawfully used by B to create new goods, whether or not B incorporates other material of his own, the property in the new goods will generally vest in B, at least where the goods are not reducible to the original materials.'*

Accordingly, while cane growers have an exposure, under a CSA, to prices for raw sugar, they have no proprietary interest in any part of the raw sugar itself. Understanding this point is crucial to analysing a proposed law which would give growers 'choice' as to how raw sugar is to be marketed. Such a law would give cane growers the power to determine how a product that is produced and owned by another person (the mill owner) is to be sold to third parties.

5.2 Cane pricing is distinct from sugar marketing

None of the above means that the cane price formula, which has been used in CSAs, in various forms, for over a century, cannot continue to be used. The cane price formula determines a price for cane by reference to, in part, the price for raw sugar. It is this formula which gives cane growers an exposure to raw sugar prices, since these prices affect the price payable for cane.[8]

However, the pricing of cane is separate to the marketing of raw sugar. Millers supply raw sugar to QSL under a Raw Sugar Supply Agreement (**RSSA**). The price that goes into the cane price formula is typically the price under the globally traded Intercontinental Exchange No. 11 raw sugar futures contract (known as the 'ICE#11' price), net of marketing costs and marketing premiums. Marketing premiums represent the difference between the ICE#11 price and the actual prices achieved by the marketer for the raw sugar sold in export markets.[9]

Growers also have the ability to forward price the bulk of their cane production up to three years ahead, giving them substantial control over the pricing of their cane, irrespective of the party who markets it. However, from the standpoint of the marketing entity, a 'grower choice' model could have a significant financial impact. A mill owner who is deprived of the right to market the sugar it produces loses the ability to earn the marketing premiums that can be realised on the sale of that sugar in export markets.

5.3 The Bill deprives mill owners of property rights without compensation

The key objective of the Bill is to impose upon a mill owner a 'supply contract', that deprives the mill owner of the rights that it would otherwise enjoy to market a sizable proportion of the raw sugar that it creates. The ability for a mill owner to determine what is done with its sugar, and to enjoy the monetary fruits of that production, are exemplars of property rights. They are the kinds of rights that inherently attach to ownership and possession. They are arguably of its essence, in the sense that depriving a miller of the right to sell its raw sugar as it wishes and to receive income from its sale (even if the miller is obligated under contract to pass most of that income onto another) deprives the miller of much of what made its ownership of that sugar worth having, and leaves it with little more than an 'empty husk' of that ownership.

The Bill makes no express provision for mill owners to be compensated for the loss of these rights over their sugar. Unlike the Commonwealth Parliament, the Queensland Parliament is subject to no constitutional limitation on its power to make laws for the acquisition of property except on just terms.[10] However, Australia is a party to numerous free trade agreements that prohibit the expropriation of property without compensation. We discuss this below.

5.4 Potential contravention of the Singapore-Australia FTA (SAFTA)

Chapter 8 of the SAFTA contains provisions relating to the protection of *'investments made ... by an investor of a Party in the territory of the other Party'*.[11] An 'investment' includes every kind of asset owned or controlled, directly or indirectly, by an investor, including movable and immovable property and other

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[8] For a more detailed explanation of the cane price formula, see J M Cragie, *Regulation and Reform of the Queensland Sugar Industry* (annexed to Wilmar's submission to the Senate inquiry into Current and Future Arrangements for the Marketing of Australian Sugar).

[9] For a more detailed explanation of raw sugar pricing, see Wilmar's submission to the Senate inquiry into Current and Future Arrangements for the Marketing of Australian Sugar at pages 16 to 22.

[10] cf. section 51(xxxi) of the *Australian Constitution*.

[11] Article 2.1.

property rights. An 'investor' includes an enterprise of a Party or a natural person who is citizen of a Party. An 'enterprise' of a Party includes a corporation that is incorporated under the laws of a Party.[12]

Article 11.1 of Chapter 8 of the SAFTA provides as follows:

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

A law enacted by the Queensland Parliament is a 'measure' that is subject to Chapter 8 of the Treaty, just as much as a law enacted by or under the authority of the Australian Parliament.[13]

There is, in our opinion, a strong argument that the Bill would, if enacted, be a measure that has an effect equivalent to the expropriation of the 'grower economic interest sugar' produced by Wilmar, as the Bill would deprive Wilmar of virtually all of the benefits of the ownership of that property.

Even where a measure interferes with only part of the property of a foreign investor, it can amount to an expropriation where the investor's rights over the affected property are impaired to such an extent that it must be seen as 'taken'.[14] An expropriation that is effected in this manner is described as an 'indirect' expropriation. Indirect expropriation can result from interference by a state in the use of property or with the enjoyment of the benefits of that property, even where it is not seized and the legal title is unaffected.[15]

The Bill provides no direct compensation to a mill owner for the assignment of its 'grower economic interest sugar' to the marketing body designated by the grower.

The terms of the existing cane price formula provide, in effect, that the bulk of the proceeds for the sale of raw sugar by a mill owner is to be passed on to the grower by way of payment for the cane, with the remainder kept by the mill owner as payment for crushing cane and producing raw sugar.[16] However, from the perspective of the mill owner, there is revenue to be earned both from crushing cane and producing raw sugar, *and* from selling the raw sugar that it produces. The Bill purports to compensate the mill owner for the first of these activities, but deny the mill owner any compensation for the second (in so far as it relates to 'grower economic interest sugar'). The right to earn this revenue would be taken from the mill owner and vested in the cane grower.

As noted above, the price paid to a mill owner is based primarily on the ICE#11 price. The additional margin that can be generated through the marketing of raw sugar is represented by marketing premiums, net of marketing costs. While marketing premiums fluctuate from year to year, on average, marketing premiums, net of marketing costs, have added approximately 1% to the ICE#11 price paid by QSL to millers under RSSAs in recent years. While this may appear to be a modest amount in percentage terms, it would be substantial in monetary terms to Wilmar (potentially in the order of tens of millions of dollars per annum).

A mill owner is not financially indifferent to the volume of its sugar that it can bring to the market. As a global sugar trader, Wilmar believes it has the ability to achieve significantly higher premiums than QSL.[17]

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[12] Article 1.1.

[13] See definition of 'measure' in Article 1.1(e) of Chapter 8.

[14] *GAMI Investments v Mexico* (NAFTA), Award, 15 November 2004 at [126]-[127].

[15] see *Indirect Expropriation" and the "Right to Regulate" in International Investment Law*, OECD Directorate for Financial and Enterprise Affairs, Working Papers on International Investment number 2004/4, September 2004; also see U. Kriebaum, *Partial Expropriation*, Journal of World Investment and Trade, Volume 9, No. 1, February 2007.

[16] While the Bill does not expressly provide for the retention of the specific formula currently in use, it appears to contemplate the use of a formula of this type (proposed section 33B(2)(a)).

[17] See WSA, *'Growers could achieve better returns with Wilmar'*, Information Update 4, 20 June 2014 (at https://www.wilmarsugarmills.com/images/Wilmar/Grower_Information_Update_No._4.pdf).

Wilmar is also able to generate additional value, by taking account of arbitrage opportunities in conjunction with its other global sugar trading operations, from the sale of the raw sugar that it produces. Wilmar's ability to achieve these higher premiums will be impaired if it is deprived of the right to market the 'grower economic interest sugar' it produces in its mills.

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Partner

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