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Regulation of Agriculture
Productivity Commission
Locked Bag 2
Collins Street
MELBOURNE VIC 8003

Dear Review Commissioner

Submission to Draft Report

Our organisation is a bargaining representative pursuant to section 33(3) of the *Sugar Industry Act 1999* (Qld) (SIA) and represents growers in the Burdekin who supply Wilmar Sugar Australia Limited (WSA).

Please find *attached* our organisation's submission to section 11.1 Statutory Marketing of the Commission's draft report. Please note that our organisation's submission is limited to a discussion regarding WSA, as we only represent growers who supply WSA.

Please contact the writer should you have any queries, or wish to discuss further with us, our organisation's submission.

Yours faithfully

PIONEER CANE GROWERS ORGANISATION LTD

Julie Artiach LL.B
MANAGER

SUBMISSION TO PRODUCTIVITY COMMISSION DRAFT REPORT

11.1 STATUTORY MARKETING

Background

Since early April 2014 when WSA gave notice to growers of its intention to give the requisite notice to Queensland Sugar Ltd (**QSL**) to withdraw from the current commercial arrangements (that is, to cease QSL as the marketer of the sugar utilised to pay growers), growers have been on a perpetual merry-go-round having to justify their concerns and objections to the unilateral decision taken by WSA.

The important facts that need to be considered in this on going debate –

- “Grower’s choice” was in fact propositioned by WSA to growers on 23 May 2013. This was not a concept that growers divined. This was offered by WSA as a choice to growers – growers could nominate a percentage of their sugar to be marketed by WSA or QSL.
- Early 2014 WSA’s offer of “grower’s choice” was withdrawn and WSA advised growers that it proposed to market, as well as its own “miller economic interest” sugar (**MEI sugar**), that portion of the sugar utilised to pay growers (referred to as “growers’ economic interest” sugar (**GEI sugar**)).
- Historically, the reward for the sugar produced from the grower’s cane has been shared on a one-third : two-third split between miller and grower respectively. This formed the basis of the cane payment formula –

$$0.009 \times \text{Sugar Value} \times (\text{CCS} - 4) + 0.662 = \$ \text{ per tonne of cane}$$

where –

Sugar Value = determined by the activities of QSL in pricing and marketing the sugar

4 units of CCS = miller receives a one-third share of the sugar

- From 2012 WSA and QSL had come to a separate arrangement whereby WSA could acquire access to its MEI sugar to market.
- WSA has access to the 4 units of CCS (which translates into a certain amount of sugar) which essentially compensates the miller for processing the cane into sugar.
- In 2014 WSA then sought to control the grower’s two-third share of the sugar, or GEI sugar, where the reward from GEI sugar was utilised to pay the grower, as per the cane payment formula. This fact appears to have been completely ignored. Growers are not seeking to interfere with WSA’s MEI sugar, merely stop WSA dictating the reward growers receive for their GEI sugar.
- Historically, the miller has not had access to, or determined the Sugar Value of, what is now referred to as GEI sugar.

- WSA has essentially sought, in relation to all of the growers who supply WSA, to substitute itself for QSL in the “single desk model” of sugar marketing. WSA is not promoting competition for marketing services and is the only provider of milling services in the Burdekin.
- WSA’s proposal was that growers would not have a choice of marketer to determine the Sugar Value of GEI sugar utilised to pay the grower. WSA’s pricing and marketing activities in relation to GEI sugar would now determine the Sugar Value in the cane payment formula.
- Growers were concerned that WSA had a conflict of interest in relation to marketing their GEI sugar given Wilmar International Ltd’s global interests in sugar (for example, related party transactions).
- WSA’s unilateral actions to force a change to the commercial arrangements with growers would have been successful due to there being no competition for milling services in the Burdekin. WSA owns the four mills in the Burdekin, the mill to the south (Proserpine) and the two mills to the north (Herbert/Ingham). Growers have no option but to use WSA for milling their cane.
- Growers have not sought to change the cane payment formula. Thus, WSA will be in no worse financial position in 2017, than its position since deregulation.
- In fact, WSA now has the ability to compete for access to GEI sugar. WSA offering a superior marketing service will ensure growers will utilise WSA as their marketing entity. **This is in stark contrast to WSA otherwise utilising its monopsony power to dictate commercial arrangements and enshrine itself as the marketer (creating a “single desk” model for all of its suppliers) to gain access to all GEI sugar.**
- As there is no competition for milling services in the Burdekin, the market will not be able to overcome WSA utilising its monopsony powers to dictate a commercial arrangement that includes WSA as the sole marketer of GEI sugar. If there was a competitive market for milling services, a grower dissatisfied with the commercial arrangements propositioned by WSA, could simply contract with the alternate miller. Such option, however, does not exist. Thus the *Sugar Industry (Real Choice in Marketing) Amendment Act 2015* is a proportionate response to remedy this market failure.

The question that needs to be answered by WSA - **Why does WSA seek access to the GEI sugar processed at its mills, when the reward from marketing activities of GEI sugar is used to pay growers for their cane?** At the public hearing held by the Senate Rural and Regional Affairs and Transport References Committee’s enquiry into future marketing arrangements for marketing of Australian sugar held in Townsville on 13 March 2015, WSA’s evidence, articulated by Mr Shane Rutherford, was, in relation to questioning of WSA’s motivations, “*..our entire motivation in this process is to ensure that our growers are sustainable. So our fear, if you turn it around, is that our growers will not achieve the benefit of the best possible price.*” The Commission needs to look behind the rhetoric and ascertain what is the benefit to a miller to control GEI sugar, the rewards of which are paid to the grower. Does the Commission accept WSA’s altruistic motivation? The Commission needs to ascertain the answer this question. This is the fundamental issue in this on-going debate. All other issues, in our opinion, being articulated by millers are merely red herrings.

Reregulation of sugar marketing in Queensland

Set out below is our organisation's response to the matters (that is, statements) specifically made and relied upon by the Commission in its draft report in reaching its recommendation that the *Sugar Marketing (Real Choice in Marketing) Amendment Act 2015* (Qld) be repealed.

- 1. Statement** - The Queensland Productivity Commission (QPC) found that the information that millers were proposing to provide growers was “*comprehensive*” and “*would provide the information that growers would need to form a view on whether the premiums that should be being paid to growers is in fact being paid.*”

Response – Growers do not have competition for milling services. Growers in the Burdekin must contract with WSA to process their cane. The QPC failed to explain how the provision of information by WSA regarding premiums would be an effective mechanism to ensure growers are in fact being properly paid. Further, the QPC failed to explain where a grower would source information to compare premiums and cost performances from year to year. Individual millers' performance is not publicly available. The only possible source of information would be from QSL, should QSL continue to be a marketer for other millers and such information remains available to all growers. A grower dissatisfied with WSA's marketing performance still has no alternative but to contract with WSA to process his/her cane and market his/her GEI sugar.

The provision of information is of little probative value unless there is the ability to effect change; that is, only if a dissatisfied grower has the option to choose an alternate marketer.

- 2. Statement** – The QPC was of the opinion that “*some millers may have a degree of market power*” but this was “*offset by the co-dependency of mills on sugarcane growers in local supply areas.*”

Response – The Commission has not analysed the evidence the QPC relied upon in reaching its conclusion that only some millers have some market power.

Millers have natural geographical monopolies. There is only one miller per geographical region. Overlapping mill areas are rare, and limited to a small number of growers within the outer boundary of the supply area of the alternate miller.

The QPC stated: “*It is generally thought that sugar cane can only be transported for approximately 100 kms*”. This formed the basis of the QPC's conclusion that there was competition for milling services and a grower dissatisfied with one miller, could simply contract with an alternate miller up to 100 km away. The commercial cost of transporting cane up to 100 km or who would bear the cost was not considered or discussed by the QPC. This is a fundamental flaw in the QPC's reasoning. From our enquiries (at the time) the cost of transporting cane 120 km (from the Tablelands to Mossman) by road was in the vicinity of \$15 - \$18 per tonne of cane. With current high sugar prices (say \$500 per tonne IPS sugar), growers would receive approximately \$45 per tonne of cane. Costs of production in the Burdekin are in the order of \$32 - \$35 per tonne of cane. A cost analysis demonstrates that transporting cane 100 km is not viable. Thus there is limited, if any, competition for milling services.

The QPC's opinion that any market power was offset by growers having demonstrable alternatives for land use, failed to take into account the financial investment made by growers and the lack of infrastructure for growers at large to grow an alternate crop.

In the Burdekin there is approximately 90,000 hectares of irrigated agricultural land, of which approximately 80,000 – 85,000 hectares is utilised for sugar cane. Each year (excluding fallow

land) approximately 72,000 – 75,000 hectares of land supplies sugar cane to WSA. The predominance of growers are committed to growing sugar cane. Growers have made substantial financial investment to growing sugar cane on a large scale. Growers would need to develop an export market for an alternate crop, given the amount of agricultural land in the Burdekin alone. Further, there would need to be substantial infrastructure to grow an alternate crop of the scale of sugar cane grown in the Burdekin. Without substantial investment there is limited opportunity for growers on mass to grow an alternate crop.

Our organisation is of the view that millers, and in particular WSA, has considerable market power.

3. Statement – Growers have an opportunity to take advantage of the collective bargaining provisions in the *Competition and Consumer Act 2010* (Cth).

Response – The QPC similarly stated “*this means statutory authorisation allows growers to collectively make a decision that none of the cane growers will provide product to the miller until the miller agrees to the terms and conditions requested by growers*”.

The QPC’s opinion was startling for its lack of appreciation of the nature of sugar cane and of the financial consequences of growers refusing to supply sugar cane to a monopsony miller.

Sugar cane is a perennial crop and as such a 5 year investment by growers; that is, the cost of planting is substantial and the costs are ameliorated over subsequent seasons. Sugar cane is not an annual crop (such as wheat or cotton) where a grower can make a year by year decision to rotate in and out of different crops. Thus, the miller is aware that the grower must supply sugar cane for at least 5 years to be financially viable.

Growers’ ability to “hold out” for acceptable terms and conditions fails to appreciate the resources of an agribusiness the size of Wilmar International Ltd compared to growers’ resources, or other relevant factors such as –

- there is no alternate miller; or
- that there is an optimal period to harvest the crop so as to maximise sugar yield; or
- that the crop must be harvested each year.

The QPC failed to taken into account the huge disparity in financial resources and bargaining position of the growers and WSA. WSA can as easily refuse to consider commercial terms advocated by a bargaining representative, as it can an individual grower. Collective bargaining does not balance this inequity in bargaining power. Whilst the contract is the result of collective bargaining, growers sign individual contracts with WSA. It is our organisation’s opinion that the effect on WSA of a grower or a group of growers “holding” out for better commercial terms, has been of little consequence to WSA. In previous negotiations with WSA, it has merely responded “no” to changes in the terms of the contract sought by our organisation’s growers.

Our organisation does not accept the Commission’s reliance upon QPC’s opinion that growers merely have to “hold out” to ensure a fair commercial arrangement with WSA and the QPC produced no evidence to support this conclusion.

4. Statement – The Commission noted the potential for the types of mediation provided under codes of conduct in other industries to provide a low cost mechanism for resolving disputes over pricing.

Response – Our organisation would support there being a mandatory Code of Conduct pursuant to the *Competition and Consumer Act 2010* (Cth). The Federal Government’s Policy Guidelines on prescribing Industry Codes pursuant to part IVB of the *Competition and Consumer Act 2010* (Cth) provides that “*an industry will generally only be subject to government intervention where there is a demonstrable problem affecting other participants or consumers which the market cannot or will not overcome.*” The lack of competition for both milling and marketing services (should the 2015 amendments to the SIA be repealed) means the market will not provide a solution. The Federal Government’s competition policy endorses minimalist regulation where necessary to address market failure. A mandatory Code of Conduct would also be a proportionate response to remedy the market failure and ensure resolution of disputes involving the manner in which growers were remunerated for their cane.

5. Statement – The *Sugar Industry (Real Choice in Marketing) Amendment Act 2015* will likely restrict competition.

Response – The 2015 Amendment Act prescribes that a grower can nominate a marketer of GEI sugar; that is, there is competition for marketing services. A repeal of the 2015 Amendment Act permits the miller to dictate that it is the only marketer of GEI sugar. The QPC only gave consideration to the miller’s position. The QPC failed to recognise that the rewards of marketing activities of GEI sugar were for the account of the grower. Thus, how is it unreasonable for growers to have a level of control over the price they receive for their GEI sugar by determining the marketer of the GEI sugar? The Commission must give consideration to this issue and provide evidence of the alleged restriction in competition.

6. Statement – The QPC found that the Act increases risk for millers, which is likely to make Queensland a less desirable investment destination compared with other jurisdictions.

Response – The QPC has not recognised that the miller, pursuant to the cane payment formula, has received 4 units of CCS, which translate into a certain amount of sugar. Thus, the miller has in fact been compensated at first instance. Thus the risk to millers would be negligible. This is the manner in which the current system operates and neither miller or grower is propositioning a change to the miller’s share of the sugar or the reward received by the miller.

The QPC has similarly failed to recognise the investment and increased risk for growers, whose investment in the Queensland Sugar Industry is estimated to be considerably more than millers, in an environment where the miller is the sole marketer of GEI sugar and the sole determinant of the price growers receive for their cane. The QPC failed to give any consideration to the on going investment made by growers in relation to their businesses, improving productivity and reducing costs. Growers are an integral part of regional communities; they live locally; their children go to school; they shop locally; purchase infrastructure and machinery; volunteer their time at sporting clubs etc. The Commission needs to take into account growers’ investment.

The 2015 Amendment Act does not prescribe a cane payment formula. Consequently the 2015 Amendment Act does not determine a change in the cane payment formula. The Commission’s comment that the miller’s risk is compounded by changes over time in the cane payment formula is not explained, nor supported by the facts. The cane payment formula is a matter of negotiation between the miller and growers, as has been the case since deregulation. This aspect of the commercial arrangement has not been changed by the 2015 Amendment Act.

7. Statement – A related issue is that grower confidence in the ability of QSL to generate the best possible market premiums is untested.

Response – It is in fact WSA’s ability to generate market premiums that is untested. WSA has to date been unable to advise of its likely costs in marketing GEI sugar. The Sugar Value is a function of pricing outcomes *plus* premiums *less* costs. WSA’s performance is untested. Thus there is significant uncertainty in WSA’s performance as a marketer of GEI sugar.

8. Statement – Competition would enable claims by millers that they can generate higher premiums for growers through alternative marketing arrangements to be tested in the marketplace and drive innovation.

Response – The 2015 Amendment Act promotes competition for marketing services. The alternative propositioned by WSA is that the GEI sugar of all growers who supply WSA will be marketed only by WSA. This is not generating competition for marketing of GEI sugar. This is merely substituting WSA for QSL as the sole marketer. Growers are seeking competition for marketing services and the 2015 Amendment Act responds accordingly in facilitating a choice of marketer. It is important to acknowledge that growers are not advocating the continuation of a single desk marketing model.

Further, it has been WSA’s position (refer to WSA’s submissions to the Senate Standing Committees Rural and Regional Affairs and Transport’s enquiry into future arrangements for the marketing of Australian sugar – page 21 of submission 10), the marketing premiums net of marketing costs represents “*approximately 1 percent of the Net Sugar Price*” or \$1.67 per tonne of sugar. Assuming the accuracy of WSA’s calculations, a miller generating a higher premium of 1 percent is not going to drive innovation or provide any incentive for profitable restructuring of the sugarcane growers, as expressed by the Commission (refer to page 425 of the draft report). The Commission should produce the evidence relied upon to support its conclusion.

9. Statement – The average size of sugarcane farms in Australia increased from 80 hectares in 1997-98 to 110 hectares in 2014-15; compared to 495 hectares in the United States in 2007. The Industry Commission cited research indicating cost savings of around 30 percent from expanding farm area from 100 to 300 hectares.

Response – A comparison between the average size farm in Australia, to that of the United States, and the implication that in Australia the average size farm should be 300 hectares, is nonsensical and simplistic. The implication from the Commission’s statement is that somehow it is the single desk marketing model that has constrained growers’ investment in increasing farm size.

The Commission has failed to consider multiple other factors influencing the investment by growers and the average size farm. For example (and not exhaustive) –

- Growers do not receive the same reward for their sugar. The domestic American market is paid substantially more than the world sugar price (that is, ICE 11 futures contracts). This is demonstrated by growers being paid for their GEI sugar based on the ICE 11 (today’s spot price AUD \$571.20 per tonne IPS sugar). Growers in the United States would be paid in reference to the ICE 16 (the basis upon which growers are paid for a portion of the US Quota, AUD \$769 per tonne IPS sugar).
- The Queensland Sugar Industry is the least subsidised agricultural industry in Australia. What level of protection exists for American growers?
- The level of investment in Research and Development by the Australian Government compared to the American Government.

- The growers' costs of production (for example: electricity, water, fertiliser) in Australia compared to America.
- The cost of land.
- The level of Government red and green tape adding to the costs of production and prohibiting investment in Australia compared to America.
- The taxation system of Australia compared to America.

The Commission has produced no evidence to support the proposition that the single desk marketing model has constrained grower investment and farm size, particularly given other confounding factors such as those referred to above.

Conclusion – The Commission's recommendation that the Queensland Government should repeal the amendments made by the *Sugar Industry (Real Choice in Marketing) Amendment Act 2015*

The purpose of the 2015 Amendment Act was to remedy the action taken by WSA (and other millers) to control the whole of the supply chain from processing the growers' sugar cane, pricing, marketing and selling GEI sugar. In this regard, the Commission is specifically referred to the Explanatory Notes for the *Sugar Marketing (Real Choice in Marketing) Amendment Bill 2015* (Qld), in passages of Hansard and in Mr Knuth's MP address to the Queensland Legislative Assembly on 19 May 2015 and again on 2 December 2015. These documents are a matter of public record. The Commission must properly consider the objectives of the 2015 Amendment Act and we do not believe this has been done.

The Responses provided above have challenged the Statements relied upon by the Commission in reaching its recommendation that the 2015 Amendment Act should be repealed. The Responses seek to illustrate that growers have valid concerns regarding the construct³ being propositioned by WSA, namely that WSA would act as the sole marketer of GEI sugar. Growers are seeking competition for marketing services, as first propositioned by WSA on 23 May 2013; they are not seeking to entrench a single desk marketing model.

Our organisation remains of the view that there is substantial evidence to sustain a position that there is an imbalance in bargaining power; that WSA has sought to rely upon monopsony powers to force a commercial arrangement that is unacceptable to growers and that the market will not provide an adequate response, resulting in a market failure. The 2015 Amendment Act is a proportionate response to remedy the market failure.

We remind the Commission of our initial query – why does WSA seek access to GEI sugar, when the rewards of the sale of GEI sugar are for the account of the grower? How does a restriction on WSA marketing the GEI sugar possibly stifle its investment opportunities? The Commission needs to respond to these questions.

Given the serious implications of the Commission's draft recommendation that the 2015 Amendment Act should be repealed, it is encumbered upon the Commission to reassess the probative weight of the evidence it has relied upon to date when formulating its final report.