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13 October 2014

Rural and Regional Affairs and Transport References Committee
Senate Proof Committees

Re: Senate Enquiry into the current and future arrangements for the marketing Australian sugar
- Submission by Mackay Sugar Limited

In respect of the matters raised in the Senate reference speech we make the following submissions.

Background – Mackay Sugar

Mackay Sugar Cooperative was formed on 1 February 1988 as a result of a merger by five Mackay district cooperatives (Marian, Racecourse, Cattle Creek, North Eton and Farleigh mills) and the acquisition of Pleystowe mill. The merger created a large financially viable cooperative sugar milling entity which aimed to maximise the returns to growers from cane production and sugar manufacturing and shield the businesses from the difficulties faced by small 'stand-alone' cooperatives. The newly established Mackay Sugar Cooperative sought to take advantage of greater economies of scale to keep costs under control and to take advantage of commercial opportunities arising from regulatory changes.

In 2008, Mackay Sugar converted from a cooperative and was registered as a public company known as Mackay Sugar Limited (MSL). Restrictions in the company's constitution mean that shares in Mackay Sugar can only be held by growers and former growers and their related entities.

On 4 June 2012 Mackay Sugar acquired the milling assets at Mossman mill to enhance Mackay Sugar's operations and contribute to the growth of Mackay Sugar's core business by providing additional cane expansion opportunities, with the aim of increasing Mackay Sugar's production of raw sugar. Mackay Sugar's operational mills are at Farleigh, Racecourse, Marian and Mossman. Mackay Sugar's four sugar mills rely on a supply of sugar cane from growers under Cane Supply and Processing Agreement for each of our mill supply areas in Mackay, Mossman and the Atherton Tablelands.

In 2013 Mackay Sugar established Queensland Commodity Services Pty Ltd to enable Mackay Sugar to consider opportunities to achieve higher returns from its sugar pricing function, to provide better services for its sugar cane suppliers, to provide pricing alternatives to growers and to position Mackay Sugar to be able to manage the export of its raw sugar production should the current arrangements with Queensland Sugar limited (QSL) change. Despite other suppliers giving notice to withdraw supply from QSL with effect from the 2017 Season, Mackay Sugar has opted to remain within QSL as a joint exporting marketing body of the growers, Bundaberg Sugar, Isis Central Mill and Mackay Sugar.

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a. The impact of proposed changes on the local sugar industry , including the effect on grower economic interest sugar

Until the 2014 season, sugar produced by millers supplying QSL was marketed for export exclusively by QSL via Raw Sugar Supply Agreements (RSSA). In the 2014 season, the RSSAs changed so that milling companies were able to elect to physically market for export a portion of that sugar independently of QSL, which represents their “economic interest sugar”. This new marketing system was agreed to by all milling companies supplying QSL, as well as the lobby groups representing cane farmers, Australian Cane Farmers Association and CANEGROWERS.

In 2014, 3 milling companies (Wilmar, Tully Sugar and MSF) gave notice to QSL that they were not willing to extend their RSSAs beyond the 2016 season. This means that from the 2017 season and beyond, these 3 milling companies will market and price all sugar produced at their mills independently of QSL. This will include the sugar that determines the cane price for farmers that supply those mills. This represents a significant change from the current centralised marketing and pricing provided by QSL.

There are two important elements to sugar marketing, pricing and physical marketing:

- ***pricing*** involves locking in the underlying sugar price via New York #11 sugar futures and foreign exchange contracts. Physical marketing involves actually selling the sugar to a customer and all the premiums and costs created from that marketing. Pricing accounts for a large proportion of the eventual sugar price;
- ***marketing*** represents a relatively small portion; However the marketing portion is often seen as the “cream” of the transaction, where the premium received can often be the difference between a profitable and unprofitable trade.

To a large degree, growers and millers are able to manage their own risks relating to the underlying sugar futures price as well as currency. This is achieved via a range of market based products that are provided by a range of service providers, including banks, QSL and millers. The fact that the sugar price is determined by the New York #11 sugar futures contract (which is traded on the open market), as well as foreign exchange rates (which are also traded on the open market) provides a high level of transparency to growers as to how that portion of their cane price is set.

Transparency of physical marketing is more difficult to maintain, as the physical transactions, along with the premiums and costs created by these transactions, are confidential to the parties involved with the trades.

We understand a key concern of growers in the industry is around transparency of returns. QSL has historically been able to provide a high level of transparency with a complete pass through model. Whilst absolute returns from QSL varied, the industry received the total of all revenues and costs incurred by QSL in pricing and marketing the sugar, with QSL making no profits from its activities. The major concern we expect for growers (outside of the QSL system) in the post 2016 season future is a potential loss of transparency in relation to physical marketing returns as these returns will be created by the milling companies (Wilmar, Tully Sugar and MSF) independently of QSL. The pricing returns are potentially of less concern, as growers are provided transparency by the New York #11 sugar futures contract and the Australian dollar.

This is not an issue for Mackay Sugar and our growers going forward as we market sugar for export via QSL, and domestically via an internal model that gives the same level of transparency to growers as QSL. We also offer our growers a range of pricing and pooling options that they can elect to utilise.

A further issue we think necessary to raise is the handling in the future of the US Quota for sugar being sold for import into to the US market. US Quota is a quota for sugar imports issued by the US government to the Australian Department of Agriculture, Fisheries and Forestry (DAFF), and distributed by DAFF to individual milling companies (for sharing with their growers) based on historical production of the mills owned by the respective milling companies. Traditionally, QSL has then accumulated these quotas for marketing purposes from the milling companies and historically has handled all sales of Australian sugar to the US market via the US Quota system for the benefit of the suppliers (growers and millers) of QSL. We believe that, for efficiency and transparency purposes, QSL should remain as the sole marketer of raw sugar from Australia to the US from the 2017 season and beyond, and should continue to be the accumulator of all US Quota, as distributed to individual milling companies by DAFF.

b. Equitable access to essential infrastructure

QSL and Sugar Terminals Limited (STL) originated from a statutory marketing body for all sugar produced in Queensland. Following the transition from bagged to bulk handling of sugar in the 1950s, 6 bulk sugar terminals (BSTs) were constructed. The BSTs were paid for through borrowings by the relevant port authorities, under arrangements where QSL financed the interest and capital repayments out of QSL's sales proceeds each season until the loans were repaid.

In 1999, as part of the deregulation of the sugar industry, the BSTs and marketing operations were returned to industry ownership through the creation of STL and QSL (which had been commercialised from the previous Queensland Sugar Corporation).

STL was established as a limited company with shares being issued to growers and millers on a two thirds, one third basis to reflect their contributions over time to the construction and financing of the BSTs. STL held the 7 BSTs located in Cairns, Mourilyan, Lucinda Townsville, Mackay, Bundaberg and Brisbane (which was subsequently sold). STL operates on a for profit basis with returns being distributed as dividends to its shareholders.

The land on which the BSTs are located are on long term leases from the port authorities at minimal rentals for so long as the BSTs are used primarily for sugar storage. In September 2007, QSL agreed to a long term lease arrangement with STL. QSL and STL agreed to an appropriate model to calculate the access changes for the use of the BSTs. These were based on regulatory principles of the Queensland Competition Authority, which are applied to monopoly infrastructure assets and was required regardless of whether QSL or STL were to be the operator of the BSTs.

In our submission we believe that any future access to the BSTs should be governed in a similar way and the assets should be treated as monopoly infrastructure assets.

The current lease now expires in December 2018. Under the lease QSL pays outgoings, and attends to repairs and maintenance for the BSTs. STL pays for any capital expenditure required for the BSTs and QSL manages the capital program for STL (which has been pre-approved by STL).

We believe there is a solid rationale for continuing with a single operator of the BSTs:

- the BSTs should continue to be controlled by a sugar industry participant rather than independently operated;
- current millers/growers who are no longer representative of the industry should not be able to decide the fate of the BSTs but the ongoing interest of the users of the BSTs should be paramount;

- the existing arrangements, delivered through a single operator, are able to provide efficiency benefits resulting in lower storage and handling costs to industry for usage of the BSTs;
- consolidation of the responsibility for logistics, terminal operations, maintenance and capital works delivery allows flexibility and provides for economies of scale through a single operator;
- costs of the operations and management currently undertaken by QSL are transparent and this approach should be retained regardless of who ultimately operates the BSTs;
- if the BSTs were to be transferred to a 'for profit' operator they will seek to make a profit (compared to QSL which is a not for profit entity) so there needs to be some control over the charges that can be made should a different single operator be appointed;
- consideration needs to be given to the fact that QSL is the incumbent terminal operator and has significant investment in storage and handling assets, mobile equipment, computers & process control software. There should be no additional charge built in should a different operator be appointed to operate the BSTs and be required to acquire similar equipment;
- it doesn't make commercial sense to have numerous operators, which will potentially diminish the synergies in place. Currently 4 out of 6 Terminals are dual occupancies making single miller control of specific terminals difficult;
- if the operation of the BSTs is to transfer to an alternative operator, then that operator should be required to provide the same open access arrangements to the BSTs and the pricing should be regulated to stop profiteering at the expense of the industry;
- any arrangements for terminal access should be regulated and come under either the Australian Competition and Consumer Commission (ACCC) or more likely the Queensland Competition Authority (QCA);
- there is some precedent in Australia for supervision due to regional concentration of port ownership by grain handlers, most grain ports are subject to access agreements, as required by the ACCC;
- there is considerable strategic value associated with the bulk sugar terminals and in commercial terms the BSTs are a natural monopoly. Australia is not a major producer of sugar by world standards but it is a large exporter. There are no other comparable storage assets; they would be difficult to replicate and have a strategic location at the ports.

Mackay Sugar has, over the years, made a number of submissions to the ACCC and the Foreign Investment Review Board and we have consistently maintained that the STL assets and their operations should be for the benefit of the industry and not be influenced by large shareholding interests or commercial drivers of the owners or operators. In this submission we promote the consideration of the bulk sugar terminals to be regulated assets.

c. Foreign ownership levels in the industry and potential to impact on the interest of the Australian sugar industry

We do not believe that foreign ownership is the issue. We understand the concern of growers is the transparency of marketing and pricing of the raw sugar rather than foreign ownership.

As title to the cane, and subsequently the raw sugar produced from that cane, passes to the miller under the cane supply agreements (CSAs) we can understand that the growers want the miller to be accountable to them on a transparent basis for the sales proceeds of the raw sugar. We expect they are concerned to ensure that the milling company can justify the price and/or marketing premiums achieved on behalf of the growers without risk of transfer pricing between related entities to the ultimate detriment of the growers.

This is not an issue for MSL as we have an open and transparent pricing mechanism with our growers where all sales are shared proportionately under the CSAs. We also offer our growers various pricing pools which they can elect to participate in.

In this submission we contend that the nationality of the ownership of the assets is not the issue.

d. Whether there is any emerging need for formal powers under Commonwealth competition and consumer laws, in particular, whether there are adequate protections for grower-producers against market imbalances

We understand the imbalances that the growers are seeking to address are:

- having a transparent pricing alternative to which the miller pricing could be benchmarked;
- allowing the growers to choose who they want to price and market their sugar.

The sensitivity on the marketing of the raw sugar could be addressed if there was some transparency on the pricing. This could be achieved by having a benchmark comparison so that the growers could get some comfort as to the price they are receiving for their cane/raw sugar regardless of where and how the milling company sought to market the raw sugar.

Mackay Sugar has a concern that if “grower choice” model is implemented on a scale that allows individual growers to choose between their milling company, another milling company (or even a trade house) or QSL (as a benchmark entity) for the physical marketing of their sugar (as opposed to simply choosing between their milling company or QSL), that there would be a significant fragmentation of the marketing of the sugar with a potential for a less efficient and therefore more costly outcome.

Potentially this would also give rise to competition issues as the larger millers and/or large international trade houses could leverage far greater access to capital to “win away” grower sugar from smaller milling companies, which in turn makes the smaller milling companies less financially and commercially viable, and a more likely target for takeover by the larger milling companies or international trade houses, with the result that in the longer term, there is a reduction in competition within the milling sector.

All milling companies rely on the fact that they have full title and control of all raw sugar they produce to remain viable in terms of access to funding and also for generating returns. So while growers may achieve short term gains via higher prices offered in order to entice them away from their own milling company, in the end there could be fewer milling companies for growers to choose between for marketing therefore reducing competition for their sugar.

A model whereby the grower choice was restricted to marketing either via their own milling company or QSL could alleviate these concerns.

e. Any related matters

No further comments.

We appreciate the opportunity to submit to the Committee to ensure a viable future for the Australian sugar industry and remain available to provide further comment upon request.

Yours faithfully

Andrew Cappello
Chairman

Quinton Hildebrand
Chief Executive Officer