Wilmar Sugar

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Mr Tim Watling
Committee Secretary
Senate Standing Committees on Rural and Regional Affairs and Transport
PO Box 6100
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By email: rrat.sen@aph.gov.au

Dear Mr Watling

Inquiry into current and future arrangements for the marketing of Australian sugar

I am pleased to provide the attached submission for the Committee to assist with its inquiry into current and future arrangements for the marketing of Australian sugar.

In addition to our submission, we have provided copies of separate reports on related matters which may also be of assistance to the Committee in its consideration of these issues.

They include: a report by the Centre for International Economics, *Current and future arrangements for the marketing of Australian sugar: Senate Inquiry*, October 2014; a paper by MinterEllison, *Australian Sugar: a review of current and future arrangements for the marketing of Australian sugar*, October 2014; and a paper by J. M. Craigie, *Regulation and Reform of the Queensland sugar industry*, October 2014.

We would like our submission and the above mentioned reports to be treated together as a public submission, and look forward to the opportunity to be of further assistance to the Committee during its Inquiry.

Yours sincerely

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Submission to Senate Rural and Regional Affairs and Transport References Committee

Current and future arrangements for marketing Australian sugar

October 2014

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GLOSSARY

ASMC	Australian Sugar Millers Council
CSA	Cane Supply Agreements
QSL	Queensland Sugar Limited
RSSA	Raw Sugar Supply Agreement
STL	Sugar Terminals Limited
WSA	Wilmar Sugar Australia
WST	Wilmar Sugar Trading

EXECUTIVE SUMMARY

The Australian sugar industry has transitioned from one of the most heavily regulated sectors in Australia to a more globally focused industry that competes successfully in export markets and has attracted much-need foreign investment which has delivered improvements in infrastructure and strengthened management and operational expertise.

The sugar marketing reforms introduced in 2006 represented the high water mark for industry deregulation after many years of review, consultation and discussion involving all industry participants, including federal and state governments, growers and millers. The Commonwealth Government committed more than $440 million for industry assistance and restructuring programs.

Wilmar's future plans for sugar marketing are entirely consistent with the objectives of the reform process, and the actual terms of the reforms introduced in 2006. Wilmar considers that by marketing its sugar, it can achieve better returns for cane growers through its expertise as one of the world's leading sugar traders with superior market intelligence, global scale and international presence. Wilmar's sugar marketing capabilities and the potential gains for growers are described in more detail in this submission.

Most importantly, the principles that underpin the price paid to growers for their cane **do not change** under the future marketing arrangements being proposed by Wilmar. The cane price formula will remain linked to the net price of sugar. Wilmar will continue to provide growers with choice about how they manage their exposure to the sugar price, and growers will have a range of pricing mechanisms available to them to do so.

Wilmar is committed to ensuring that growers receive the benefit of all marketing premiums earned by Wilmar on the sale of its sugar, and that in marketing its sugar production, Wilmar will act at all times to maximise the net sugar price on which growers' cane prices are based. Wilmar is also committed to transparency in relation to its sugar marketing activities.

These commitments are contained in the Principles for Wilmar Sugar Marketing Post-2017 which are described in this submission and summarised below:

1. Growers' cane price will remain linked to the net price of sugar
2. Wilmar recognises grower 'nominal sugar exposure'
3. Growers will be able to independently manage their own sugar price exposure
4. Growers will have choice of pricing mechanisms managed at the grower's discretion
5. Wilmar has choice over commercial sale and marketing of sugar
6. Growers will receive the full economic benefit from the marketing and sale of sugar
7. Growers will have access to details of all transactions affecting grower sugar price exposure
8. Growers will have full independent audit rights, contractually documented protection measures and formal dispute resolution processes
9. Growers will have ongoing access to price risk management education and support
10. Growers will benefit from ongoing innovation

One of the key principles for the future of sugar marketing, and consistent with the 2006 reforms, is that mills have clear ownership and title to the sugar they produce, and should be able to exercise choice about how they deal with the commercial sale and marketing of that sugar.

A fundamental issue being considered by the Committee, is the notion being pressed by some groups that growers have some form of ownership stake or 'grower economic interest' in the sugar that is manufactured by millers such as Wilmar and therefore rights to determine how this sugar is marketed. This proposition is without foundation and a misrepresentation of the long-standing arrangements established under the cane price formula which recognises

growers have an exposure to the net sugar price, and thus have an interest in how their exposure to the sugar price is managed. However, in the current debate, some grower representatives are seeking to change this principle from one of pricing into actual ownership or control of the sugar manufactured by mills.

As demonstrated in this submission, and the attached reports from Minter Ellison, the Centre for International Economics (CIE) and J.M. Craigie, clearly demonstrate, there is absolutely no historical or legal basis for this proposition. Any recommendation that growers have some sort of legal ownership or 'economic interest' in sugar or control over the marketing of sugar would be highly undesirable and would have serious consequences for the commercial and contractual arrangements that govern the relationship between growers and millers. It would be an issue of significant concern for mill owners, future investment in the Australian sugar industry, and indeed Australia's broader trading interests (as outlined in the section on Foreign Investment and Trade-Related Issues). It would represent an overturning of the objectives behind sugar industry reform over the past couple of decades.

Wilmar does however recognise that growers have an exposure to the net sugar price because of its relationship to the cane price formula. This issue is considered in some detail in this submission, including the mechanisms that growers have now, and can use in the future, to manage their nominal sugar exposure. Wilmar strongly supports providing growers with a choice of mechanisms to manage their sugar price exposure. Growers also want some certainty that their miller is seeking to achieve the best marketing premiums for the mill's sugar, as the net sugar price is linked to the cane price formula.

The current regulatory arrangements and oversight by bodies such as the Australian Competition and Consumer Commission (ACCC) are generally considered to be adequate to protect the interests of industry participants, and there are no grounds for additional regulatory intervention, particularly given the strong mutual dependency of millers and growers and also the existence of authorised collective bargaining for growers. Furthermore, the industry has operated effectively since 2006 within the existing regulatory arrangements and there has been no major market or system failure as a result of deregulation. Imposing additional regulation would therefore be counter to recent achievements of the Commonwealth and Queensland Governments and industry participants to unshackle the industry to improve its efficiency and competitiveness through the major industry reform program.

This submission also addresses issues related to infrastructure access, noting that there is scope to eliminate the potential for future conflict of interest where a sugar marketer (such as QSL) is the operator of a bulk export terminal which may also be used by its competitors. However, addressing this potential future impediment to infrastructure access may be achieved within the existing commercial arrangements and does not require any regulatory intervention.

The benefits of foreign investment in Australia's sugar industry which have followed the deregulation of the industry and its more commercial orientation and greater flexibility are highlighted in the submission. This investment has brought additional capital investment which has supported the upgrading of infrastructure, as well as strengthening the management and operational expertise available for the industry. However, it is cautioned that moves towards re-regulation of the sugar industry could have serious consequences for Australia's reputation as a destination for investment, as well as potentially exposing the Commonwealth to liability for compensation under current free trade agreements (including the 2003 Singapore-Australia Free Trade Agreement).

1. WILMAR SUGAR AUSTRALIA

Wilmar Sugar Australia (WSA) is the largest producer of raw and refined sugar (through its joint venture with Mackay Sugar) in Australia.

Wilmar owns and operates eight sugar mills in Queensland, which crush about 15 million tonnes (Mt) of cane, producing around 2Mt of raw sugar for export per year, representing around 55 per cent to 60 per cent of Australia's total raw sugar exports. In 2013, a combined total of about 14.1 Mt of cane was harvested from about 163,000 hectares of land. Total installed milling capacity is sufficient to crush over 17 Mt of cane if it were available.

Around 95 per cent of Australian raw sugar is produced in Queensland.

Wilmar mills are supplied by more than 1,500 predominately family-owned and operated sugarcane farming businesses across four growing regions in central and north Queensland. The mills operate during the crushing season, which typically runs from June to November each year.

Cane rail network

Wilmar owns and maintains an extensive network of over 1,500 kilometres of cane railway line throughout the Herbert, Burdekin, Proserpine and Plane Creek milling regions.

Wilmar also owns more than 16,000 cane bins – ranging from 4-10 tonnes in size, and more than 75 locomotives. During the crushing season locomotives work 24 hours a day, seven days a week.

Wilmar uses a fleet of diesel locomotives to transport harvested sugarcane in cane bins from the cane railway sidings to its sugar mills. The locomotives can haul up to 200 cane bins in one trip, depending on the size of the locomotive and bins.

Cane growing farms

Wilmar owns almost 6600 hectares (ha) of agricultural land within the Herbert, Burdekin, Proserpine and Plane Creek milling regions. Of this total area, Wilmar farms 3500ha in the Burdekin, with water supplied from the Burdekin Haughton Water Supply Scheme.

As well as operating farms, Wilmar leases about 2000ha of land to local cane growers. Of this land, 1300ha is located in the Burdekin and 750ha is located in the Sarina (Plane Creek) area.

Once fully developed, Wilmar Sugar's self-operated farms will produce approximately 500,000 tonnes of cane, with a further 170,000 tonnes coming from leased farms.

Wilmar's strategy for ownership of cane growing farms has been driven by the imperative of keeping land available for cane given the critical dependence of mills on sufficient cane supply. This has included acquisition of land previously used in managed investment schemes.

Wilmar Sugar owns two cane harvesting groups, both of which harvest about 150,000 tonnes of cane each season (total 300,000 tonnes). Currently, 80,000 tonnes of the cane is sourced from non-Wilmar farms.

Renewable energy

Wilmar is Australia's largest renewable energy generator from biomass, using the sugar-milling by-product, bagasse – the fibre leftover after sugarcane is crushed to extract its juice.

Bagasse is recycled as fuel for the sugar factories' boiler furnaces. It is burned at temperatures of up to 800˚C. The energy in the generated steam is either converted into electricity or used as heat in the factories. This process is called cogeneration.

Wilmar's eight sugar mills have a total cogeneration capacity of 197 megawatts. Surplus electricity (about 123 megawatts) is exported into the Queensland power grid. The combined export volume is enough to power about 60,000 homes each year (based on 6.3MWh typical household consumption per year).

Wilmar has a 75 per cent interest in Sugar Australia through a joint venture with Mackay Sugar. Sugar Australia is the largest sugar refiner in Australia, and sells sugar using the CSR consumer brand.

Corporate Structure

Wilmar Sugar Australia is owned by Wilmar International, a global agribusiness group with a number of interests in the world sugar industry. As part of its sugar group, Wilmar

International operates a sugar trading division and is one of the top six sugar traders in the world.

Wilmar International commenced operations in Australia in 2010 following Foreign Investment Review Board (FIRB) approval of its $1.75 billion acquisition (through Wilmar Sugar Australia) of full ownership of Sucrogen Limited from CSR Limited.

Since then, Wilmar has invested an additional $530 million in capital expenditure upgrading existing assets and purchasing farm land to support its sugar milling business.

Wilmar also acquired the Proserpine Mill in 2011 for a total consideration of $120 million.

2. SUGAR MARKETING IN AUSTRALIA: THE ROAD TO DEREGULATION

This submission is focused on the arrangements for export marketing of raw sugar which represents around 80 per cent of all sugar produced in Australia and 85 per cent of Queensland production.

Any discussion of current and future arrangements for marketing of Australian sugar must be informed by a detailed and accurate understanding of the history of the industry's development, particularly in Queensland, and the changing role of government and regulation over the more than 100 years since the industry was established. The rationale for moves towards greater deregulation starting in the late 1990s, and culminating in the deregulation of sugar marketing in 2006 are particularly important to understanding the drivers behind Wilmar's decision to leave the QSL voluntary marketing arrangement from the end of the 2016 season.

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 of extensive regulation and government intervention for various policy reasons through to an increasingly deregulated and global market oriented industry.

> ***The road to deregulation has involved extensive consultation over many years with all of the industry participants***

It also needs to be highlighted that the road to deregulation has involved extensive consultation over many years with all of the industry participants, including federal and state 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 for the Sugar Industry Reform Program between 2004 and 2007.

A more detailed overview of the history of the sugar industry and the progressive steps towards deregulation and government initiatives to support industry restructuring and transitioning are available in *Regulation and Reform of the Queensland Sugar Industry* (J.M. Craigie, 2014).

The road to deregulation

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. It was a significant

milestone in the transition to a more innovative, commercially-focused and globally competitive Australian industry.

Decisions by the Queensland Government in relation to the industry, as well as those taken by the Commonwealth, have a significant bearing on the future development of the Australian industry as a whole. As such, any discussion of past, present and future sugar marketing practices is heavily influenced by Queensland Government policy.

From its beginnings in the 19th century, the Queensland sugar industry was heavily regulated by colonial and state governments. Government involvement in the development of the industry was guided by concerns around European settlement and external defence as much as the requirement for the commodity itself.

The origins of the single desk and raw sugar price regulation through legislative mechanisms such as the *Sugar Acquisition Act 1915* arose mostly out of circumstances related to wartime, including the high global price for sugar, which would have impacted Australian consumers. The *Regulation of Sugar Cane Prices Act 1915* saw the regulation of pricing between cane growers and millers to secure a reasonable price for growers sufficient to encourage them to remain in the North and pay higher wages for their workers.

.. the role of the regulatory structure in the sugar industry was 'arguably the most complex and all encompassing of any Queensland industry, primary or otherwise'

Against a background of extensive government involvement in the agricultural sector through controls over pricing and marketing, the extent of government intervention in the sugar industry was quite exceptional. In *Sugar: The Way Forward* published by the Queensland Government in 2003, it was noted that the role of the regulatory structure in the sugar industry was 'arguably the most complex and all encompassing of any Queensland industry, primary or otherwise'.

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.

Under the Act, growers and millers negotiated the supply and processing of cane through individual or collective agreements with a view to maximising profit for both growers and millers. The Act specified the minimum requirements for cane supply agreements. The price of cane was a matter for the relevant parties, although the Act at that time required that the price of cane be related to the price of sugar. Importantly, the 'cane price formula' which is used in this process had never been regulated in legislation. Dispute resolution and mediation mechanisms were also outlined in the Act.

The Act also sought to promote the sustainable development of the industry, and balance supply and demand for cane in each mill region through the requirement for a cane

production area (CPA) that was linked to a mill. This sought to ensure sufficient throughput to ensure mill viability and also provide certainty for growers that their cane would be crushed by their mill.

The Act continued the practice introduced in 1915 of vesting all manufactured sugar in Queensland Sugar Limited (QSL), which was the successor to previous statutory bodies such as the Sugar Board and the Queensland Sugar Corporation. 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 cane price formula in wide use today has never been legislated

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 formula used to calculate the cane price paid to growers is described elsewhere in this submission, but it is important to note that the cane price formula in wide use today has never been legislated and the concept of growers having some sort of legal entitlement to two-thirds of the sugar manufactured by the miller has never had any legislative or legal basis.

Sugar Industry Reform Program

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. 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

Highlights of the 2004 reform Bill included the removal of the Cane Production Areas (CPAs) which would remove the restrictions on growers being able to transfer from one mill to another (as opposed to being required to supply a particular mill in their location); removal of the statutory bargaining system; the creation of supply contracts which would allow growers to freely engage in the market for the supply of their cane (including the option for collective bargaining); removal of references to cane payment arrangements and therefore removal of any requirement that the price for cane be linked to the price for sugar; a phased change from compulsory arbitration; and provision for limited exemptions from the vesting of sugar with the single desk marketer, QSL (e.g. for domestic sugar, or for bagged export sugar) but with vesting for bulk sugar exports remaining unchanged.

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. Consistent with its commitment in the 2005 MoU, Wilmar (and previously CSR) has worked constructively with QSL over the eight years since deregulation to develop QSL into a commercially-oriented sugar marketing company within the constraints of the current industry structure.

The Sugar Industry Amendment Bill 2005 proposed further 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 contract-based arrangements would replace the compulsory acquisition or ‘vesting’ of raw sugar under the 1999 Act and which had prevailed in Queensland for the previous century.

Key outcomes of 2006 reforms

Following deregulation, a small number of mills (Maryborough, Mossman and Mulgrave) chose to independently market their own sugar. The majority of mills, including Wilmar, 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 pricing and selling 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 /or can price a proportion (approximately one-third) of their output separately. Each pool represents different pricing and risk management strategies. Millers are also entitled to sell approximately one-third of their production to their own customers.

The introduction of forward pricing in 2008 has provided growers with more choice

Through the cane supply agreements, growers also 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 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.

The deregulation of marketing has seen increased competition in pricing and marketing of a certain proportion of raw sugar production. However, there are still constraints. Under the voluntary agreements with QSL, millers only very recently have been extended the opportunity to independently market approximately one-third of their sugar. This has limited millers in their commercial flexibility and ability to respond to new opportunities and challenges. Cost and quality pooling also holds back various opportunities to achieve better returns through higher valued sales and discourages best production and marketing behaviours.

In keeping with the terms agreed for the future of 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 for their company and its growers.

3. CANE PRICE AND SUGAR PRICE

Cane Supply Agreements

The supply of cane by growers to Wilmar is governed by Cane Supply Agreements (CSAs) which are commercially negotiated and agreed between Wilmar and cane growers or their collective bargaining representatives. CSAs are typically three year rolling agreements. The CSAs document terms and conditions for the harvesting, delivery, transport, crushing of, and payment for, sugar cane that is produced by growers and supplied to Wilmar.

The terms and conditions of CSAs are negotiated with several grower collectives, as well as a number of individual growers. Grower collectives are specifically authorised to collectively bargain with Wilmar under section 237 of the *Sugar Industry Act 1999*.

> ***Cane Supply Agreements (CSAs) which are commercially negotiated and agreed between Wilmar and cane growers or their collective bargaining representatives***

Under the CSAs, growers agree to supply cane and deliver it to a delivery point, which is usually a cane railway siding or another location specified. The CSAs expressly provide that title and risk in the cane passes to Wilmar immediately upon delivery of the cane to Wilmar at the delivery point. This has been the case throughout the history of the sugar industry. Growers sell cane to millers (they do not make or own sugar).

The payments that growers receive for cane supplied to Wilmar are defined in the CSA and include cane payment calculated in an accordance with a cane price formula, plus various allowances (e.g. harvesting, productivity etc.) paid on a per tonne of cane basis and a 20 per cent share of any molasses revenue above a specified reference selling price. The major determinant of cane payments made to growers is the cane price formula.

Cane Price Formula

The price of cane under Wilmar CSAs is determined via a cane price formula which is a function of the sugar content of the cane (CCS) and a “net sugar price”.

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

Where:

Cane Price = the price per tonne of cane ($/tonne cane)

CCS = Commercial Cane Sugar, a measure of the recoverable sugar content in cane (units)

Net Sugar Price = the selling price of sugar net of marketing costs ($/tonne sugar)

Constant = a regionally specified amount, but approximately $0.60/tonne cane. For example, assuming a Net Sugar Price of $450/tonne and CCS 14.5 units, the cane price determined under the formula is:

Cane price = 0.009 x (14.5 – 4) x 450 + 0.6

= $43.13/tonne of cane

The basic structure of the cane price formula has existed for almost a century. It was first developed in 1915 and initially used as the basis by the Cane Prices Boards to establish the price scales for cane in different regions. This was the case until 1965, when the formula was more specifically referenced in cane supply agreements determined under awards. The

origins and history of the cane price formula are complex and often misunderstood. A detailed discussion on this topic is provided in *Regulation and Reform of the Queensland Sugar Industry* (J.M. Craigie, 2014).

.. the fact that any specific division of sugar proceeds is not, and has never been regulated is the source of considerable misunderstanding in the industry

The fundamental construction of the formula was based on the particular circumstances of the industry in 1915 and the principle that both growers and millers should receive adequate compensation for their costs and share profits from sugar proceeds in relative proportion to their costs and capital investment which were assumed at that time to be in the ratio of 2:1. However, the fact that any specific division of sugar proceeds is not, and has never been regulated is the source of considerable misunderstanding in the industry.

Since the early 1900's there has been a significant increase in both the average sugar content of cane and milling sugar extraction efficiency on which the original cane price formula was based. The relative proportion of production costs and capital investment between growers and millers has also at times materially varied from those assumed in the early 1900's however, despite this, the cane price formula has endured, albeit with the introduction and changes to the constant term over the years. One of the reasons for this is that the structure of the original cane price formula has independently rewarded growers and millers respectively for increases in the sugar content of cane and milling sugar extraction efficiency.

Also often misunderstood, is the fact that despite its enduring nature, the cane price formula itself has never been legislated. Prior to its amendment by the Sugar Industry Reform Act 2004, the Sugar Industry Act required that all collective cane supply agreements were to include payment arrangements linking the price of cane to the selling price of sugar, unless the negotiating parties decided otherwise. However, the form of the cane price formula has never been regulated in legislation.

Under the compulsory acquisition regime, which existed until January 2006, the selling price of sugar was taken as the price paid by QSL (and its predecessors) to millers for raw sugar being exported. The price paid to millers by QSL was the selling price less selling costs. The selling price includes the underlying sugars futures price (the ICE #11 price), plus marketing premiums. The major components of the selling costs include the cost of storing and handling sugar in the bulk sugar terminals prior to sale, the cost of providing finance to fund the industry's advance payment system and the administrative cost of managing sugar pricing and the sales program.

The linkage of cane price to sugar price is an important feature for the sustainability of a sugar industry based around production of raw sugar

Since 2004, the legislative requirement that cane price be linked to sugar price was removed from the *Sugar Industry Act 1999* and the basis for the cane price formula is now a matter agreed by negotiation between growers and millers. The rationale for the removal of the requirement linking the cane price with sugar price was to provide flexibility for commercially negotiated outcomes to determine the most appropriate basis for the price of cane. For example, to facilitate the price for cane being determined so as to accommodate the potential manufacture of alternate products such as ethanol or bioplastics. However, the structure of the cane price formula in all Wilmar's CSAs and the fundamental linkage of cane

price to net sugar price has not changed since deregulation. The continued use of the cane price formula still has widespread industry support today and it underpins the current grower price risk management mechanisms that were first introduced in 2008 after sugar marketing was fully deregulated in 2006.

Wilmar believes that the linkage of cane price to sugar price is an important feature for the sustainability of a sugar industry based around production of raw sugar. It aligns the price of cane with the world price for sugar and therefore ensures that price signals from the world sugar market correctly drive growers' decisions regarding input spending, capital investment and growth. It also means that growers cannot be subjected to a 'farm gate' price where the price that a primary producer gets paid may be deliberately discounted and disconnected from the downstream value chain.

A good example of the dysfunction that can occur in the sugar industry if cane prices and sugar prices are not linked is observed in India. Cane prices are fixed by government and can quickly fall out-of-step with the cashflows received by mills in response to movements in world sugar prices. Either the cane price is too low relative to growers' costs and does not encourage adequate planting of cane by growers, or the cane price is too high relative to world sugar prices and mills find it difficult to remain financially viable and do not process all the available cane. As a result, the supply of cane becomes quickly disconnected from the demand for sugar and the industry tends to operate in a boom/bust cycle, which forgoes many opportunities. India is the largest sugar producer in the world and consequently these boom/bust cycles have a direct impact on world sugar price cycles and volatility.

Grower Nominal Sugar Exposure

As a result of the linkage between cane price and sugar price in the cane price formula, growers have an underlying exposure to sugar price. Growers therefore have an interest in the price that millers receive for the sale of their sugar production, as this price impacts on the price that growers receive for cane. However, this economic interest has never given rise to growers having any title or ownership of the sugar produced by a mill. References made by some industry participants to 'grower's economic interest sugar' which seek to imply otherwise, have no legal basis or foundation.

Growers … have an interest in the price that millers receive for the sale of their sugar production

As noted in the Minter Ellison document, *Australian Sugar – a review of current and future arrangements for the pricing and marketing of Australian sugar*, following the removal in 2005 of the vesting provisions which had existed in the *Sugar Industry Act 1999*, and in the absence of any contractual arrangements to the contrary, the ownership of sugar manufactured by a miller is governed by the usual legal principles. That is, it belongs to the miller who manufactures it. Under deregulation since 2006, Wilmar has voluntarily entered into arrangements with QSL for marketing of its sugar. The Raw Sugar Supply Agreement (RSSA) between Wilmar and QSL documents the terms and conditions on which Wilmar supplies its raw sugar to QSL for export sale.

As the sugar industry has progressively deregulated, growers have been provided opportunities to individually manage their sugar price exposure independently from the price risk management decisions of their miller.

In essence, grower price risk management is an agreement between growers and millers whereby growers agree to be paid for cane on the basis of a specified or pooled sugar futures (or ICE#11) price outcome. In accepting this obligation, the miller ensures hedging is put in place, (via sugar and currency hedging contracts), to ensure that the price the miller is

paid for that portion of its sugar production is based on the same futures price on which the mill has agreed to base the price of cane to the grower.

In practice, grower price risk management is enabled by a miller quantifying a grower's sugar price exposure and facilitating the grower making decisions about how the sugar price risk on this exposure is managed.

A grower's 'nominal sugar exposure' may be derived from the cane price formula and the tonnes of cane that a grower supplies the mill

A grower's 'nominal sugar exposure' may be derived from the cane price formula and the tonnes of cane that a grower supplies the mill. As growers do not produce or own sugar, Wilmar refers to a grower's Nominal Sugar Exposure to indicate that the sugar tonnes are 'in name only' and therefore 'nominal'. A grower's Nominal Sugar Exposure may be defined as:

Nominal Sugar Exposure = 0.009 x (CCS-4) x Cane Supply Tonnes

Where:

Nominal Sugar Exposure = Sugar Exposure in Tonnes of ***nominal*** sugar

Cane Supply Tonnes = Tonnes of cane supplied by the grower to the mill

For example, assuming a grower delivers a total of 10,000 tonne of cane at an average CCS of 14.5 units, the grower's Nominal Sugar Exposure is determined as:

Nominal Sugar Exposure = 0.009 x (14.5 - 4) x 10,000

= 945 tonnes of nominal sugar

A grower's price risk management is undertaken by 'allocating' their Nominal Sugar Exposure to various pricing mechanisms or pools. In practice, this is effected by Wilmar agreeing to accept the pricing outcomes achieved in each of these pricing mechanisms, thereby determining the price Wilmar receives for the sale of that portion of Wilmar's sugar which in turn is used as the basis for the grower's cane payment to also be based on the same price outcome.

The term Grower Economic Interest Sugar is also the source of considerable misunderstanding … it has been taken by some to imply ownership of sugar by growers

The term Nominal Sugar Exposure as defined above and used by Wilmar in grower pricing risk management is often confused with the term 'Grower Economic Interest Sugar'. The term Grower Economic Interest Sugar is also the source of considerable misunderstanding in the sugar industry as it has been taken by some to imply ownership of sugar by growers but this has no basis or foundation.

The term 'Grower Economic Interest' first originated in the 2014 Raw Sugar Supply Agreement (RSSA) between millers and growers. It was defined in order to determine the amount of 'Supplier Economic Interest Sugar' being that portion of the total sugar supplied by a miller to QSL, which QSL agreed to sell back to that miller (approximately one third) to enable them to directly manage the physical sales to end customers.

More specifically, Supplier Economic Interest Sugar is defined as that portion of a mill's total sugar supply to QSL less Grower Economic Interest Sugar. The RSSA defines Grower

Economic Interest Sugar as that sugar for which growers bear the price exposure under the cane supply or other agreements between the Supplier (miller) and the Grower.

In other words, Grower Economic Interest Sugar is the total of the Nominal Sugar Exposure (in Wilmar's terminology) for all growers who supplied cane to the mill from which the mill produced raw sugar.

Grower Economic Interest Sugar is therefore merely a contractual construction created in the RSSA to allow for the determination of Supplier Economic Interest Sugar (i.e. that portion of a miller's sugar supplied to QSL which QSL would sell back to the miller ..) It confers no special rights of ownership or control to growers over any portion of a mill's sugar production.

The historical context of the finalisation of the 2014 RSSA between QSL and millers was that it was agreed that QSL would manage the physical sales and therefore determine the marketing premiums on that portion of a miller's sugar for which growers bear the price exposure under the growers' cane supply agreements.

Grower Economic Interest Sugar is therefore merely a contractual construction created in the RSSA to allow for the determination of Supplier Economic Interest Sugar (i.e. that portion of a miller's sugar supplied to QSL which QSL would sell back to the miller to enable direct management of physical sales by the miller). It confers no special rights of ownership or control to growers over any portion of a mill's sugar production.

Net Sugar Price

Under the cane price formula, the price of cane is a function of the sugar content of the cane and the Net Sugar Price received by the mill in respect of the sale of sugar produced from that cane.

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

Under current voluntary marketing arrangements between millers and QSL, QSL operates a number of different pricing pools to which growers or millers may allocate sugar exposure and also facilitates individual grower and miller managed price risk management. QSL averages all QSL managed marketing premiums and costs across all sugar tonnes. The marketing premiums for sugar sold back to millers by QSL (i.e. in Wilmar's case, sugar sold

from WSA to QSL and then from QSL to WST) is determined by agreement between QSL and mills and has no financial consequence for any other millers or any growers.

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 and the applicable marketing premiums and costs. In turn, millers base the price of cane supplied by individual growers on the basis of 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.

> ***.. the price on which any individual cane grower's cane delivery is based is therefore a function of the outcome of that grower's individual price risk management decisions***

It is important to recognise that the price on which any individual cane grower's cane delivery is based is therefore a function of the outcome of that grower's individual price risk management decisions. In other words, each individual grower may have a different Net Sugar Price resulting from different ICE#11 outcomes. The net marketing premium and marketing cost component of each grower's Net Sugar Price will however be common to all growers, as these components are averaged across all QSL managed sugar sales.

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

- The ICE#11 price represent approximately 99 per cent of the Net Sugar Price
- Marketing Premiums represent approximately 8 per cent of the Net Sugar Price
- Marketing Costs represent approximately 7 per cent of the Net Sugar Price

ICE#11 Price

Raw sugar is traded in a global market. The Intercontinental Exchange No.11 contract (ICE#11) is a futures contract for the physical delivery of raw cane sugar and is the benchmark and basis for the price risk management and physical trading of raw sugar around the world. There are four ICE#11 contract months in each calendar year (March, May, July and October) and ICE#11 contracts are liquid three years in advance of the current year. The ICE#11 contract is one of the most heavily traded futures contracts in the world and is characterised by significant liquidity and volatility.

The ICE #11 contract is based on free on board (FOB) sales of sugar of 96 purity (polarisation) as measured by the International Polarisation Scale and is priced in US cents per pound. The ICE#11 contract terms specify standard payment adjustment factors to account for sugar of different purity or polarisation. The Queensland sugar industry typically produces 'Brand 1' sugar which has minimum polarisation of 98.85 and typically gives rise to a polarisation payment adjustment of an additional ~3.7 per cent.

Buyers and sellers of raw sugar use the ICE#11 futures contract to hedge their sales and purchases of sugar. Using hedging, buyers and sellers are able to separately determine the effective price of a future sugar sales transaction independent of the prevailing sugar price at the time of the transaction. Although sugar sales contracts are typically made with reference to an underlying ICE#11 futures contract, mechanisms facilitated by the Intercontinental Exchange facilitate buyers and sellers of raw sugar to close out their original hedging, such that the sum of hedging gains/losses with cashflows from the physical sale transaction return both parties to a position equivalent to that based on their originally hedged prices.

Similarly, grower price risk management is effected via management of the ICE#11 component of Net Sugar Price. Growers can exercise choice, either directly (e.g. using forward pricing) or indirectly (through pool and pool manager selection), which determines the ICE#11 price outcome for their Nominal Sugar Exposure (see Section 4 Grower Price Risk Management) on which the price of their cane is based.

The ICE#11 price makes up approximately 99 per cent of the Net Sugar Price (see figure 3.2). Therefore, via grower price risk management, growers exercise choice that determines ~99 per cent of the Net Sugar Price used to calculate the price of their cane. Importantly, growers exercise the price risk management choices independently of the price risk management choices that millers make on their own price exposure.

.. growers exercise choice that determines ~99 per cent of the Net Sugar Price used to calculate the price of their cane

Marketing Premiums

Raw sugar sales contracts are typically quoted with reference to a particular ICE#11 sugar futures contract and reflecting when that sugar will be shipped. The invoice price for the sales contract therefore reflects the underlying settlement price of the ICE#11 contract, plus adjustments for sugar purity/polarisation, plus any additional price components negotiated between the buyer and seller.

The additional price components over and above the underlying ICE#11 future price are referred to as Marketing Premiums and consist of physical premiums and polarisation premiums.

Marketing Premiums = Physical Premiums + Polarisation Premiums

Physical Premiums are negotiated between the sugar marketer and customer for a specific quantity of raw sugar. They are typically ~$10 - $30/t for sales of Queensland sugar.

Physical Premiums arise for Queensland sugar producers, primarily due to location advantages compared to other suppliers (e.g. Brazil) into the Asian region and the supply/demand specifics at any point in time. For example, if Asia is in short supply during a period of the year and therefore needs supply of sugar from Brazil or Central America, the higher freight cost from these supply origins, compared to Australia, will mean Australia effectively achieves a higher Physical Premium. Conversely, if Asia requires little sugar from outside the region (e.g. is there adequate availability from Thailand), the Physical Premium is likely to be more modest.

Polarisation Premiums are price premiums paid, as specified under the ICE#11 contract, for sugar that has higher sucrose purity (or polarisation) than the ICE#11 reference of 96 polarisation. For the sugar quality typically produced in Australia, this premium is approximately 3.7 per cent. The Polarisation Premium is by convention applied to the total of the ICE#11 price plus the Physical Premium.

Marketing premiums typically contribute approximately 8 per cent of the Net Sugar Price (see figure 3.1 and figure 3.2)

Marketing Costs

Marketing Costs are incurred in managing the physical sale and associated price risk management activities of sugar marketing. Queensland mills have traditionally delivered

sugar to QSL on a free in store (FIS) basis, at the bulk sugar terminals. Marketing costs include items such as:

- Storage and handling costs in Queensland sugar terminals
- Finance charges for advance payments to suppliers ahead of sugar sales
- Indirect marketing charges/costs for quality sampling and management
- Marketing services charges for managing the pricing and pooling, physical sales, operations, funding, advances and administration

Marketing costs typically account for approximately 7 per cent of the Net Sugar Price (see figure 3.1 and figure 3.2)

Net Marketing Premiums and Costs

Marketing Premiums and Marketing Costs are of similar magnitude and have tended to net each other out. Over the last 5 years, the QSL the Marketing Premiums net of Marketing Costs has averaged $1.67/t of sugar, representing approximately 1 per cent of the Net Sugar Price (see figure 3.1 and figure 3.2). Marketing Premiums net of Marketing Costs over that period has ranged from minus $1/t to plus $6.50/t of sugar.

QSL 5 Year Average Data

	A$ per tonne
Marketing Premiums	34.66
Physical Premiums	17.74
Pol Premiums	16.92
Marketing Costs	33.00
Storage & Handling	22.07
Finance Charges	4.86
Indirect Marketing	3.45
Marketing Services	2.61
Net premium / (cost)	1.67

Figure 3.1

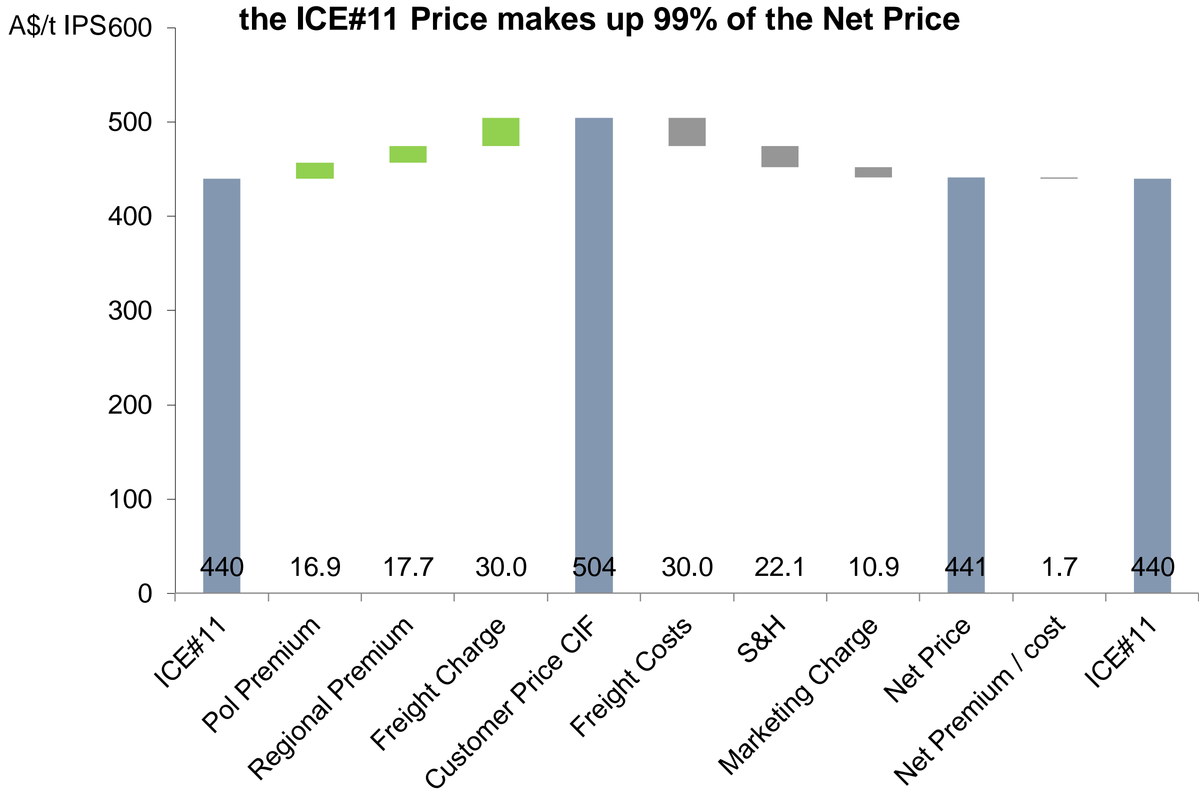

Figure 3.2

4. GROWER PRICE RISK MANAGEMENT

Historically, millers received a single price for their sugar from QSL, because all raw sugar for export was vested in QSL and it was responsible for managing physical sales and undertaking price risk management for 100 per cent of Queensland sugar exports. QSL (and its predecessors) therefore determined all three components of the net sugar price (i.e. ICE#11 price, marketing premiums and marketing costs) and 'pooled' all revenues and costs. The resulting single pool price was paid to all millers and used in all CSAs for the purpose of setting a cane price for individual growers.

The full deregulation of export marketing and the abolition of the compulsory acquisition by QSL in 2006 that marked a turning point for the industry

As the sugar industry progressively deregulated, the opportunity for millers to manage price risk became available and more sophisticated. QSL offered some initial flexibility for millers to manage their own price risk exposure in the early 2000's. However, it was the full deregulation of export marketing and the abolition of the compulsory acquisition by QSL in 2006 that marked a turning point for the industry in terms of innovation in price risk management for growers and millers.

In 2008, Wilmar's predecessor, CSR Sugar, introduced 'grower forward pricing' options which effectively enabled its growers to individually manage a portion of their sugar price exposure independently from the price risk management decisions of CSR or QSL. The introduction of this innovation in price risk management for growers, came after many years of effort by CSR, and resistance from both CANEGROWERS and QSL. Forward pricing provided the scope for growers to target A$/t sugar price levels for up to three seasons ahead. Growers could use CSR's web-based system to request price levels, subject to ICE#11 and AUD/USD exchange rates providing the opportunity for CSR to hedge at growers' target levels and therefore commit to base forward cane prices on the hedged sugar price outcomes.

Under existing arrangements, growers cannot forward price their cane for more than three years in advance, and the proportion of a grower's cane that can be forward priced reduces the further ahead the forward pricing is undertaken over those three years. These limits are imposed to manage the risk (to both Wilmar and growers) of an inability to deliver the contracted cane volumes in later years.

Aside from price risk management undertaken via any grower forward pricing or undertaken by the millers to manage their own sugar price exposure, QSL initially continued to manage all other ICE #11 pricing in a single pool. After initial steps in 2009 and 2010, QSL progressively developed a suite of different pools, with different risk management profiles. Millers make these pools available to growers (via grower nomination to allocate their Nominal Sugar Exposure) as the basis for the determination of the sugar price on which a grower's cane price is based.

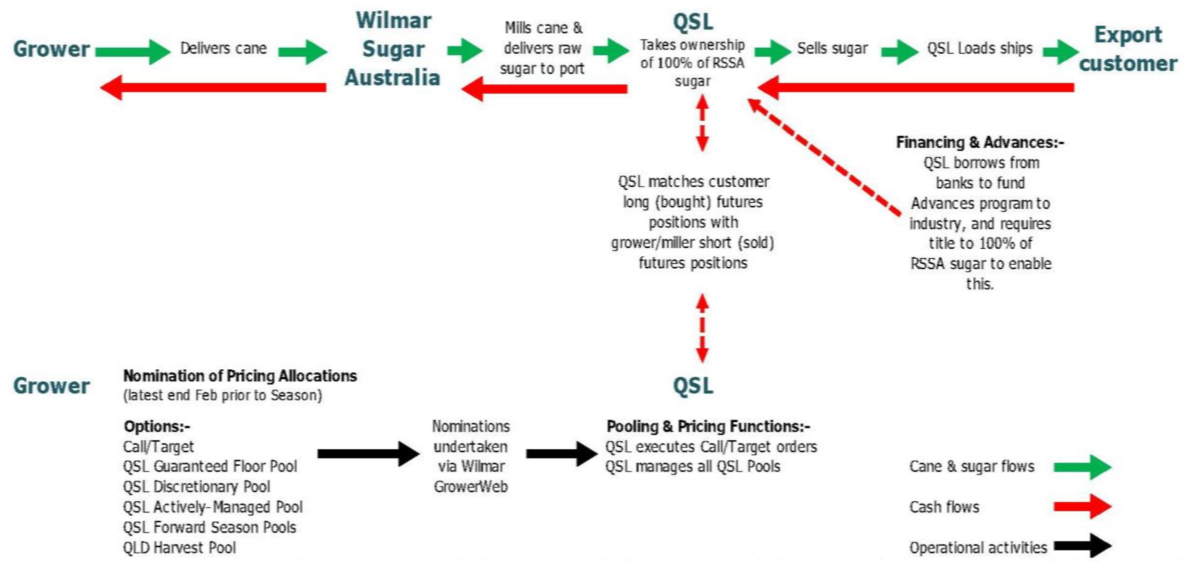

Figure 4.1

As can be seen from figure 4.1 above, QSL now operates a number of different pricing pools, which are in addition to the forward pricing mechanisms, which Wilmar makes available to growers. Millers can nominate growers' Nominal Sugar Exposure on behalf of growers into these pools. These different pricing pools have different features and different risk profiles which are managed by QSL. Therefore, growers have a number of different choices about how they manage the price risk associated with their Nominal Sugar Exposure. Importantly, they can do this independently of the pricing management decisions of their miller. Furthermore, as the ICE#11 futures price accounts for 99 per cent of the net sugar price on which the price of their sugar cane is based, growers can exercise a large degree of choice in price risk management for the cane that they supply to the miller.

Queensland growers today enjoy access to price risk management facilities which are unique in the world

Queensland growers today enjoy access to price risk management facilities which are unique in the world. No other sugar industry in the world provides for growers to manage their exposure to sugar price in this way. This will continue under the arrangements announced by Wilmar.

Pricing versus Marketing

It is important to understand the distinction between marketing and pricing and the impact of both activities on the Net Sugar Price on which growers are paid for cane. Recall that Net Sugar Price has three components and can be expressed as:

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

The marketing of sugar is the process of managing the physical sale of sugar to end customers and is associated with the Marketing Premiums and the Marketing Costs. The

sugar price risk management activity is associated with the management of the ICE#11 price via hedging of futures contracts.

Progressive innovation in the industry's pricing mechanisms since marketing deregulation in January 2006, now enable all growers to undertake their own price risk management decisions independently of the price risk management decisions of their miller.

While there has been significant change in price risk management since marketing deregulation, most millers, including Wilmar, have continued to sell 100 per cent of their export raw sugar to QSL, albeit under three year voluntary marketing arrangements, instead of compulsory vesting. As a result, approximately 90 per cent of all sugar exported from Queensland today is initially sold by mills to QSL.

QSL continued to manage the physical sale of 100 per cent of all sugar supplied to it until 2012, when Wilmar first negotiated arrangements to manage the sales to end customers for up to approximately one third of the sugar it supplied to QSL. This arrangement was facilitated by Wilmar buying back a portion of the sugar it sold to QSL (on a FOB basis), prior to then re-selling it to a range of Asian sugar customers.

From 2014 season, this same arrangement has been documented in the RSSA and is available to all millers. The RSSA limits the amount of sugar that QSL will sell back to a miller to include only that sugar for which growers do not bear any price exposure under cane supply agreements with the miller. The Marketing Premiums achieved by QSL on these sugar sales are negotiated between QSL and each miller and form part of the Net Sugar Price paid by QSL to the miller for the miller's original sale of this portion of the sugar to QSL.

Consequently, QSL still manage the physical sale of all other sugar and therefore determine the Marketing Premiums which form part of the Net Sugar Price paid to millers by QSL for this sugar. In turn, millers use the QSL-determined Marketing Premiums in the determination of the Net Sugar Price used in the cane price formula to determine the price of cane paid to growers. QSL continue to manage all the Marketing Costs associated with *all* the sugar that is sold to them by millers.

Under existing arrangements therefore, millers who supply QSL do not determine any component of the Net Sugar Price on which grower cane prices are based. The ICE#11 component is managed either by the grower directly (via grower forward pricing), or by QSL in one of the QSL pricing pools as a result of grower nominations. QSL determines the Marketing Premiums and Marketing Costs.

5. WILMAR'S EXIT OF QSL VOLUNTARY MARKETING ARRANGEMENT

On 3 April 2014, Wilmar Sugar Australia formally announced it would exit the QSL voluntary marketing system and proposed a partnership with growers as the basis for new marketing arrangements from the 2017 season.

Wilmar has given three years notice of its intention to leave the QSL marketing system in accordance with the requirements of the contractual arrangements between Wilmar and QSL. Subsequent to Wilmar's announcement, MSF Sugar and Tully Sugar also announced their intentions to withdraw from the QSL marketing arrangement.

Background

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.

In 2012, Wilmar secured QSL agreement to market its 'Supplier Economic Interest' (SEI) sugar; that is, the sugar for which Wilmar carries pricing exposure, approximately one-third of the sugar produced by Wilmar. In late 2013, other suppliers to QSL were provided access to their respective SEI sugar quantities. From 2014, with millers able to market their SEI sugar, QSL will have rights to market around 2 Mt per annum.

Wilmar's decision to exit QSL followed more than two years of discussions with Queensland industry leaders about alternative sugar marketing arrangements in keeping with the terms of the deregulation of sugar marketing that took effect in 2006.

> ***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.***

This included so-called 'growers' choice' proposals put forward by Wilmar and later by all millers. These proposals were rejected outright by CANEGROWERS and Australian Cane Farmers Association (ACFA) leadership. Grower collectives not aligned with CANEGROWERS OR ACFA were excluded from these discussions because they were not members of the Australian Sugar Industry Alliance (ASA), notwithstanding their interest in pursuing the concept.

Under the previous Wilmar and millers' 'growers choice' models, millers would have remained in QSL, continued to sell 100 per cent of their export sugar to QSL, and provided growers with the choice each year to have their miller or QSL market some or all of their underlying Nominal Sugar Exposure. QSL would also have been provided by millers a guaranteed minimum volume of one million tonnes of sugar to market, which is equivalent to approximately one third of total export volumes.

Following rejection of these proposals, Wilmar decided it was not possible to achieve its objectives for marketing innovation within the QSL system, and consistent with its legal and

contractual rights, elected to operate outside the QSL system and gave formal notice of its intentions.

Delivering better returns for growers

Wilmar is leaving the QSL marketing arrangement because it firmly believes it can deliver better returns for growers through a more innovative approach to marketing and by drawing upon its global marketing expertise and capabilities.

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.

Wilmar's success as a company within Australia and internationally is closely aligned to the success of its growers

The regional Asian market is increasingly under-supplied and needs to import significant quantities of raw sugar from outside the region, and from Brazil in particular. Queensland's importance as a supplier to the Asian market has declined over the past two decades. Australian sugar producers are no longer the price makers in Asia (when they supplied up to 50 per cent of all imports into the region). 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 the CIE report, which is attached to this submission, 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).

Wilmar's success as a company within Australia and internationally is closely aligned to the success of its growers, most of all because Wilmar's sugar milling and trading business is heavily reliant on a strong and sustainable cane supply. Wilmar has capacity installed in Australia to crush 17 Mt of cane annually, but is currently only crushing 15 Mt. A relatively small change in cane supply can also have a sizeable impact on the company's earnings.

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 (compared to QSL's 2.3 Mt).

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 is progressively developing an extensive global footprint in sugar milling, refining, shipping and trading and now operates in countries including India, Brazil and Indonesia, all key players in the world sugar market. Wilmar also has investments or trading partnerships

in the US, Europe, Morocco, Algeria and Myanmar, and support offices in China and Thailand.

The synergy and flexibility afforded through a large, multi-origin sugar trading book will allow Wilmar to deliver a preferred package of supply to its end customer base, and to seek arbitrage opportunities arising from volatility in the physical, futures and freight markets. Its global network of operations enables Wilmar to develop market intelligence and optimise the timing of sugar sales, the ICE#11 positions to sell against, and when to hedge sugar.

Wilmar is also an experienced global sea freight provider with a fleet of 120 vessels under management and moving approximately 50 Mt of bulk product annually.

Wilmar's global scale and reach places it at a distinct advantage relative to the current sugar marketing structure within Australia, which is focused on marketing a modest quantity of single-origin sugar, resourced by a small team in Brisbane and without access to real-time, on-the-ground market intelligence. Wilmar's intent is to produce a higher Net Sugar Price so that both Wilmar and the growers that supply it cane can become more profitable.

Wilmar's proven track record compared to QSL

Averaged over the 2012 and 2013 seasons, Wilmar's net sugar price including premiums was A$45 per tonne higher than growers received on average under the QSL system. Contributing to this result, Wilmar achieved marketing premiums that were approximately 60 per cent higher than QSL, equivalent to $11 per tonne of the net sugar price.

If growers had achieved the same sugar price as Wilmar, they would on average have received a cane price more than $4 per tonne higher, resulting in an increase of more than 50 per cent in average farm gross margins.

This means a typical Wilmar grower producing 10,000 tonnes of cane would have made an additional $40,000 per year over the last two years if they had received the same sugar price as Wilmar.

Wilmar achieved marketing premiums that were approximately 60 per cent higher than QSL

In 2010, QSL suffered significant financial losses of $106 million following unusually persistent rains for much of the harvest, which stopped the crush well short of expectations and reduced raw sugar production by around 20 per cent. Much of the expected sugar volume had been hedged and some physical sugar was also pre-sold by QSL on international markets. When it was unable to supply the contracted tonnages of raw sugar due to the production shortfall, QSL was forced to close out its hedge positions under those contracts and renegotiate committed sales.

QSL's financial losses were passed onto the millers and growers via a lower sugar price. This event highlighted the importance of issues of transparency, price risk management and governance.

Proposal for a Joint Marketing Company

In April 2014, Wilmar proposed the establishment of a Joint Marketing Company (JMC) to operate from the conclusion of its contract with QSL in 2017. The JMC would be responsible for the marketing of 100 per cent of sugar from Wilmar's mills under an agreement with Wilmar Sugar Trading (Wilmar International's sugar trading arm).

The JMC would be responsible for the sale of raw sugar, coordination of storage and handling, sugar pricing and pools, and grower payments. The JMC would be controlled by

growers and Wilmar, and under this arrangement, growers would have greater visibility and control over marketing and pricing than they currently have with QSL.

It was proposed the JMC would:

- Purchase raw sugar produced by Wilmar Sugar Australia (WSA);
- Manage storage and handling (via a contract with the operator of the sugar terminals at Lucinda, Townsville and Mackay);
- Manage grower pricing and pooling;
- Manage the sale of sugar to Wilmar Sugar Trading (WST) for marketing and sale to end customers under a Marketing Alliance Agreement (MAA);
- Make payments for cane to growers (including advances) on WSA's behalf;
- Make payment for sugar to WSA.

The JMC would return all proceeds of sugar sales, net of costs, to WSA and its cane suppliers on an annual basis.

To ensure transparency in sugar marketing, it was proposed the JMC's governance would comprise:

- A board of four grower-appointed directors, four Wilmar directors and two independent directors, one each appointed by the relevant groups;
- Independent audit of sales made by WST to ensure that WST passed on value from sales and all marketing premiums as agreed;
- WST to pay the JMC the greater of the average net premium achieved on sales of JMC sugar or on all WST sugar sales (i.e. including Australian and other-origin sugar);
- WST to also pay JMC 50 per cent of any 'net trading value' generated by WST as a result of arbitrage benefits that arise from marketing JMC sugar in conjunction with WST's other origin trading books.

Wilmar has undertaken several rounds of consultation with growers to discuss the proposed new marketing partnership. More than 500 growers attended 25 grower information sessions covering every cane growing region, in addition to meetings with the leadership of grower collectives from each region; meetings with non-collective members; meetings with CANEGROWERS; briefings with the relevant regulatory bodies and relevant state and federal ministers, departments and agencies; and, communications via a new website and updates via email.

Wilmar's exit from the QSL arrangement was not growers' primary concern compared to issues related to higher costs (electricity, inputs, etc.) and low cane yields which have led to lower grower returns

Consultation around the marketing partnership is continuing to improve grower understanding of and support for the proposal. It is worth noting that focus group discussions undertaken for Wilmar found that growers' understanding of the fundamentals of sugar pricing and marketing was low, and that Wilmar's exit from the QSL arrangement was not growers' primary concern compared to issues related to higher costs (electricity, inputs, etc.) and low cane yields which have led to lower grower returns. In response, Wilmar has engaged an additional three Grower Pricing Officers (total team of five) and has embarked on a comprehensive grower education program, which will be implemented over the next 12 months to two years.

Interim Forward Pricing Agreements

Forward pricing for the 2017 season would normally be offered from July 2014 through the execution of a forward pricing agreement and with an underlying cane supply agreement in place. With WSA's exit from the QSL system, the existing forward pricing and cane supply agreements need to change to allow forward pricing for 2017.

In the absence of agreement on the proposed JMC model, WSA has provided a temporary forward pricing agreement in respect of the 2017 season. This temporary agreement will provide full access to the forward pricing options that would have ordinarily been made available to growers up to June 2015.

For the period from July 2015, Wilmar intends shortly to table proposed interim agreements that allow for forward pricing from 2017, 2018 and 2019 (when available), comprising:

- a new Cane Supply Agreement between growers and WSA;
- a Pricing and Pooling Agreement between growers and WSA;
- a Queensland Sales, Pricing and Reporting Agreement between WSA and WST.

These agreements (collectively referred to as Interim Forward Pricing Agreements) will represent a fully documented marketing model which is consistent with the key principles for sugar marketing beyond 2017 that have been developed by Wilmar (see below).

The marketing model contained in the Interim Forward Pricing Agreements is an alternative to the JMC proposal and potentially preferable in terms of reduced cost and bureaucracy. The interim agreements are built around virtually all of the same principles as the JMC model, but are independent of it.

In the event the JMC concept is endorsed by growers, the interim agreements can be readily adapted to cater for that marketing model as both models are built on the same fundamental principles.

Changes from 2017

Wilmar and growers share similar views on many of the fundamental elements of the current arrangements that support the commercial relationship between growers and millers, particularly on pricing issues that are of greatest importance when considering the viability and sustainability of cane-growing farm businesses.

Most importantly, the future arrangements continue the longstanding existing link between the cane price and the sugar price and continue to provide all of the pricing and payment option choices currently available to growers. They will also deliver a range of new options and services that are of value to growers. Growers will still be able to directly manage 99 per cent of their net cane price exposure to the net sugar price.

Wilmar understands and accepts growers' concerns about effectively managing their sugar price exposure

The new arrangements will require new cane supply and other related pricing and pooling agreements. Those agreements will be negotiated and agreed with growers in the usual manner that new cane supply agreements are negotiated. This includes the option for growers to collectively bargain using their representative organisations.

Wilmar understands and accepts growers concerns about effectively managing their sugar price exposure given its relationship with the cane price formula, and also the importance of

transparency and independent auditing of marketing outcomes to demonstrate that Wilmar is achieving the best possible outcome through its marketing activities.

The interim agreements being proposed by Wilmar, pending agreement on a possible Joint Marketing Company model, also offer a significant benefit for growers compared with the current QSL arrangements because WSA will be responsible for managing and accepting the risk of a shortfall event and any associated hedging losses in the growers' Production Risk Pool. This means in the event of a forecast not being realised that leads to hedging losses, this risk is borne by Wilmar, in contrast to the current arrangement with QSL where losses are passed through to millers and growers as lower sugar prices. .

Wilmar wrote to growers in 8 September 2014 summarising the changes to sugar marketing arrangements from 2017, as follows:

<u>No change after 2017</u>

- Cane price formula will remain unchanged;
- Forward pricing via Wilmar's grower website, Grower Web, will still be available;
- Access to a range of pricing and pooling options via Grower Web, including Call and Target pricing methods will continue;
- Access to the US Quota will continue;
- Nominal Sugar Exposure will be allocated by default to a pool to manage production risk (similar to current QSL Harvest Pool) in lieu of specific pooling and pricing options being selected;
- Via an option to select a range of cane payment options, growers will continue to be able to select a default option based on existing advances arrangements;
- Growers will still receive actual marketing premiums achieved on physical sales to end customers;
- Net sugar price will still reflect storage and handling charges, finance charges for grower advances and other selling costs consistent with current practices.

<u>New elements from 2017</u>

- Additional pricing and pooling options will be available;
- Growers will have the opportunity to participate in pool where sugar pricing is managed with same strategy that Wilmar uses for its own Australian sugar exposure;
- An option will be available for growers to choose an independent third party pricing manager for a pool administered by Wilmar (could be QSL or another provider);
- New cane payment options, including:
  - Pre-harvest payment (e.g. payment in March) with the balance paid progressively from July to June during the relevant season
  - Cash on Delivery, where a cash payment is made when the cane is delivered, for a Nominal Sugar Exposure which has already been forward priced (e.g. 90 per cent payment within seven days) with the balance paid in July the following year;
  - A Deferred advance payment, similar to the existing advance system but with the first payment deferred to 1 July in the year of harvest.
- Opportunity to review Wilmar's marketing performance each year, including the right to have an independent audit conducted with growers or grower collectives to ensure transparency of marketing premiums.

6. SUGAR MARKETING AFTER QSL

Wilmar acknowledges that growers are concerned about its plans to leave the QSL marketing arrangement, and the company is committed to continuing its engagement with growers to explain its approach to the future of sugar marketing. Wilmar's preference is to achieve consensus with growers on its preferred model for the future marketing activities.

Fundamentally, Wilmar views growers' concerns as arising from apprehension around their exposure to sugar marketing costs and premiums which are associated with the physical sale of sugar and not subject to independent grower price risk management. They regard the ongoing involvement of QSL as a form of protection against conduct by millers which may reduce their returns through deliberate practices or less than optimal marketing performance.

Wilmar has provided assurances including contractual protections, transparency, independent audit rights and dispute resolution mechanisms

In recognition of these concerns, Wilmar has provided assurances including contractual protections, transparency, independent audit rights and dispute resolution mechanisms. In marketing its sugar production, Wilmar will act at all times to ensure that marketing premiums and costs are negotiated on a commercial arm's length basis to maximise the net sugar price on which growers' cane prices are based. Growers will also continue to be able to exercise price risk management via the ICE#11 sugar futures price which makes up 99 per cent of the net sugar price on which a grower's cane price is based.

As outlined in this submission, Wilmar is committed to the continuation of the cane price formula and to providing growers with a range of options to manage their price exposure. Wilmar considers that it is better placed than QSL to deliver better returns for growers from its marketing activities, and to do so in a more transparent and accountable way.

Wilmar has already undertaken wide-ranging consultation with growers about alternative models for sugar marketing following its announcement that it plans to exit from QSL in 2017. However, it recognises the importance of ongoing dialogue to achieve a better understanding among growers of Wilmar's objectives for the future of sugar marketing and the benefits Wilmar considers it can deliver growers outside of the QSL marketing arrangement.

Wilmar's key principles for sugar marketing post-2017

Wilmar's approach to the marketing of Australian raw sugar beyond 2017 will be guided by the following key principles which will form the basis of the future commercial relationship between Wilmar and its cane growers. These principles are the foundations for post-QSL marketing arrangements, whether they are formalised through or a Joint Marketing Company or some other type of commercial agreement.

1. Growers cane price will remain linked to the net price of sugar.

Wilmar believes that the linkage of cane price to sugar price is an important feature for the sustainability of a sugar industry based around production of raw sugar. It aligns the price of cane with the world price for sugar and therefore ensures that price signals from the world sugar market correctly drive growers' decisions regarding input spending, capital investment and

growth. The price millers pay to growers for their cane will remain directly linked to the net price of sugar, via the cane price formula as it has been since the early 1900's.

2. *Wilmar recognises grower 'nominal sugar exposure'.*

The price for cane is a function of the net sale price received by a mill for the sale of sugar, and Wilmar acknowledges that cane growers therefore have an exposure to that net sugar price. A grower's nominal sugar exposure expressed in tonnes of 'nominal' sugar can be determined from the cane price formula. Recognition of grower's nominal sugar exposure is fundamental to enabling the operation of grower price risk management, which Wilmar strongly supports.

3. *Growers will be able to independently manage their own sugar price exposure.*

Wilmar believes that growers should have choice to manage their exposure to the net sugar price and this choice should be independent of how a mill seeks to manage its own sugar price exposure. In practice, this is best achieved by providing growers choice to manage the futures price or ICE#11 component of the net sugar price for their 'nominal sugar exposure'. The ICE#11 price represents on average approximately 99 per cent of the net sugar price with the balance comprising marketing premiums net of marketing costs.

4. *Growers will have choice of pricing mechanisms managed at the growers' discretion.*

Wilmar will provide growers with mechanisms to manage the ICE#11 component of net sugar price for their 'nominal sugar exposure' via direct grower forward pricing or by allowing growers access to a choice of pricing mechanisms. Pricing mechanisms will be managed professionally by Wilmar or by suitably qualified and experienced third party pricing managers who act on behalf of growers. Third party pricing managers could provide pricing instructions to Wilmar for execution, or undertake execution of futures contracts in their own right and subsequently transfer those contracts to Wilmar to facilitate the close out of these positions with the sale of the physical sugar by Wilmar.

5. *Wilmar has choice over commercial sale and marketing of sugar.*

As all mills have clear ownership and title to the sugar they produce, mills should be able to exercise choice about how they deal with the commercial sale and marketing of that sugar. Accordingly, Wilmar will exercise its legal and commercial right to independently market its sugar production.

6. *Growers will receive the full economic benefit from the marketing and sale of sugar.*

Wilmar will ensure that growers receive the full benefit of all marketing premiums earned by Wilmar on the sale of sugar, net of associated marketing costs incurred in storing and selling the sugar and making payments to growers (i.e. storage and handling, advance payment finance costs, marketing services costs etc.). In marketing its sugar production, Wilmar will act at all times to ensure that marketing premiums and costs are negotiated on a commercial arm's length basis to maximise the net sugar price on which growers' cane prices are based.

7. Growers will have access to details of all transactions affecting grower sugar price exposure.

Wilmar will report transparently to growers regarding all the components of a grower's sugar price exposure managed by Wilmar. Where we cannot widely distribute market sensitive information to all growers, we will make any such market sensitive information available on a confidential basis to members of a smaller 'grower representative group'.

8. Growers will have full independent audit rights, contractually documented protection measures and formal dispute resolution processes.

Wilmar will provide growers with independent audit rights and other contractually documented protection measures and formal dispute resolution processes to demonstrate and ensure the integrity of its dealings with growers in relation to sugar marketing activities and to provide for the efficient and equitable resolution of any discrepancies or disputes.

9. Growers with have ongoing access to price risk management education and support.

Wilmar is committed to continuing education for growers in relation to sugar pricing and marketing in support of growers achieving better returns.

10. Growers will benefit from ongoing innovation.

Wilmar's predecessor first introduced grower forward pricing and Wilmar will continue to be a leader and innovator in price risk management and cane payment options for growers in order to deliver additional service and value.

7. OPEN AND TRANSPARENT INFRASTRUCTURE ACCESS

Queensland's bulk sugar terminals are owned by growers and millers through Sugar Terminals Limited (STL). STL owns six bulk terminals corresponding to the various sugar regions. The terminals are leased to QSL on a contract that runs to the end of 2018 unless volumes drop below specific thresholds. Some terminals are used exclusively for storing the sugar of a particular milling company while others are shared.

This arrangement reflects the regional concentrations of sugar produced by particular milling companies and the locations of terminals.

> ***Ownership of STL is shared between growers and millers***

Previously some mills in Queensland (e.g. Maryborough, Mossman and Mulgrave) have marketed their sugar independently of QSL. These mills have had access to the terminals via storage and handling arrangements with QSL.

While the sugar terminals exhibit natural monopoly characteristics due to the industry's commercial need for economies of scale, ownership of STL is shared between growers and millers.

Miller's choice of terminal and grower's choice of miller

Both growers and millers have geographic constraints over their choice of where they ship their cane and sugar production. Queensland's sugar terminals were built to service cane regions and similarly the sugar mills were built to process sugar at the optimum point between the farms and the terminals. While there are exceptions on the fringes of cane regions, where growers have a choice of miller, for the majority of the sector the industry dictates a natural monopoly supply chain from farm to ship.

Queensland's sugar industry has, however, developed a unique approach to mitigate its monopoly characteristics. Both growers and millers have ownership rights over the sugar terminals (STL). Importantly, no one group has a majority shareholding, nor is likely to obtain one, due to STL's constitution.

STL's shareholding is highly dispersed. The largest single shareholder is Wilmar with only 18.6 per cent of shares. QSL is also a significant shareholder with almost 10 per cent of shares. In a recent industry newsletter, QSL explained its rationale for purchasing shares in STL since 2007:

> QSL purchased a strategic stake in STL in 2007 to ensure that it would have input in any future discussions on the usage and operation of the terminals. Since this date QSL has intermittently purchased G-class shares from growers in order to help

> create a market for these shares and subsequently provide liquidity for our members seeking to cash in their shareholdings (QSL Update, 9 October 2014).

The shareholding structure (with two classes of shares, Grower and Miller) and company constitution limit the control of any one shareholder, any group of shareholder, or class of shareholder. Trading of shares is restricted to industry participants and split into Grower and Miller class shares with special resolutions requiring a 75 per cent majority of both Grower and Millers share classes.

The shareholding structure (with two classes of shares, Grower and Miller) and company constitution limit the control of any one shareholder, any group of shareholder, or class of shareholder

Minter Ellison have provided a more detailed analysis of the shareholdings in STL and the corporate governance arrangements. It notes: ‘Given the composition of STL’s shareholders and board of directors, together with its voting rules, it is clear that Wilmar is not able to control STL’s decisions; (Minter Ellison, October 2014, p.11).

Shared ownership provides for shared performance incentives

The shared STL ownership structure was a conscious decision made during the industry deregulation process and is derived from the industry’s inherent commercial reliance on the viability of each aspect of the value chain (grower, miller, and terminal) and the industry’s contribution to funding the original construction of the assets.

There is enough capacity to store 2.5 million tonnes, or about half the size of a large Queensland crop. Seasonal shipping patterns are such that storage capacity is sufficient to efficiently handle logistical arrangements. As such, the capacity does not represent a major constraint (or bottleneck) on the performance of the industry. In fact, the Queensland sugar industry enjoys significantly greater storage capacity relative to throughput than any of its major international sugar trading competitors.

Both growers, and millers, through their company STL, have strong incentives to see these facilities efficiently run and to ensure throughput is maximised to realise economies of scale irrespective of who conducts the marketing.

Current terminal operation arrangements

There is a clear distinction between terminal ownership and terminal handling and storage operations. STL currently leases the bulk sugar terminal operations to QSL who operate them to store, handle and load sugar onto ships as part of their marketing function.

The QSL lease expires in 2018 and requires continued QSL minimum throughputs to remain valid. While changes to Queensland’s marketing arrangements will likely impact on QSL’s ability to maintain throughput volumes, STL with its grower and miller ownership structure has strong incentives to determine efficient and equitable outcomes should marketing arrangements change.

Future terminal operation arrangements

Wilmar's decision to exercise its right to cease acquiring marketing services from QSL will not affect the ownership structure of STL. Terminals will still be co-owned, through STL, by

growers and millers. It will be a decision for STL, and its grower and miller owners, to determine the most appropriate terminal operator should marketing arrangements change.

Wilmar's exit from QSL will cause a reduction in overall QSL volumes, and consequently that reduction is likely to enliven STL's right to terminate QSL's lease of the bulk sugar terminal operations. Whether STL exercises that right or not is a matter for STL. STL is not obliged to terminate QSL's lease. STL will have a number of options available to it in the event that it decides to terminate the lease with QSL. For example, STL may operate the terminals itself (owner/operator), involve a specialist third party operator/agent, or lease individual terminals to regional suppliers.

> ***There is an inherent conflict if QSL were to operate terminals that are accessed by Wilmar and other competing marketers.***

Sugar terminals should be operated with due regard to the *Competition and Consumer Act (CCA) 2010 - National Third Party Access Regime Part IIIA,* which is premised on delivering open and equitable access to monopoly port infrastructure for all proponents. However, notwithstanding the regulatory oversight and protections offered under the CCA, to eliminate potential for future conflict of interest and safeguard open and fair access it would be preferable that common user terminals are not managed by sugar marketing companies that are competing with other sugar marketing companies operating through that same terminal. This leads to suboptimal competition outcomes as has been witnessed in the grain industry. The grain industry has recently dealt with this issue through a Port Terminal Code of Conduct announced by the Minister for Agriculture, the Hon. Barnaby Joyce MP on 19 September 2014. The bulk wheat Port Terminal Code of Conduct seeks to ensure support for farmers and exporters to access critical port infrastructure in a transparent, fair and equitable manner.

The circumstances in the sugar industry are different to those in the grain industry as the sugar terminals are owned by STL who is not a sugar marketer and it is in STL's power to determine how terminal operation is undertaken. Provided that STL ensures that sugar terminals are not operated by a marketer who competes with another marketer at any terminal, then no potential conflict of interest arises and grain industry type codes of conduct are not required.

QSL is both a sugar marketer and a sugar terminal operator, and also participates in cane farming in order to meet eligibility requirements for its significant holding of STL grower (G class) shares. There is an inherent conflict if QSL were to operate terminals that are accessed by Wilmar and other competing marketers.

To safeguard open and fair access and deliver industry transparency, future arrangements for bulk terminal operations should include an STL commitment to source independent terminal operators for common user sugar terminals.

Wilmar's Foreign Investment Review Board undertaking to operate terminals under open access

On 9 July 2010, Wilmar notified the Foreign Investment Review Board (FIRB) of its proposal to acquire 100 per cent of the ordinary shares in Sucrogen Limited. On 15 November 2010, FIRB confirmed that it had no objection to the proposal subject to Wilmar's compliance with certain undertakings given in November 2010. In particular, Wilmar undertook that:

> If, contrary to its existing intention, Wilmar does, through Sucrogen or otherwise, seek to operate STL's sugar terminal infrastructure, either through a lease, direct ownership or other means, then Wilmar will provide the same open access arrangements to STL's sugar terminal infrastructure that are currently provided by QSL.

Wilmar continues to be bound by that undertaking. Accordingly, even if Wilmar were to operate any bulk sugar terminals pursuant to a lease with STL or otherwise, Wilmar must provide open access arrangements as QSL does currently. If Wilmar breached that obligation, it would be in breach of the undertaking and the Treasurer could enforce the undertaking against it.

Maintaining and regulating open access – *Competition and Consumer Act 2010*

Sugar terminals are purpose built. They have limited alternate uses other than the storage, handling and loading of sugar. This dictates a natural mutual dependency between STL, mills and growers. Each aspect of the sugar supply chain, from grower to miller to terminal is volume dependent to remain commercially viable. Thus there is an inherent reliance on open access to ensure the maximum throughput of sugar to the terminal.

Notwithstanding this commercially-driven supply chain regulation, the *Competition and Consumer Act (CCA) 2010 - National Third Party Access Regime Part IIIA* provides legislated regulatory oversight over the efficient and equitable access to monopoly infrastructure.

8. THE ROLE FOR GOVERNMENT

As has been highlighted earlier in this submission, there has been a history of government intervention and regulation of the sugar industry which has been progressively wound back as it was found to be undermining the industry's future competitiveness and sustainability.

The Centre for International Economics (CIE) has over the years produced a number of studies on the deregulation and reform of the sugar industries in many countries, including Australia. It has previously prepared reports on the deregulation of sugar marketing in Queensland, including its 2005 report *Unshackling Queensland Sugar*, which looked at the proposal to replace marketing arrangements based on compulsory vesting of all bulk raw sugar, with voluntary arrangements involving QSL. In its latest report, which is attached with this submission, the CIE stated:

> The recent decision of three more mills to independently market their own sugar was a scenario strongly anticipated by CIE in its 2005 report. In 2005, CIE assessed that, were this to occur, it would arise due to commercial and competitive responses to pursue economic opportunities in the market previously denied the industry under compulsory acquisition and monopoly marketing. (*Current and future arrangements for the marketing of Australian sugar: Senate Inquiry*, October 2014, p.12)

The future approach being proposed by Wilmar for marketing of its raw sugar is entirely consistent with the principles and terms of the last major deregulation which took effect in 2006 with full support of growers and millers. The industry has operated effectively since 2006 within the existing regulatory arrangements and there has been no major market or system failure as a result of deregulation. During this time, a number of mills (e.g. Maryborough, Mulgrave and Mossman) have also successfully marketed their own sugar outside QSL.

The profitability of mills is extremely sensitive to the amount of cane supplied by growers and growers rely on the viability of the mills to support their cane farming enterprises. Both millers and growers are directly exposed to the global sugar price. These factors result in strong interdependencies between millers and growers that support equitable and commercial dealings between them. Growers are also able to collectively bargain in the negotiation of cane supply agreements with millers.

The industry has operated effectively since 2006 within the existing regulatory arrangements and there has been no major market or system failure as a result of deregulation

In light of the above, the existing regulatory arrangements and oversights, including the role of the Australian Competition and Consumer Commission (ACCC) and the undertakings Wilmar has given to the Foreign Investment Review Board should therefore provide sufficient comfort for industry participants, without the requirement for additional regulatory intervention.

Interdependency

There are strong interdependencies between millers and growers that support commercial interaction between them which is focused on mutual benefit, success and sustainability.

These interdependencies and a balance in commercial bargaining power mitigate the need for industry specific external regulatory controls.

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)

Sugar milling is more risky than cane growing. 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. The capital losses associated with the closure of a mill are such as to encourage mill owners to ensure that growers continue to want to grow cane and supply a mill.

As noted elsewhere in this submission, even a small variation in cane throughput to a mill has a significant impact on the mill's earnings. Millers are dependent on growers' production decisions, with no offsetting obligation on growers to grow or supply a defined quantity of cane each year. Millers are 'downstream' from growers and face risks related to quality of incoming product. They face greater risk of plant obsolescence than growers, and their risk of capital loss is much higher due to the specialised nature of mill assets and their low salvage value for alternative business use.

Institutional safeguards

> ***The Queensland sugar industry is already supported with numerous institutional safeguards to protect all proponents of the sugar value chain***

The Queensland sugar industry is already supported with numerous institutional safeguards to protect all proponents of the sugar value chain. As detailed in the Minter Ellison report *Australian Sugar*, the sector's legislative oversight is governed by numerous laws, including:

The Sugar Industry Act 1999 (Qld). The principal object of the Act is "*to facilitate an internationally competitive, export oriented sugar industry based on sustainable production that benefits those involved in the industry and the wider community.*"

The authorisation of collective bargaining under the Sugar Industry Act 1999. As detailed in the Minter Ellison report, Australian Sugar, Wilmar is party to a series of cane supply agreements (CSAs) with growers, made in accordance with section 31 of the Sugar Industry Act. The CSAs document terms and conditions for the harvesting, delivery, transport, crushing of, and payment for, sugar cane that is produced by growers and

supplied to Wilmar. The terms and conditions of CSAs are negotiated with several grower collectives (who are authorised to collectively bargain with Wilmar under section 237 of the Sugar Industry Act), as well as a number of individual growers.

Competition and Consumer Act 2010 (Cth) (CCA). Wilmar's commercial operations fall under the far reaching auspices of the Competition and Consumer Act 2010 (Cth) (CCA), notably Part IV which prohibits anti-competitive conduct.

Competition and Consumer Act (CCA) 2010 - National Third Party Access Regime Part IIIA. Part IIIA of the CCA also provides legislated regulatory oversight over the efficient and equitable access to monopoly infrastructure, such as sugar terminals.

Queensland Competition Authority Act 1995 (Qld). Provides similar provisions to those of the CCA giving added regulatory oversight to ensure open access to the bulk sugar terminals owned by STL.

The Australian Consumer Law (ACL). The ACL is the national regime for consumer protection and fair trading. It prohibits unfair business practices that regulate trade or commerce in Australia and applies across all states and territories.

Australia's transfer pricing rules. Foreign firms investing in the Australian sugar industry are subject to Australian tax laws relating to transfer pricing. New rules governing transfer pricing, which commenced from July 2013, are designed to ensure that foreign companies operating in Australia cannot use related party transactions to artificially reduce their taxable income in this country.

Australia's transfer pricing rules require firms to ensure that cross border transactions involving related parties are priced by reference to what independent parties, dealing at arm's length, would be reasonably expected to do in the same situation. Pricing must reflect a fair return for activities undertaken in Australia, taking into account the Australian assets used and the risks involved in the relevant activities.

Government policy settings

The deregulation of the sugar industry has been a lengthy and exhaustive process, subject to numerous reviews, legislative actions and significant taxpayer funding to support industry transition and adjustment. A return to regulation would also be contradictory to the stated policy objectives of both the current State and Federal Governments.

For example, the Queensland Government has detailed policies that are designed to promote growth, investment and confidence for business in the state.

A return to regulation would also be contradictory to the stated policy objectives of both the current State and Federal Governments.

In February 2014, Premier, Campbell Newman, and Deputy Premier, Minister for State Development, Infrastructure and Planning, Jeff Seeney, jointly released the Governing for Growth Economic Strategy. The strategy clearly identifies the following objective: 'To provide the best business environment in the nation to start or grow a business'.

In the foreword to the strategy, Deputy Premier Seeney said:

'The Queensland Government is committed to providing certainty for businesses and investors, reducing the cost of doing business and creating the right conditions for industry to flourish.'

The strategy also sets out the following as part of the six priority areas for economic reform to create the conditions for the private sector to invest, innovate, grow and create new jobs:

- Simplifying business regulation
- Minimising impediments to business growth
- Fostering economic growth and resilience

At the Commonwealth level, the Government has committed to an extensive program of red tape reduction through the repeal of redundant and costly regulation.

Wilmar's proposed exit from QSL sugar marketing arrangements is consistent with Commonwealth policy to build on the strengths of Australia's agricultural export industry.

The Coalition acknowledged that over-regulation is strangling businesses and driving up costs.

The key policy from the Coalition of building a 5-pillar economy and unleashing Australia's potential details how the Coalition government would build on our strengths in agriculture exports:

'We will unleash the real economic strength in our agricultural industry by removing the shackles and burdens holding the industry back and by making the industry more productive and globally competitive.'

In line with this objective, the Government is also preparing a white paper on agricultural competitiveness. At the time of the announcement of the white paper process in February 2014, the Minister for Agriculture highlighted improving competitiveness through the value chain and the reduction of inefficient regulation as priority areas for attention.

The Commonwealth is also committed to promoting free trade, particularly through comprehensive bilateral agreements. The potential serious negative consequences for current and future free trade agreements arising from reregulation of the sugar industry are discussed elsewhere in this submission.

9. FOREIGN INVESTMENT AND TRADE-RELATED ISSUES

Foreign ownership impacts on the industry

In the past five years, the industry has attracted considerable amounts of foreign capital. Around 75 per cent of milling capacity in Queensland is now owned by foreign parent companies. The industry was financially depressed between 1999 and 2005 due to low world prices, climate, disease and competition for land from forestry managed investment tax schemes. The industry was highly dependent on government assistance during this period and it accepted, in return, that it needed to restructure, deregulate, modernise and become more commercial if it were to survive.

To survive through this period the industry delayed needed on-going capital replacement and upgrading. By the end of the period the milling sector, in particular, needed to be recapitalised to recondition and upgrade milling assets and infrastructure.

Deregulation helped attract foreign investment and provided recapitalisation

Progressive deregulation and eventually (almost) full deregulation of the sugar industry in 2006 held the promise of a more commercial orientation and flexibility, reduced bureaucratic and political interference, a stable and predictable regulatory environment, an increased application of modern and global business strategies and skills and an opportunity to integrate with the globalised world sweetener market. This, and a much modernised and globalised Australian economy, helped attract the foreign investment that subsequently flowed in to support the needed recapitalisation of the industry.

Sugar deregulation followed two decades of commercial and policy reform of the wider Australian economy aimed at modernising the whole economy and making it attractive, predicable and less vulnerable to sovereign risk[1] for investors, including foreign investors. Investors want certainty and fear inconsistent and poor government decision-making (lacking consultation, evidence and forethought).

Through the 1980s, 1990s and early 2000s, Australia established a good record of stable and generally well-regarded (evidence-based) policy-making, which provided businesses with rising degrees of certainty about their investments. Government, or sovereign, risk was generally regarded as low.

In a globalised world, it became increasingly obvious that Australia needed a more competitive tax system; less government intervention; and, a more open business regulatory environment were it to continue to attract capital and to gain productivity advantages from the uptake of new technologies.

Australia also became highly active in seeking multilateral, regional, bilateral and unilateral trade and investment agreements to help deregulate and depoliticise the economy and to

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[1] Euromoney measures aspects of sovereign risk in its country risk ratings for instance (see http://www.euromoney.com/poll/10683/PollsAndAwards/Country-Risk.html). These evaluate the investment risk of a country taking into account such factors as political risk, economic performance/projections, structural assessments, debt indicators, credit rating and access to bank finance. Political risks have a quantitative weighting in the overall index of 30 per cent. They also provide assessments of a country's regulatory environment, taking account of labour freedoms, freedom from corruption, property rights, financial freedoms, monetary freedoms, government spending, fiscal freedom, trade freedom and business freedom. In 2011 Australia was ranked 3rd out of 41 countries in the Asia–Pacific region, but its overall score was lower than the global average. http://www.euromoneycountryrisk.com/Wiki/Australia).

provide frameworks that facilitated and protected inward and outward foreign investment, as well as free trade. Some of these agreements have Investor-State Dispute Settlement Provisions (ISDS) designed to protect foreign investors from breaches of commitments, discrimination against foreign investors and expropriation.

Wilmar purchased Sucrogen from CSR Limited in December 2010 for $1.75 billion. Since then, Wilmar has invested another $530 million in capital expenditure to upgrade existing assets and purchase farmland to support its sugar milling business. These investments, and the acquisition of the Proserpine Mill which was in voluntary administration for an additional $120 million, have increased the capacity of Queensland's sugar industry, supported the industry's overall viability and grown jobs in North Queensland.

Wilmar purchased Sucrogen from CSR Limited in December 2010 for $1.75 billion. Since then, Wilmar has invested another $530 million in capital expenditure

Investments assumed low sovereign risk and compliance with business law

Foreign investments were made in the knowledge that foreign companies operating in Australia must comply with the same business and competition policy law as Australian owned companies. Moreover, foreign investments were made assuming a deregulated, stable and depoliticised sugar regulatory environment and a wider Australian political economic environment with safeguards to avoid sovereign risks that would otherwise discourage foreign investment.

Foreign investment in the sugar industry has had a positive impact on the industry by helping to recapitalise it, sustain it and introduce new ideas and technologies and putting it on a sustainable basis for the future. In a deregulated environment foreign investment has the opportunity to help integrate the Australian industry with the global market and ensure an on-going flow of capital, best practice ideas and new market opportunities.

Foreign investors must comply with the same business and competition policy law as Australian owned companies and they are subject to the same commercial, economic and political pressures as Australian companies. It has long been realised that having the ownership of capital contestable through an open stock and wider globalised capital market helps attract operators with a strong comparative advantage in managing particular assets. The change in sugar milling ownership that has occurred in Australia in recent times is consistent with this. It has attracted new capital and supported an important Queensland industry that was struggling to remain viable.

Foreign investment in the sugar industry has had a positive impact on the industry by helping to recapitalise it, sustain it and introduce new ideas and technologies

The on-going supply of foreign capital will depend on the stability of the regulatory environment and the opportunity to freely pursue commercial ideas and opportunities. Without it, the Australian sugar industry is less likely to be able to compete successfully on the world market.

Australia’s commitments under its Free Trade Agreements

Australia has entered into free trade agreements with several of its major trading partners, to promote two-way trade in goods and services and attract investment.

As previously noted, Wilmar invested $1.75 billion in the Australian sugar industry when it acquired Sucrogen in 2010. It has since invested more than $650 million in the Australian industry, mostly to maintain and improve its milling assets.

Wilmar made this investment in a deregulated sugar industry, where it would negotiate with growers (bargaining collectively) to acquire sugar cane, and would have the ability to determine its how its raw sugar, produced in its mills, would be sold.

Wilmar’s investment in the Australian sugar industry is protected by the commitments entered into under the 2003 Singapore-Australia Free Trade Agreement (SAFTA)

As a Singaporean listed company, Wilmar’s investment in the Australian sugar industry is protected by the commitments entered into under the 2003 Singapore-Australia Free Trade Agreement (SAFTA). Under the terms of this agreement, Australia has entered into a series of commitments to promote and protect foreign investment in Australia, 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. These commitments apply to measures imposed by the Commonwealth, as well as States and Territories.

Calls for the 're-regulation' of the Australian sugar industry raise the possibility of measures, at either the Commonwealth or State level, that could seriously interfere with Wilmar’s use of its mills or the sale and marketing of its raw sugar. If such measures were to be put in place, there is a risk that they may constitute measures tantamount to the expropriation of Wilmar’s property, invoking the commitments under Article 11 of Chapter 8 of the SAFTA. Similar commitments have been made by Australia in other free trade agreements, including Australia's free trade agreement with Thailand.

The legality of any measures to re-regulate the sugar industry, as well as the compensation to which foreign-owned investors may be entitled, would depend upon the precise nature of the measures imposed and their financial impact on those investors. Article 16 of Chapter 8 of the SAFTA makes provision for the resolution of disputes through negotiation and, if necessary, arbitration, in cases where a Singaporean investor alleges a breach of an obligation under Chapter 8 which causes loss or damage to the investor or its investment.

10. RECOMMENDATIONS

Wilmar respectfully proposes the Committee considers including the following conclusions in its report, which should also inform any recommendations arising from the Inquiry:

1. Reaffirm that **legal title to sugar is held by millers** who manufacture the sugar, and their ability to market their sugar without regulatory constraint is entirely consistent with the principles of sugar marketing deregulation introduced in 2006, and is in the best long term interests of the industry.

2. **Growers' exposure to sugar price** under the cane price formula has been recognised by millers, and Queensland cane growers have access to price risk management mechanisms which provide growers with choice to manage 99 per cent of their sugar price exposure in arrangements which are unique in the world.

3. The legitimate interest of growers in **maintaining existing price risk management options** is strongly supported by millers and will remain unchanged and underpinned by the linkage of cane price to sugar price in the cane price formula under future marketing arrangements.

4. The Committee acknowledges the importance of future sugar marketing arrangements being established on a **sound commercial basis and through contractual relationships** between growers and millers as currently provided for under the *Sugar Industry Act 1999*.

5. That a **return to regulated marketing arrangements would be a retrograde step** for the industry which has undergone significant restructuring since the late 1990s, including the expenditure of more than $400 million in public funds to support the most recent industry restructuring which had the full support of industry participants.

6. Encourage millers and growers to continue to explore **future marketing arrangements that include accountability and transparency measures** consistent with the key sugar marketing principles outlined by Wilmar in this submission.

7. Note that the unique industry-owned shareholding structure of STL and the protection offered by the current regulatory and legal framework of the Australian Competition and Consumer laws are sufficient to ensure that all industry participants will have equitable access to critical bulk sugar terminal infrastructure, although it is **highly preferable that a sugar marketer is not the operator of a terminal that is used by its competitors**.

8. Acknowledge the **significant injection of human and financial capital** that foreign investment has brought to the Queensland sugar industry that was desperately in need of recapitalisation and reinvestment after the very poor returns of the early 2000's and the ongoing importance of foreign investment in maintaining assets and accessing global markets.

9. Conclude that growers and millers are mutually dependent on each other and have a vested interest in their mutual success. **No one party holds materially greater market power over the other** and collective bargaining which is specifically authorised under the *Sugar Industry Act 1999* along with existing provision under

Australian Competition and Consumer laws provide adequate protections for growers in commercial negotiations with millers.

11. ATTACHMENTS

The following attachments are provided with this submission to provide further information on issues related to the legislative and regulatory arrangements in place for the sugar industry; industry-specific pricing and marketing issues; and, the process of reform and deregulation of the Australian sugar industry in recent decades.

- The Centre for International Economics, *Current and future arrangements for the marketing of Australian sugar: Senate Inquiry,* October 2014.
- Minter Ellison, *Australian Sugar: a review of current and future arrangements for the marketing of Australian sugar* (October 2014)
- J. M. Craigie, *Regulation and Reform of the Queensland Sugar Industry*, October 2014.