



**QUEENSLAND
PRODUCTIVITY
COMMISSION**

**CONSULTATION
REGULATORY
IMPACT
STATEMENT**

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

October 2015

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SUBMISSIONS

Closing date for submissions: 13 November 2015

This is a Consultation Regulatory Impact Statement (RIS) only, and subject to revision. Public involvement is an important element of the decision-making processes of the Queensland Productivity Commission (QPC). Therefore submissions are invited from interested parties concerning its assessment of the impacts of the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015*. The QPC will take account of all submissions received.

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Confidentiality

In the interests of transparency and to promote informed discussion, the QPC would prefer submissions to be made publicly available wherever this is reasonable. However, if a person making a submission does not want that submission to be public, that person should claim confidentiality in respect of the document (or any part of the document). Claims for confidentiality should be clearly noted on the front page of the submission and the relevant sections of the submission should be marked as confidential, so that the remainder of the document can be made publicly available. It would also be appreciated if two copies of each version of these submissions (i.e. the complete version and another excising confidential information) could be provided. Where it is unclear why a submission has been marked 'confidential', the status of the submission will be discussed with the person making the submission.

While the QPC will endeavour to identify and protect material claimed as confidential as well as exempt information and information disclosure of which would be contrary to the public interest (within the meaning of the *Right to Information Act 2009* (RTI)), it cannot guarantee that submissions will not be made publicly available.

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EXECUTIVE SUMMARY



The Queensland sugar industry is Queensland's second largest agricultural export industry after beef. It generates around \$2 billion per year in earnings and employs around 16,000 people. There are almost 4,000 cane farming enterprises in Queensland supplying 21 mills, owned by seven different milling companies.

Before deregulation of the industry in 2006, the Queensland sugar industry had been highly regulated, with regulation affecting almost all aspects of the industry – from the allocation of cane production areas to the acquisition, marketing and sale of the raw sugar.

In the early 2000's increasing global competition, particularly from Brazil, and several poor seasons, saw sugar industry returns halve from around \$2 billion per year to around \$1 billion per year. A series of reviews found that the regulatory framework at the time was impeding innovation and productivity improvements – with strong recommendations for removing unnecessary regulation and allowing the sector to reorganise itself to flourish.

There is evidence that deregulation has generated improvements. There has been consolidation of farming and milling activities – and significant investment in improving milling. It is also evident that the sector is seeking to add value through the supply chain and through international trading arrangements.

However, it is evident that segments of the industry are at an impasse about agreeing future cane supply agreements. This impasse has arisen from Queensland's three larger millers' decision to cease contracting with Queensland Sugar Limited (QSL) for marketing of export raw sugar from 1 July 2017 and instead market export raw sugar through their own arrangements. Some growers and grower organisations are concerned that this change could adversely affect returns to growers and have indicated the need for Government intervention.

Purpose of the Bill

On 19 May 2015 the Member for Dalrymple, Mr Shane Knuth MP, introduced the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015* to the Queensland Parliament. The Bill's intent is to protect the interests of Queensland's canegrowers in the State's vitally important sugar industry as mill owners opt out of long-standing sugar marketing arrangements with QSL.¹ To this end, the objects of the Bill are:

- (a) To ensure that a grower has real choice in terms of nominating the marketing entity for on-supply sugar in which they have an economic interest.
- (b) To facilitate the fair and final resolution of any commercial disputes that 'rise between a grower or bargaining representative and a mill owner, including by arbitration'.²

To achieve this objective, the Bill would require a supply contract to include:

. . . a term requiring the mill owner to have an agreement with a stated entity (the GEI sugar marketing entity) to sell that quality of the on-supply sugar at least equal to the quantity of the grower economic sugar . . .

¹ Agriculture and Environment Committee (2015), page v

² Revised Explanatory Notes, *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015*, Page 1

Role of the QPC in undertaking a Regulatory Impact Statement (RIS)

On 30 September 2015, the Honourable Curtis Pitt, Treasurer, Minister for Employment and Industrial Relations and Minister for Aboriginal and Torres Strait Islander Partnerships asked us to undertake an independent regulatory (including economic) impact assessment of the Bill. The Queensland Parliament's Agriculture and Environment Committee (AEC) recommended that a regulatory impact assessment be completed prior to the Bill being brought on for the second reading debate.

Regulation can impose significant costs on business and the wider community, so it is important there is a clear rationale and strong case for Government intervention. The purpose of a RIS is to identify the case for government intervention and provide decision makers with the information they need to make an assessment of the benefits and costs of regulatory intervention on the affected stakeholders including business, community, employment, environment and the economy.

Draft impact assessment – conclusion

Our draft impact assessment of the Bill has been completed in two parts:

- (a) is there evidence of market failure in the sugar industry arrangements that would indicate the need for government intervention; and
- (b) is there a net benefit from the Bill; or are there alternative options that would meet the overall industry objective – including no additional regulation.

No evidence to support a case for market failure in Queensland sugar industry

While we have assessed that some mills may have a degree of market power, we consider that there are aspects of the industry and current regulation which mitigates against this market power. In addition, we have not been able to identify evidence that any market power, which does exist, is being abused and that would suggest there is need for government intervention. Our draft assessment is that it appears the existing legislation:

- supports a pricing negotiation framework which provides an appropriate balance of risk and reward between growers and millers, noting that almost ten years after deregulation, the Cane Price Formula is still the dominant form of pricing in the sector and growers are authorised to bargain collectively
- allows for millers to provide transparency about pricing and premiums to growers and there is evidence that they are doing so
- supports investment in the sugar industry, which is important to the long-term economic sustainability of the sugar industry, noting that millers have been investing in mill improvements, which increase overall productivity within the sector.

Even if there were an abuse of market power in the future there are a number of current regulatory options available to growers. For example, it is clear that the unconscionable conduct provisions of the *Competition and Consumer Act 2010* (Clth) (CCA) apply to circumstances of business-to-business contracts. There is also section 46 of the CCA which prohibits an abuse of market power. These options would be open to the growers should contractual arrangements post 2017 be either unconscionable or constitute an abuse of market power.

Benefits of additional regulation do not outweigh the costs

The Bill proposes to provide growers with the ability to choose a marketer for the proportion of raw sugar to which they have an 'economic interest'. However, without changes to the existing terms of Cane Supply Agreements (CSA) between growers and millers, title to cane transfers to millers at the point cane is delivered to the mills.

Around 80% of raw sugar produced in Queensland is exported.

The value of export raw sugar is determined by the world sugar price – for Queensland this is the ICE No.11 price.

Australia is not a price setter in the global market and it is estimated that 99 per cent of the value of raw sugar production is set in this way.

Queensland's sugar exports are valued at around \$1.7 billion in an average year.

Around 1 per cent of the value of raw sugar exports is derived from net premiums – around \$14 million per annum to growers and \$7 million per annum to millers.

Our draft conclusion for the Consultation RIS is that potential benefits that may accrue from passage of the Bill, are outweighed by the potential costs and risks. Specifically, the Bill, if enacted:

- (a) interferes with the property rights of millers, assuming the existing structure of CSAs is retained. This is likely to reduce the profitability of future sugar mill investment and dampen longer term innovation and productivity compared to no additional regulation
- (b) could reduce the overall returns to the sugar industry. The larger millers have made commercial decisions that they can improve financial outcomes by marketing export raw sugar – the remaining millers have made the commercial decision to market export raw sugar through QSL. There is nothing to suggest that millers – with a commercial incentive to improve returns from their production of raw sugar – are not well equipped to make this decision. Further, to the extent that returns are distributed to growers – it is difficult to see how growers are disadvantaged and the proposals by MSF and Wilmar seem to have sufficient transparency that if a disadvantage were to arise, it would be identifiable to the growers
- (c) could reduce the returns to the industry by adding extra costs. Marketers would need to compete for the business of 4,000 cane producers with costs to attract and retain customers and additional transaction costs. As marketing premiums are still capped by global factors, it is possible that any additional competitive benefits of having growers chose a marketer could be offset by higher costs
- (d) re-introduction of pre-contract arbitration may lead to both financial (legal) and time loss costs for the industry. Legal costs for an average arbitration are estimated to range between \$1.2 million and \$1.5 million per dispute, with the time to resolve dispute estimated at 12 – 18 months, with a ‘fast track’ of 9 months. It is not clear that pre-contract arbitration adds additional benefits above the existing mediation arrangements
- (e) could leave parties exposed to action by the ACCC, if the Australian Government does not accept that there is a net benefit from the authorisation of anti-competitive conduct included in the Bill. Clause 8 of the Bill would authorise some additional anti-competitive behaviour. If the Queensland Parliament legislates for a restriction on competition, it must advise the ACCC within 30 days. The Australian Government can disallow the authorisation if the benefits of the anti-competitive conduct do not outweigh the costs. A cost benefit assessment was not completed prior to introduction of the Bill and there is the risk if the Australian Government is not satisfied by the public benefit justification that parties engaged in anti-competitive conduct would not have the protection of an authorisation.

Table 1 summarises the likely impacts on key sugar industry parameters under the Bill option, as well as the base case of 'do nothing'; a mandatory code and a tolling option (where growers contract with millers to crush cane and retain control of raw sugar marketing). Under any option, the major influence of the value of cane and raw sugar production continue to be world sugar prices, input costs, and environmental conditions and mill availability.

Given our first conclusion that there is no evidence of market failure that would indicate a need for additional regulation, we consider that retaining the existing regulatory framework — with no additional regulation — will provide the greatest net benefit to Queensland.

Next steps

This is a Consultation RIS, which means it is a draft impact assessment. Our assessment of impacts may change in response to issues raised by stakeholders and the presentation of additional information. We invite all interested stakeholders to make written submissions on the Consultation RIS. We will take into account all submissions received by **13 November 2015**.

Table 1: Summary of likely impacts on sugar industry under alternative regulatory options

	<i>Option 1 - Base Case — Do nothing</i>		<i>Option 2 — Bill</i>	<i>Option 3 — Mandatory Code</i>	<i>Option 4 — Tolling</i>
	<i>Pre 1 July 2017</i>	<i>Post 1 July 2017</i>	<i>(compared to post 1 July 2017 base case)</i>		
Cane production	Influenced by forecast world sugar prices, input costs, and environmental conditions and mill availability.	Change of marketer is unlikely to change the influences of cane production.	Change of marketer is unlikely to change the influences of cane production.	Change of marketer is unlikely to change the influences of cane production.	Influenced by forecast of world sugar prices, input costs and environmental conditions and mill availability.
Raw sugar production	Most likely influenced by cane production volumes and quality, mill availability and miller efficiency	Change of marketer likely to have minimal impact on raw sugar production in the short term. May increase production longer term if marketing improvements yields higher return.	Perceptions of sovereign risk may lower mill investment leading to lower mill availability and raw sugar production.	Similar to the Bill	Unchanged unless the tolling arrangements lead to a reduction in mill investment relative to the existing model where millers make the commercial decision to invest.
World raw sugar price (ICE No.11)	Set by world market	Set by world market	Set by world market	Set by world market	Set by world market
Net premiums	Average range of plus or minus \$5/net tonne raw sugar Assumed \$21 M per annum raw sugar distributed <ul style="list-style-type: none"> • \$14 M to growers • \$7 M to millers 	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Some millers may be able to achieve a higher premium from alternative marketing.	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Some millers may be able to achieve a higher premium from alternative marketing.	Similar to the Bill	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Millers may exit marketing sugar, which would reduce competition in marketing.
Investment in cane production	Influenced by forecast world sugar prices, input costs and availability of suitable cropping land	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land	Continue to be influenced by forecast world sugar prices, input costs (including tolling and transaction costs) and availability of suitable cropping land. Greater volatility returns.
Investment in mills	Influenced by forecast world sugar prices, input costs, and ability to lift productivity	Influenced by forecast world sugar prices, input costs, and cane production in mill area	May result in reduction in mill investment if millers perceive better returns on capital from other parts of international businesses.	Similar to the Bill	The level of mill investment would depend on the commercial terms negotiated with growers.
Employment	Estimated 16,000	No material change in employment expected	Potential reduction if reduced mill investment	Similar to the Bill	Unknown

ROLE OF THE QPC



The Queensland Productivity Commission (QPC)'s role is to provide independent advice on complex economic and regulatory issues, and propose policy reforms, with the objective of driving economic growth, lifting productivity, and improving living standards across Queensland. A wide level of open and transparent public consultation will underpin these functions.

We have initially been set up as a government entity under the *Public Service Act 2008*, and are part of Queensland Treasury.

The Government has announced its intention for the QPC to be converted to a separate legal entity as a statutory body under its own legislation. The *Queensland Productivity Commission Bill 2015* was introduced into the Queensland Parliament on 15 September 2015.

Our work encompasses three key streams:

- economic reform and policy
- regulatory advice and guidance to departments
- economic research into private and public sector productivity.

Our operation and reporting is independent, with tasks referred to the QPC by the Government.

We are committed to providing a transparent and consultative process to allow all interested stakeholders to participate in inquiry processes.

The QPC's final reports for each inquiry will be submitted to Government to allow a government response at the same time as public release

We operate on the principles of independence, rigour, responsiveness, openness, transparency, equity, efficiency and effectiveness.

ABOUT THE CONSULTATION RIS



Scope

On 30 September 2015, the Honourable Curtis Pitt, Treasurer, Minister for Employment and Industrial Relations and Minister for Aboriginal and Torres Strait Islander Partnerships asked us to undertake an independent regulatory (including economic) impact assessment of the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015* (the Bill).

The Bill is a Private Member's Bill, and was not subject to the regulatory impact assessment process that would normally be undertaken for Government-initiated legislation. Recommendation 2 of Report No. 6, 55th Parliament Agriculture and Environment Committee (AEC) September 2015 *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015* was:

that the Minister requests his Department of Agriculture and Fisheries to conduct a regulatory impact assessment of the Bill in conjunction with the Queensland Productivity Commission, and that the Minister tables the department's report on this assessment prior to the Bill being brought on for the second reading debate.

Conduct of the regulatory impact assessment

In referring the Bill to us for a RIS, the Treasurer noted that this is not the usual approach to assessment of legislative proposals. However, given our expertise in regulatory review, and independence from Government, it was considered the QPC was best placed to provide advice.

As the Bill is listed for debate in the sitting week starting 3 December 2015, there is urgency attached to the preparation of a RIS to inform the Queensland Parliament's consideration of the Bill. The timetable for the preparation of the RIS reflects the urgency, rather than the normal practice set out in the RIS Guidelines.

We have prepared the Consultation RIS in accordance with the Queensland Treasury RIS System Guidelines and with the assistance of the Department of Agriculture and Fisheries (DAF).

We encourage all interested parties to be involved in the process.

Register your interest – www.qpc.qld.gov.au/contact-us

If you wish to participate in the QPC's inquiry process, please register your interest to ensure you receive our email alerts on key developments including release of reports, calls for submissions and details of public inquiries.

Key dates

Referral from Treasurer
30 September 2015

Initial submissions
9 October 2015

Release of Consultation RIS
30 October 2015

Due date for submissions
13 November 2015

Decision RIS provided to government
25 November 2015

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1 BACKGROUND

1.1 Overview of the Queensland sugar industry

The Queensland sugar industry is located mainly along Australia's eastern coastline, from Mossman in far north Queensland to Rocky Point in south east Queensland. The industry is one of Queensland's largest rural industries and forms a major part of the economy in many coastal regional communities.

The sugar industry represents significant infrastructure investment across rural and regional communities. In Queensland there are around 4,000 cane farming enterprises growing sugarcane on a total of 350,000 hectares annually, supplying 21 mills, owned by seven separate milling companies. The vast majority of cane farms are owned by sole proprietors or family partnerships. The mill ownership structures are a combination of publicly owned entities, privately held companies limited by guarantee, and co-operatives.

Queensland contributes 95 per cent to the nation's raw sugar production. In 2014, 30.8 million tonnes of sugarcane was crushed, producing approximately 4.2 million tonnes of sugar. Total industry revenue was just under \$2 billion, which includes sales from sugar, molasses and electricity exported back into the grid.

Around 80 per cent of the raw sugar produced in Queensland is exported. Australia is the third largest exporter of sugar, after Brazil and Thailand, with around \$1.7 billion in export earnings.

The perishable nature of sugar cane means that it must be processed within 16 hours after harvest. Location and transport costs limit the mills available to growers to process the cane. Due to the 16 hour crushing window, harvested cane must be delivered to mills soon after harvest and growers generally use the services of a miller located close to their farms. In many cases, growers have no alternative mill to supply their cane crop. Millers also require harvested cane to be delivered quickly to their mill as it is not economically feasible to source cane from distant locations.



1.2 History of Queensland's sugar marketing arrangements

Historically, the Queensland sugar industry was highly regulated. Before extensive legislative reform in 2004 and 2005, government regulation controlled almost all aspects of the industry — from the allocation of cane production areas to the acquisition, marketing and sale of the raw sugar product.

1.2.1 Steps toward deregulation of the Queensland sugar industry

Under the *Competition Principles Agreement 1995*, all Australian governments agreed to review restrictions on competition, and regulatory arrangements that contained restrictions on competition, every 10 years. The Queensland sugar 'single desk' arrangements were reviewed in 1996.

In 2004, prior to the competition review required for 2006, CANEGROWERS and the Australian Sugar Milling Council (ASMC) signed an agreement committing to the establishment of a working group to progress a new marketing system for bulk raw sugar. Industry agreed to take a pro-active approach to future sugar marketing arrangements, rather than a defensive ‘protection of the status quo’.

At the time the industry was facing a fundamentally changed market situation, because:

- the industry’s historic advantage in efficiency had been eroded, with very low uptake of new technology and practices
- Brazil was emerging as a major new competitor, with a more efficient and commercial export sector – in 2004 alone Brazil increased its cane production by the size of the total Australian industry; and
- the industry remained focused almost entirely on raw sugar exports, and had done little to promote either alternative products from cane or sugar, or to further value-add.

Because of these factors, and several poor seasons, industry returns in the early 2000’s declined from approximately \$2 billion per year, to approximately \$1 billion.

The costs and benefits of the working group’s recommendations were independently evaluated and it confirmed the single desk was hindering the industry from making the changes it needed to remain competitive in the global sugar market by preventing competition in the marketing of raw sugar. Such anti-competitive powers were:

- hindering the industry from embracing opportunities to manage finances and risks of marketing more effectively
- mitigating against opportunities for product diversion from bulk raw sugar
- impeding the take-up of opportunities to install whole-of-chain systems in all operations, preventing the industry from developing a range of commercial marketing skills; and
- negating the need to attract and develop the enterprise and management required to run growth oriented commodity marketing organisations.

1.2.2 2006 deregulation of the Queensland sugar industry

Final deregulation of Queensland's single desk marketing arrangements for sugar commenced on 1 January 2006. Vesting of raw sugar to Queensland Sugar Limited (QSL) was removed and control of raw sugar consequently reverted to millers.

While the industry was deregulated, QSL entered into voluntary agreements with the majority of Queensland mills to continue to market their export raw sugar. Under the Raw Sugar Supply Agreements (RSSAs), which QSL has with each of the seven Queensland mill owners, millers supply 100 per cent of their raw sugar production, intended for bulk export, to QSL.

Raw sugar for domestic supply (or exported in bags or containers) is not supplied under the RSSA and marketing can occur independently of QSL.

Today, the SIA imposes few regulations on the sugar industry and facilitates some aspects of production, transport and milling. The principal object of the SIA (section 3) 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 SIA continues to require that the relationship between a grower and a miller is governed by CSAs. However, since the deregulation of the sugar industry, growers and millers have been free to negotiate terms relating to the sale of the cane crop.

1.3 Role of Queensland Sugar Limited

QSL is a not-for-profit company in which both growers and millers own shares. Under its constitution, QSL is required to act in the best interests of the sugar industry. As a tax exempt, not-for-profit entity it is not permitted to distribute profits to its members.

QSL is the modern incarnation of the former Sugar Board that was established in 1923 and controlled all Australian sugar exports. Legislation originally required that all sugar be sold to the Sugar Board. In 1991, the Queensland Sugar Corporation (QSC) was established as a statutory authority under the *Sugar Industry Act 1991*, replacing the Sugar Board.

The primary activities undertaken by QSL today include:

- acquiring raw sugar intended for bulk export from Queensland mill owners under the RSSAs
- selling export raw sugar
- chartering shipping for export raw sugar
- financing and hedging activities related to that raw sugar
- sub-leasing, operating and providing storage and handling services at the six bulk sugar terminals; and
- conducting other initiatives considered to be in the best interests of the Queensland sugar industry.

QSL sells raw sugar directly to refiners in a number of countries. Proceeds are pooled for payment purposes and distributed back to mills and growers after being adjusted for marketing costs incurred by QSL. With the pooling of sales proceeds, producers receive an average of prices received from sales of export raw sugar each year.

The arrangements for marketing and export of raw sugar are made between milling companies and QSL under a RSSA. Growers are not a party to the RSSA.

RSSAs acknowledge growers have an ‘economic interest’ in the raw sugar produced from their sugar cane crop — equal to around two-thirds of the raw sugar sold. The miller has the remaining one-third interest. This reflects the historical revenue sharing arrangement which has been in place for the past 100 years — commonly referred to as the Cane Payment Formula.

1.4 Role of Sugar Terminals Limited (STL)

Queensland has six bulk sugar terminals — at Cairns, Mourilyan, Lucinda, Townsville, Mackay and Bundaberg — leased from the relevant port authorities by STL under long term leases.

In 1999, the terminals were separated from QSL's marketing operations but kept in industry ownership through the creation of STL. STL was established as a ‘for profit’ company with 360 million shares: 229.4 million issued to growers (‘G class’) and 130.6 million issues to mill owners (‘M class’). The Brisbane bulk sugar terminal was sold to Wilmar Gaviion in 2009. The ‘G’ class shares were listed on a restricted market on the NSX (National Stock Exchange of Australia).

Trading in STL's shares is restricted to mill owners for M class and growers for G class — with requirements for growers to sell shares within a reasonable time if no longer actively growing cane. This is intended to ensure that terminal assets remain within industry control. However, millers can purchase G class shares through their farming operations and QSL also has an interest in G class shares.

QSL subleases the terminals from STL and operates them on behalf of the industry. Sublease payments are one of QSL's major marketing costs and STL's only material source of income. QSL

stores all Queensland raw sugar in the bulk sugar terminals on an open access and cost-recovery basis, including domestic sugar and export sugar for which QSL is not conducting the marketing.³

1.5 Recent developments in the Queensland sugar industry

1.5.1 Changing ownership arrangements

Prior to 2006, there had been a significant degree of under-investment in the sugar industry. Since 2006, the industry has attracted significant investment, and as a result of ongoing industry consolidation, many milling companies are now foreign-owned. The scale of global investment in the industry has been substantial and is shown in **Table 2**.

Table 2 Foreign investment in Queensland sugar mills

<i>Company</i>	<i>Details</i>
Wilmar Sugar Australia	Singapore-based Wilmar paid \$1.75 billion for Sucrogen (formerly CSR) in 2010
Tully Sugar Limited	China-based food conglomerate China National Cereals, Oils and Foodstuffs Corporation's made a \$136 M investment in Tully Sugar Limited in 2011
MSF Sugar Limited	Thailand-based Mitr Phol's made an investment of \$313 M in MSF Sugar Limited in 2012.

The Australian sugar milling market is highly concentrated. Wilmar Sugar Australia (Wilmar) accounts for around 55 to 60 per cent of Australia's total raw sugar exports. The next three largest millers — Mackay Sugar Limited, MSF Sugar Limited (MSF) and Tully Sugar Limited (Tully Sugar) — collectively account for about 30 per cent. **Table 3** lists the seven milling companies and the mills they operate. Raw sugar production is largely exported to international customers (around 80 per cent) — predominantly into Asia. The remaining 20 per cent of sugar is refined and consumed domestically.

Table 3 Milling companies and current ownership of mills

<i>Mill ownership</i>	<i>Trading As</i>	<i>Operating mills</i>
Wilmar International Limited (Based in Singapore)	Wilmar Sugar Australia	Macknade Victoria Invicta Pioneer Kalamia Inkerman Proserpine Plane Creek
Grower owned limited company	Mackay Sugar Limited	Mossman Farleigh Marian Racecourse
Mitr Phol Sugar Corp (Based in Thailand)	MSF Sugar Limited	Tableland Mulgrave South Johnstone Maryborough
COFCO (Based in China)	Tully Sugar Limited	Tully
Finasucre (Based in Belgium)	Bundaberg Sugar Limited	Bingera Millaquin
Grower owned, shareholder co-operative	Isis Central Sugar Milling Company Limited	Isis
Family owned and operated	Heck & Sons Limited	Rocky Point

Source: Department of Agriculture and Fisheries

³ QSL (2014). Submission to Senate Committee on Rural and Regional Affairs and Transport

1.5.2 Changing marketing arrangements

In 2010, Queensland cane farmers suffered one of the most extreme weather events in a generation. While the cane was grown, some 5.5 million tonnes of cane was left unharvested due to the wet weather. The total supply shortfall for the 2010 Season was 723,000 tonnes. The supply shortfall resulted in a 'washout' or cancellation of sales contracts and buy-back of previously priced futures positions. The cost of managing cancelled sugar sales and futures buy-back was \$105.5 million for the Pricing Platform pools. This cost was allocated back to the mills and passed on to growers in accordance with the Cane Price Formula (see Section 1.6).

This had the consequence of:

- solidifying growers' views about their economic interest in the sugar, although at the time they argued the mills should meet the full cost of the loss; and
- precipitated millers reviewing their voluntary marketing arrangements with QSL.

In 2012, QSL agreed to a system where Wilmar would sell its economic interest sugar. In 2013 all RSSAs provided millers with the option to buy back their economic interest sugar (around one third) from QSL and then on-sell it to their customers.

In 2013, Wilmar proposed a 'Grower Choice' model which it said would have given growers the ability to choose either the miller, QSL, or both, as the marketer of their economic interest sugar. CANEGROWERS and the Australian Cane Farmers Association (ACFA) rejected Wilmar's proposal due to concerns it would place growers in a weakened negotiating position in the future. Growers were concerned Wilmar might implement

a predatory pricing strategy to lure sufficient volume away from QSL such that the pricing QSL could achieve would be damaged and the price Wilmar would then have to pay for cane would be reduced (and its marketing competitor eliminated).⁴

In 2014, Wilmar, MSF and Tully Sugar gave notice to QSL that they would not be continuing with their RSSAs beyond 30 June 2017.

1.6 Sugar Pricing

1.6.1 Cane Price Formula

As sugar cane is not a tradeable commodity, the sugar industry developed a 'Cane Price Formula' in 1915 to calculate how the returns (either revenue or losses) of the raw sugar produced would be fairly allocated between both growers and mills.

Today, the price that most growers receive for the sugar cane they provide to the mill continues to be determined by the Cane Price Formula (as shown below).

Cane Price = Net Sugar Price x (0.009⁵) x (CCS - 4) + Constant

where CCS is the 'commercial cane sugar'.

When the Cane Price Formula was developed, it was estimated that grower's total costs and investment in the production of sugar cane — and ultimately raw sugar — was two-thirds of the industry's costs, while miller costs and investment represented one-third.

Therefore, under the Cane Price Formula returns are distributed to growers and mills on a similar basis (2:1). It was also assumed a mill would expect a CCS of 12 (that is, 12 per cent recovery rate of

⁴ QSL (2014). Submission to Senate Committee on Rural and Regional Affairs and Transport, page 17

⁵ Represents 'milling recovery efficiency'.

CCS from cane). The Cane Price Formula means that where CCS is greater than 12 (determined when the cane is sampled) this will result in a greater return to growers.

MSF notes that the formula

*in effect splits the revenue from the sale of raw sugar into the revenue to pay for the cane and the revenue the mill needs to operate the sugar mill and to make a profit from its business.*⁶

While growers and mills are able to negotiate variations on the formula in their CSAs we understand that the price paid is generally based on:

- the 'net sugar price' (section 1.6.2)
- the recoverable sugar content of the cane - CCS
- a regionally specified 'constant' amount which will vary depending on the mill area⁷.

The formula was also designed to provide incentives for growers and mills to operate more efficiently and improve returns. ASMC has noted that growers

*now have a range of mechanisms through which they can influence the price of sugar that will ultimately be used in their cane price formula. These include through participation in various mill or QSL pooling arrangements or through agreement with their mills to have their sugar price directly or indirectly hedged via derivatives.*⁸

1.6.2 Net sugar price

The 'net sugar price' represents the price received from the sale of raw sugar to the world sugar market and determines the aggregate returns to the Queensland sugar industry for both growers and millers. The components of the net sugar price are the:

Raw sugar futures contract price

plus marketing premiums

less marketing costs.

Raw sugar futures contract price

The raw sugar futures contract price refers to the globally traded 'Intercontinental Exchange No.11 raw sugar futures contract price' (ICE No. 11)⁹, converted to Australian dollars. ICE No. 11 sets the benchmark for world sugar prices and stakeholders consider that this contributes more than 95 per cent of the net sugar price,¹⁰ although recently this has been close to 99 per cent, as discussed in section 3.3.

Marketing premiums

Marketing premiums are the additional returns over and above the global sugar price and are the sum of a 'physical premium' and a 'polarisation premium.'

The physical premium is negotiated between the marketer and the raw sugar customer and is derived from the supply and demand specifics at the time as well as the freight differentials between different supply locations. It may also include the value paid by a customer for accessing higher quality Australian raw sugar compared with alternative products that may be available in the same shipment period.

⁶ MSF (2015). Submission to Agriculture and Environment Committee, page 6

⁷ ASMC's submission to the Agriculture and Environment Committee, used a constant of \$0.608 as an indicative example, noting this would be 'different (in the order of cents) from one mill area to the next'.

⁸ ASMC (2015). Submission to Agriculture and Environment Committee, page 11

⁹ The price for US domestic market sales is determined using ICE No.16 rather than ICE No. 11. These sales comprise a small proportion of all Australian raw sugar exports due to US import quotas.

¹⁰ MSF (2015), Submission to Agriculture and Environment Committee, page 5

The polarisation premium is an additional premium that is essentially a 'quality parameter common to almost all raw sugar export contracts'.¹¹ Where sugar has a higher 'sucrose purity' (or polarisation) relative to the standard quality benchmark under ICE No. 11, this additional premium is paid.¹²

Marketing costs

Marketing costs are those costs incurred by the marketer (currently QSL in the main) in the course of completing its sales to customers. These costs include, but are not limited to:

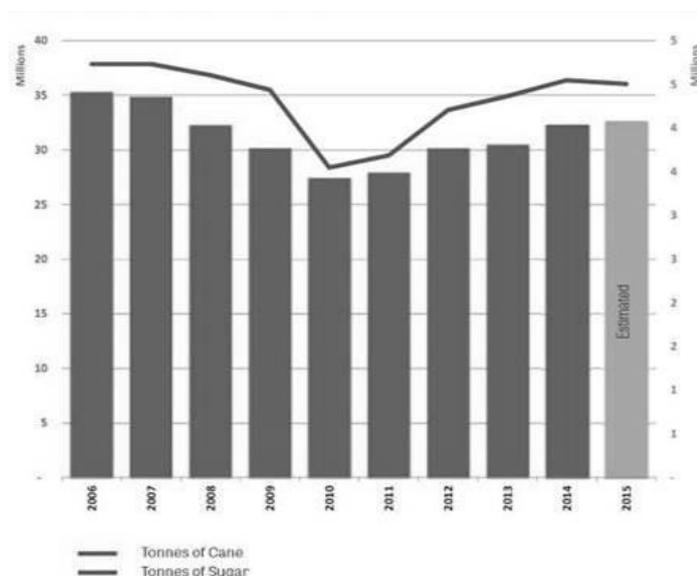
- storing and handling of sugar at bulk sugar terminals (subleased from STL)
- freight and port costs of shipping sugar to customers
- financing advance payment to growers and the administration of pricing pools
- other direct operating costs.

Further information on the value of the premium that is distributed back to growers and millers is detailed in section 3.3.

1.7 Sugar production since deregulation

As shown in Figure 1, Australia's production of cane and raw sugar experienced a decline between 2006 and 2010 – and since 2011 – has gradually increased.

Figure 1: Australian sugar production 2006-2015



Source: CANEGROWERS

Environmental issues have had a significant impact on production over the last decade:

- as part of deregulation, land no longer remained assigned to a mill and growers were able to pursue other agricultural pursuits. Around the same time as deregulation of the sugar industry, the Australian Government was facilitating Forestry Management Investment Schemes (FMIS), and a number of cane farmers sold their farms for forestry plantations. The majority of the FMIS have since failed and a number of cane growers have bought back land and have converted the land back into cane.

¹¹ Tully Sugar (2015). Submission to Agriculture and Environment Committee, page 4

¹² ICE No. 11 references 96 degrees polarisation. Queensland sugar industry typically produces sugar closer to 99 degrees polarisation.

- In 2007 the sugar mill in the Ord River Irrigation Area (WA) closed, affecting production.
- The cane disease ‘Sugarcane Smut’ was found in Childers in 2006. In response to this biosecurity threat, the Queensland sugar industry (through government regulations) stopped growing Smut susceptible varieties. Unfortunately, Smut resistant varieties are not as high yielding, and this has had an overall impact on both cane and sugar production particularly for the 2008 and 2009 harvest.
- an unseasonal wet harvest in 2010 which resulted in a approximately 20 per cent of the crop being unharvested. The 2010 decline subsequently impacted the 2011 harvest as there was a significant amount of standover cane (the unharvested cane) which impacted on CCS levels (and therefore raw sugar quantities) as well as harvesting efficiencies.
- Tropical Cyclone Larry (March 2006) and Tropical Cyclone Yasi (2011) severely impacted some of the northern sugar growing districts which affected productivity.

2 CONTEXT FOR THE BILL



The QPC has been asked to complete a RIS for the Bill. Ordinarily, a RIS would be prepared by the Government agency proposing the regulation. A clear description of the problem and associated issues would be part of the development of the proposed regulation.

As we have been asked to complete a RIS on a Bill that has already been tabled in the Queensland Parliament, we are relying on publicly available information to best describe the context and the problem the Bill is seeking to address.

Our assessment relies on the report of the AEC; submissions to the AEC; submissions we have received and submissions to the Senate Committee on Rural and Regional Affairs and Transport – Inquiry into Current and Future Arrangements for the Marketing of Australian Sugar.

2.1 Sugar Industry (Real Choice in Marketing) Amendment Bill 2015

On 19 May 2015 the Member for Dalrymple, Mr Shane Knuth MP, introduced the *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015* to the Queensland Parliament.

The *Sugar Industry (Real Choice in Marketing) Amendment Bill 2015* — Revised Explanatory Notes (the Revised Explanatory Notes) set out a range of problems the Bill is seeking to address. The following statement appears to best encapsulate the problem the Bill is seeking to address.

To remove any doubt whatsoever, the Bill is to prevent anti-competitive behaviour and promote pro-competitive outcomes. Overall, the Bill is to ensure economic viability for both growers and mill owners, among others, in the Queensland sugar industry.¹³

The AEC concluded the intent of the Bill is

to protect the interests of Queensland's canegrowers in the State's vitally important sugar industry as mill owners opt out of long-standing sugar marketing arrangements with QSL.¹⁴

The following sections set out the issues facing the key stakeholders in the Queensland sugar industry today, and that form the background for consideration of the assessment of the existing situation (the base case), the potential implications of the Bill and alternative options.

2.2 Grower views

The Bill seeks to address a range of concerns expressed by some growers, summarised below.

¹³ Revised Explanatory Notes to the *Sugar Industry (Real Choice in Marketing) Bill*, page 2

¹⁴ Agriculture and Environment Committee (2015), page 2

2.2.1 Concern about the imbalance of bargaining power between growers and millers

A central issue of concern is the potential for mills to misuse their monopoly power when negotiating future CSAs. Growers are clearly concerned that under the existing arrangements:

- millers have monopoly power as a result of the sugar cane market being a monopsony¹⁵¹⁶¹⁷¹⁸
- co-dependency does not balance the monopoly power (and mills can, and in recent years have, purchased additional land for cane production)¹⁹
- misuse of market power is an unintended consequence of deregulation. When agreement was reached on 2006 deregulation it was on the understanding that millers were not free to independently market and sell the raw sugar²⁰²¹
- the CCA does not provide sufficient protection for growers from the misuse of market power²²²³
- denying growers the right to have choice about who markets their sugar is evidence of misuse of market power.²⁴

Growers are also concerned that the imbalance in market power will result in the following impacts:

- growers being unable to obtain 'fair and reasonable terms' for their cane (including GEI)²⁵²⁶
- in the future growers supplying mills that have opted out of RSSAs will have no choice but to agree to the mill's new terms, including marketer, or leave the industry²⁷
- miller marketing of raw sugar will potentially lead to lower premiums, which are vitally important to growers²⁸
- miller marketing will lower or remove growers share of net premiums.²⁹

2.2.2 Concern about lack of transparency in miller marketing and potential for transfer pricing

Miller marketing is giving rise to a range of concerns for some growers, largely related to the future treatment of premiums. These concerns are related to both issues of market power and the lack of transparency about future premiums. These concerns include:

- lack of transparency leading to millers increasing their slice of the pie at the expense of growers in situations where foreign mill owners also own their own refineries and facilities overseas.³⁰³¹³²
- transparency about marketing risks, costs and premiums could effectively be removed to the benefit of the milling company³³³⁴

¹⁵ Tableland Canegrowers Ltd (2015). Submission to Queensland Productivity Commission, page 2

¹⁶ Canegrowers Herbert River (2015). Submission to Queensland Productivity Commission, page 2

¹⁷ Burdekin District Cane Growers Limited (2015). Submission to Agriculture and Environment Committee, page 3

¹⁸ QSL (2014). Submission to Senate Committee on Rural and Regional Affairs and Transport, page 20

¹⁹ QSL (2014). Submission to Senate Committee on Rural and Regional Affairs and Transport, pages 20-21

²⁰ Tableland Canegrowers Ltd (2015). Submission to Queensland Productivity Commission, page 1

²¹ CANEGROWERS and ACFA (2015). Submission to Agriculture and Environment Committee, page 4

²² Canegrowers Herbert River (2015). Submission to Queensland Productivity Commission, page 2

²³ CANEGROWERS and ACFA (2015). Submission to Agriculture and Environment Committee, page 1

²⁴ CANEGROWERS and ACFA (2015). Submission to Agriculture and Environment Committee, page 1

²⁵ QSL (2014). Submission to Senate Committee on Rural and Regional Affairs and Transport, page 22

²⁶ Invicta Cane Growers Organisation Ltd.(2015). Submission to Queensland Productivity Commission, Attachment 1, page 3

²⁷ QSL (2014). Submission to Senate Committee on Rural and Regional Affairs and Transport, page 2

²⁸ CANEGROWERS Innisfail (2015). Submission to Agriculture and Environment Committee, page 3

²⁹ CANEGROWERS and ACFA (2015). Submission to Agriculture and Environment Committee. Attachment 1, page 13

³⁰ Tablelands Canegrowers Ltd (2015). Submission to Queensland Productivity Commission, page 2

³¹ Burdekin District Cane Growers Limited (2015). Submission to Queensland Productivity Commission, page 5-6

³² Tablelands CANEGROWERS Ltd (2015). Submission to Agriculture and Environment Committee, page 2

³³ Canegrowers Herbert River (2015). Submission to Queensland Productivity Commission, page 2

2.2.3 Clarification of ownership of grower economic interest sugar

The recognition and ownership of grower economic interest (GEI) sugar is a key concern to growers as it relates to their level of influence and control in how raw sugar is marketed.

CANEGROWERS and ACFA noted that the RSSAs that QSL has with each mill acknowledges the price exposure held by their supplying growers, describing the quantity of sugar as Grower Economic Interest (GEI) sugar. In the RSSAs:

*Grower Economic Interest Sugar means Raw Sugar for which Growers, excluding those Growers who are Related Corporate of a Supplier, bear the price exposure under the cane supply or other agreements between the Supplier and the Grower.*³⁵

There does not appear to be full agreement about the level of property right that is implied by GEI or how the form of recognition should be achieved, with growers indicating

- GEI is not necessarily title to a specific batch of raw sugar but it is nevertheless a 'property right'³⁶
- That growers economic interest in the sugar is formally acknowledged and a framework established that gives growers choice in how that GEI sugar is priced and sold.

However, growers appear to have a common position about the rights that some more formal recognition of GEI should provide:

- growers are as much entitled as the millers are to have a say in how the raw sugar price is determined (and how the raw sugar is marketed)³⁷
- legal title to raw sugar, arising under the current CSAs is not carte-blanche for a mill to expropriate the property rights of every sugar cane grower³⁸
- growers should have choice about who markets their GEI sugar.³⁹

2.2.4 Concern about the future role of QSL

QSL is well respected by many growers. CANEGROWERS Isis commented

Growers have confidence in this system, knowing that QSL's operations always benefit the parties, are transparent, and all the proceeds from the marketing are distributed between growers and millers in accordance with the established agreements regarding the sharing of sugar proceeds.

The QSL marketing model has helped to provide stability and consistency in what is a very volatile marketing environment. This model gives some comfort to growers who struggle through difficult times to maintain their sugarcane production.

*We believe if growers lose access to QSL and the benefits this marketing model provides, this will jeopardise the areas planted to sugarcane thereby threatening the viability of the local industry and tonnages available to Isis Mill.*⁴⁰

The potential impact on QSL of the decision by the larger millers to discontinue with their RSSAs is also a concern for growers. These concerns include⁴¹:

- a reduction in tonnage through QSL will affect QSL's credit rating and borrowing facilities⁴²

³⁴ CANEGROWERS Cairns Region (2015). Submission to Agriculture and Environment Committee, page 1

³⁵ CANEGROWERS and ACFA (2015). Submission to Agriculture and Environment Committee, page 6

³⁶ SISL Group (2015). Submission to the Agriculture and Environment Committee, page 3

³⁷ SISL Group (2015). Submission to Agriculture and Environment Committee, page 3

³⁸ SISL Group (2015). Submission to Agriculture and Environment Committee, page 3

³⁹ Tablelands Canegrowers Ltd (2015). Submission to Queensland Productivity Commission, page 1

⁴⁰ CANEGROWERS Isis (2015), Submission to Agriculture and Environment Committee, page 1

⁴¹ Tableland Canegrowers Ltd (2015). Submission to Queensland Productivity Commission, page 2

- QSL and millers competing against each other in the same markets for premium quality Australian sugar will result in erosion of the premiums distributed to growers and millers
- millers will use their monopoly market power to substantially damage or eliminate QSL as a competitor and eliminate QSL as the Australian marketer
- loss of transparency will mean growers will not know if they receive the correct price for their sugar⁴³
- loss of security of cane payments, as QSL funds the advance payment system to growers. A replacement would be up to the result of negotiations with millers about CSAs
- concern that QSL's loss of control of terminals will increase costs and lose the benefit of a pooled cost across higher and lower cost terminals
- an inability to manage sugar quality issues, as QSL is able to blend all the sugar to manage quality issues
- a loss of the growers share in 100 per cent of the profits generated from QSL's trading activities.

However, many growers stressed that they are not advocating a return to the single desk arrangement.

2.2.5 Need for an adequate dispute resolution system

Several grower organisations commented that there is no adequate process to resolve deadlocks in negotiations and noted this is especially important given there is no competition for milling services. These concerns include:

- collective bargaining by growers has proven ineffective in circumstances where there has been a monopoly miller and no process to resolve deadlocks in negotiations⁴⁴
- there is no statutory or mandatory dispute resolution process in the SIA to assist growers and millers resolve commercial disputes in a mutually beneficial manner when negotiating the terms of a CSA.^{45 46 47 48}

2.2.6 Concern about adverse impacts on future investment in Queensland cane farms

In submissions to the AEC, several grower organisations expressed concern that without action to provide grower certainty about GEI and the choice of marketer, numerous growers could leave the industry and/or cease to invest. Particular concerns include:

- the loss of choice and the subsequent uncertainty will not give growers the confidence to expand⁴⁹ and could quite possibly spell the withdrawal of cane land and lessened investment in the local sugar cane industry^{50 51}
- absence of certainty could have a negative impact on third party investment given 'it is difficult to imagine any new entrant (whether domestic or foreign) looking favourably at an investment in

⁴² Tableland Canegrowers Ltd (2015). Submission to Agriculture and Environment Committee, page 2

⁴³ Canegrowers Herbert River (2015). Submission Queensland Productivity Commission, page 2

⁴⁴ CANEGROWERS and ACFA (2015). Submission to Agriculture and Environment Committee page 5

⁴⁵ Tableland Canegrowers Ltd (2015) Submission Queensland Productivity Commission, page 3

⁴⁶ Burdekin District Cane Growers Ltd (2015). Submission Queensland Productivity Commission, page 4

⁴⁷ Burdekin District Cane Growers Ltd (2015). Submission to Agriculture and Environment Committee, page 2

⁴⁸ CANEGROWERS and ACFA (2015). Submission to Agriculture and Environment Committee page 5

⁴⁹ Bondrogers Farming Pty Ltd (2015). Submission to Agriculture and Environment Committee, page 1

⁵⁰ Tableland Canegrowers Ltd (2015). Submission to Queensland Productivity Commission, page 2

⁵¹ Canegrowers Cairns Region (2015). Submission to Agriculture and Environment Committee, page 2

sugar cane farms where the revenue stream is effectively a 'farm gate' price that can be dictated or manipulated by the activities of a monopoly buyer⁵²

- there could be knock on impacts for the regional economies.⁵³

2.2.7 Changes sought by growers

The Bill encapsulates the changes being sought by some growers and grower organisations to address the problems they perceive with the existing regulatory arrangements to address the imbalance in market power and absence of grower choice about how GEI is marketed.

Questions

2.1 Are there any other grower concerns that we should take into consideration?

2.3 QSL views

QSL's pricing and marketing model provides four key service areas to members:⁵⁴

<i>Financing</i>	<i>Pricing</i>	<i>Marketing</i>	<i>Logistics</i>
Providing low-cost financing through advance payments to members	Providing knowledge, expertise and experience in managing futures markets	Maximising returns through optimising sales timing and customer premiums	Safe and efficient storage, handling and shipping of raw sugar

QSL considers its pricing and marketing model benefits Queensland growers including:⁵⁵

- through structures like limits on raw sugar which can be forward priced or sold without physical delivery, there is a more cautious approach taken to managing downside risks
- the RSSAs provide some parameters around how QSL markets and prices raw sugar and calculates the returns provided to mill owners (which can then be referred to in CSAs), providing greater certainty and transparency for growers; and
- it does not have the conflict of interests that other international sugar traders do as a result of their non-Australian based trading businesses.

QSL is of the view that changes to current title arrangements are not necessary and that it is possible to implement a Grower Choice system under the current SIA through a commercial arrangement acceptable to all parties.

QSL supports introducing a Grower Choice system where farmers are able to choose who markets their GEI sugar, and that millers would be encouraged to attract economic interest volumes from growers by providing competitive marketing services.

QSL is concerned if no action is taken this will:⁵⁶

- cause uncertainty with negative impacts on grower investment
- impact its ability to actively manage price risk by forward pricing on the ICE No.11 Futures Market; and
- negatively impact some millers – those exiting the current marketing system may potentially face reductions in cane supply.

⁵² SISL Group (2015). Submission to Agriculture and Environment Committee, page 4

⁵³ CANEGROWERS Innisfail (2015). Submission to Agriculture and Environment Committee, page 3

⁵⁴ QSL (2015). Submission to Agriculture and Environment Committee, page 1

⁵⁵ QSL (2014). Submission to the Federal Rural and Regional Affairs & Transport References Committee, page 16

⁵⁶ QSL (2015). Submission to Agriculture and Environment Committee, page 2

QSL says that when considering ways to achieve a competitive raw sugar marketing system certain key elements are required including:⁵⁷

- an obligation for millers and growers to negotiate in good faith regarding the terms on which cane is supplied
- CSAs providing for the cane price to be referable to the market price obtained from a corresponding quantity of raw sugar, and giving the grower the right to choose the entity which will market the GEI
- obligations on millers to publish specified information to growers in relation to their marketing activities; and
- a prohibition on millers discriminating against growers who choose to have an entity other than the mill owner of their affiliates market their GEI.

Questions

2.2 Are there any other QSL issues that we should take into consideration?

2.4 Miller views

Unlike some growers and grower organisations, millers generally have not expressed concerns about the existing regulatory framework. They are however, particularly concerned about the impacts on their businesses if the Bill is to be passed. A summary of miller views is provided below.

2.4.1 Current regulatory environment is effective

Millers consider that:

- the current regulatory environment of the sugar industry in Queensland is effective⁵⁸
- there are adequate protections under the SIA; ⁵⁹60 and
- any disputes should be resolved through commercial negotiation rather than government intervention.

Millers consider that increases in regulation are not required due to the co-dependent nature between millers and growers⁶¹. Wilmar considers

*Regulation is not required to achieve the outcome of mills acting in the best interests of cane farmers. This is because millers' investment is highly sensitive to and dependent on cane values. If mills were to seek to reduce payments to growers, mill cane supply would decline and mill profitability would also decline.*⁶²

Tully Sugar believes that

*there is no evidence of market failure in the industry under the current or proposed arrangements and therefore no need for legislated intervention or reregulation of the Sugar Industry*⁶³.

Millers also consider that appropriate dispute resolution services are already available⁶⁴⁶⁵. Wilmar's submission to the AEC noted that:

⁵⁷ QSL (2015). Submission to Agriculture and Environment Committee, page 3

⁵⁸ Wilmar (2015). Submission to Agriculture and Environment Committee, page 6

⁵⁹ Tully Sugar Limited (2015). Submission to the Queensland Productivity Commission, page 4.

⁶⁰ MSF Sugar (2015). Submission to the Agriculture and Environment Committee, page 5

⁶¹ ISIS Central Sugar Mill Co. Ltd (2015). Submission to the Queensland Productivity Commission, page 3

⁶² Wilmar (2015). Submission to Agriculture and Environment Committee, page 65

⁶³ Tully Sugar Limited (2015). Submission to the Queensland Productivity Commission, page 4

- commercial dealings of sugar industry participants are subject to other state and commonwealth regulation which provide adequate countervailing forces to ensure appropriate conduct of parties⁶⁶
- the SIA authorises grower collective bargaining for the purpose of negotiating CSAs; and
- existing and proposed cane supply contracts already provide a process of discussion and mediation administered by the Australian Commercial Disputes Centre and final and binding arbitration subject to the *Commercial Arbitration Act 2013 (Qld)*.⁶⁷

2.4.2 Miller marketing will increase premiums

Wilmar states that the benefit of marketing its raw sugar through Wilmar Sugar Trading is its ability to use its scale and expertise to generate higher premiums, which it estimates to be around \$46.4 million per annum compared to marketing raw sugar through QSL.⁶⁸ We note that these estimates have been disputed by QSL.

Wilmar has said it will share any gains with growers, together with a share of any net trading value generated from arbitrage opportunities that arise due to Wilmar Sugar Trading's global sugar trading presence and marketing expertise.⁶⁹ It indicated its growers would receive \$36.3 million of these additional premiums.⁷⁰

2.4.3 Deregulation has increased investment and innovation in the sugar industry

Millers pointed to the significant re-investment in the sugar industry since 2006 as evidence that the regulatory arrangements post deregulation are effective and generating results.^{71,72}

Wilmar considers that before they entered Queensland in 2010, mill reliability was suffering as a result of significant underinvestment and that its \$530 million investment in upgrading existing assets has improved mill reliability (as shown below in **Figure 2**). This has

*equated to shorter season lengths and greater returns to growers due to crushing a higher proportion of cane at increased levels of sugar content. This has also reduced milling costs and increases milling recovery, as losses are reduced through fewer unplanned stoppages.*⁷³

⁶⁴ ASMC (2015). Submission to Agriculture and Environment Committee, page 3

⁶⁵ Wilmar (2015). Submission to Agriculture and Environment Committee, page 4

⁶⁶ Wilmar (2015). Submission to Agriculture and Environment Committee, page 7

⁶⁷ Wilmar (2015). Submission to Agriculture and Environment Committee, page 10

⁶⁸ Wilmar (2015). Submission to Queensland Productivity Commission, page 23

⁶⁹ Wilmar (2015). Submission to Queensland Productivity Commission, page 22

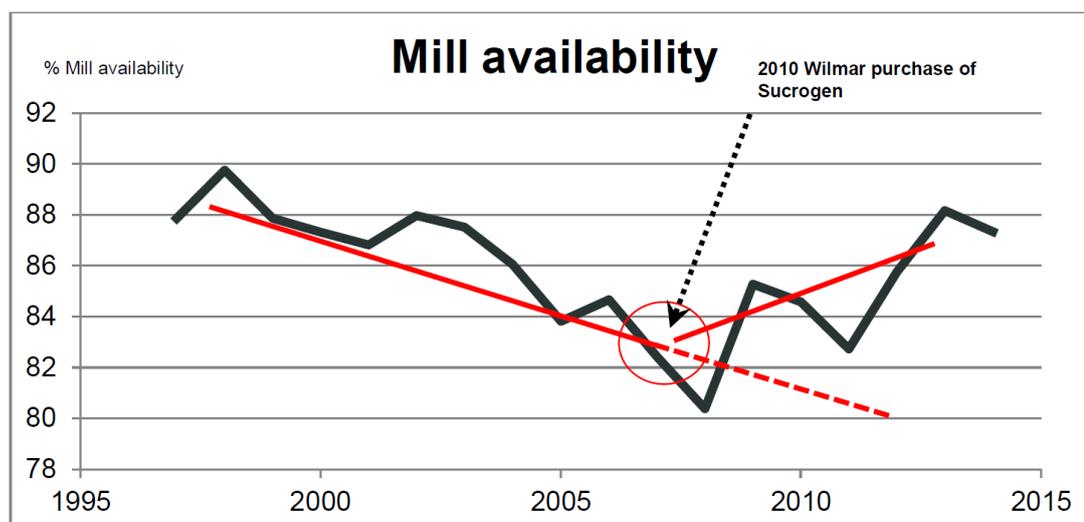
⁷⁰ Wilmar (2015). Submission to Queensland Productivity Commission, page 23

⁷¹ Wilmar (2015). Submission to Queensland Productivity Commission, page 11

⁷² MSF Sugar (2015). Submission to Queensland Productivity Commission, page 11

⁷³ Wilmar (2015). Submission to Queensland Productivity Commission, page 11

Figure 2 Wilmar mill availability showing the impacts of reinvestment



Source: Wilmar submission to Queensland Productivity Commission

Wilmar also pointed to deregulation having increased the range of pricing methods and pools available to growers allowing growers to undertake their price risk management independently from the price risk management of their miller.

The ASMC noted that deregulation in 2006

- *has given the Queensland sugar industry the flexibility to better respond to challenges posed by global market competition... provided the opportunity for individual milling regions to be more commercially responsive and better able to take advantage of niche market opportunities as they arise*⁷⁴
- *delivered ground breaking innovation, with the introduction of forward pricing and price and currency risk management tools... now embraced by approximately 70 per cent of Queensland cane growers*⁷⁵

2.4.4 Regulatory intervention would have a negative impact on investment

Millers are very concerned about proposals at the state and national levels for potential regulatory intervention in the sugar industry. Millers consider that further regulatory intervention into the industry would:

- undermine investment and implications for their business
- impair asset values; and
- fundamentally alter the structure and operation of the sugar industry supply chain.

Millers are also concerned with the return of 'pre-contract arbitration', as it 'was removed with the agreement of all industry stakeholders'⁷⁶ as part of deregulation and did not appear to exist in any other business context between a supplier and a processor/manufacturer.⁷⁷

ASMC also considered that pre-contract arbitration would be an added cost to business, would reduce the motivation for business to negotiate in good faith, and that 'commercial negotiation is going to produce better outcomes than one imposed by an arbitrator'.⁷⁸

⁷⁴ ASMC (2015). Submission to Agriculture and Environment Committee, page 2

⁷⁵ ASMC (2015). Submission to Agriculture and Environment Committee, page 2

⁷⁶ Wilmar (2015). Submission to Agriculture and Environment Committee, page 4

⁷⁷ ASMC cited in Agriculture and Environment Committee (2015), page 20

Questions

2.3 Are there any other miller's concerns that we should take into consideration?

2.5 National reviews of sugar industry marketing

2.5.1 Senate Inquiry into Current and Future Arrangements for the Marketing of Australian Sugar

On 4 September 2014, the Australian Senate moved that the current and future arrangements for the marketing of Australian sugar be referred to the Rural and Regional Affairs and Transport Reference Committee for inquiry and report by 27 November 2014.

On 24 June 2015, the Committee provided a report that recommended

*the development and implementation of a mandatory sugar industry Code of Conduct, acknowledging that, provided appropriate stakeholder consultation is undertaken, the work of the Sugar Marketing Code of Conduct Taskforce may provide a foundation upon which a Code of Conduct may be established.*⁷⁹

In forming this view, the Committee noted:

- *that any move toward re-regulation would be contrary to the stated policy objectives of both the state and Commonwealth governments. More importantly, the Committee is of the view that any move toward re-regulation of the industry would not be in the best interests of the industry – particularly over the longer term*
- *that cane growers and their representative bodies have very real concerns about the potential which would exist, under new arrangements, for milling companies to misuse their market power.*
- *current ownership structures for sugar are determined by the provisions of CSAs. ... historically, title to sugar had not been an issue because any financial gain from the sale of sugar was shared between growers and millers... under Queensland Government legislation – at the crucial stage of marketing and selling – title to the raw sugar was vested in QSL (and its predecessors)*
- *there is a legal framework which underpins the negotiation of CSAs...the framework includes provisions in relation to:*
 - *access to collective bargaining;*
 - *provisions for unconscionable conduct; and*
 - *misuse of market power.*
- *doubts... about whether the current framework will prove sufficient for growers and millers to work their way through the current impasse and reach agreement on new CSAs and, ultimately, on the future of the industry*
- *not convinced that the existing legal framework is adequate – particularly given that the problems currently facing the industry are in large part due to the imbalance of bargaining power between growers and millers...there is a need for the industry to develop and implement a mandatory Code of Conduct*
- *a mandatory Code of Conduct would provide stakeholders with access to impartial, affordable dispute resolution processes and would go some of the way to addressing the inequities in bargaining power between millers and growers... and should include formal*

⁷⁸ ASMC cited in Agriculture and Environment Committee (2015), page 20

⁷⁹ Senate Select Committee on Rural and Regional Affairs and Transport (2015), page 7

dispute resolution frameworks which support both growers and millers negotiating supply contracts.

Submissions made to the Senate Committee are publicly available.⁸⁰

2.5.2 Sugar Marketing Code of Conduct Taskforce

On 10 December 2014, the Federal Minister for Agriculture, the Honourable Barnaby Joyce MP, announced the establishment of a Sugar Marketing Code of Conduct Taskforce to consult with the sugar industry on a range of issues around marketing and export arrangements for cane growers.

On 25 June 2015, the Taskforce recommended that a Mandatory Code of Conduct be adopted for the sugar industry that addressed the following key points:

- a mechanism to distribute relevant interests in the quantities of sugar obtained from cane between growers and millers
- a link between the price paid for cane and the selling price of sugar
- the ability to choose marketing services
- non-discriminatory provisions
- a mechanism to resolve disputes.⁸¹

Submissions to the Taskforce are not publicly available.

⁸⁰ http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Rural_and_Regional_Affairs_and_Transport/Sugar

⁸¹ <http://www.georgechristensen.com.au/taskforce-recommends-sugar-code-of-conduct/>

3 PROBLEM IDENTIFICATION AND POLICY OBJECTIVES



The objective of any regulatory action is to improve situations for business, community and government that cannot be improved through existing business and social institutions and mechanisms. A RIS should clearly set out the objectives of the regulatory proposal in terms of what is to be achieved, and any constraints on the objectives should be identified.

Amongst other things, a RIS needs to consider:

- *the issue(s) that need to be addressed, including identifying the extent of market failure which suggest the need for intervention*
- *what is causing the problem(s)?*
- *what is the size of the problem?*
- *who is affected?*
- *what is the probability of the problem occurring?*
- *what are the risks and consequences of maintaining the status quo (taking no action).*

This Chapter sets out the policy objectives of the Bill and tests the case for some form of regulatory intervention in the Queensland sugar industry. In particular we have considered the extent to which market failure may be present in the Queensland sugar industry. We also make an estimate of the size of the issue.

We consider the risks and consequences of taking no action in Chapter 4.

3.1 Policy objectives

The clause 3 of SIA states that the 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 stated intention of the Bill is to prevent anti-competitive behaviour and promote pro-competitive outcomes; and ensure economic viability for both growers and mill owners in the Queensland sugar industry.

In this context, the Bill proposes to amend the SIA with the objectives of:⁸²

- (a) providing growers (and their representatives) with a new right to a statutory arbitration process to resolve contractual and pre-contractual disagreements related to supply contracts. This trigger would not be available to mill owners or other affected parties such as QSL
- (b) prescribing terms that must be included in a grower, miller supply contract

⁸² Agriculture and Environment Committee Report 2015, page 17

- (c) establishing growers economic interest (GEI) (proportion of raw sugar for which they bear a sale price exposure)
- (d) allowing growers to nominate their choice of marketing entity for their proportion of GEI sugar.

Strictly speaking, the matters indicated in (a) to (d) would be considered a policy response rather than policy objectives themselves. To prepare the RIS, we have considered it necessary to identify the underlying policy objectives behind the measures set out in the Bill.

Seeking to understand the underlying objectives is consistent with the statutory interpretation approach (particularly used when there is no objects clause) of seeking to identify the 'mischief' the legislation is responding to.

Taking into account the objectives of the Bill, the objects clause of the SIA, and the issues identified by stakeholders we consider the policy objectives the sugar industry regulation is seeking to achieve are:

- to ensure a pricing framework where there is an appropriate balance of risk and reward between growers and millers
- to ensure that there are appropriate protections for growers and millers to prevent against the abuse of market power
- to ensure a regulatory framework that supports investment and innovation in the sugar industry and supports the long-term economic sustainability of the sugar industry.

We have used these objectives to consider the potential policy and regulatory responses.

Questions

- 3.1 Have we appropriately described the policy objectives the Bill is seeking to achieve?

3.2 Framework for assessing regulatory impacts

As regulation can impose significant costs on business and the wider community, it is important that there is a clear rationale and strong case for introduction for any new regulation. Even where regulation may be successful in addressing a particular market failure, it might also involve costs that mean that overall it is not worthwhile.

Key questions to support government action include:

- Is there a market failure? For example abuse of market power?
- Is the rationale for intervention clear? For example is there clear evidence of market failure?
- Is it reasonable to assume that the benefits of intervention will exceed the costs?

The RIS Guidelines state that the most common types of market failure are: incomplete property rights; market power; incomplete information; and missing and incomplete markets.⁸³ For this RIS, the key issues that need to be considered to establish a case for regulatory intervention are:

- What is the estimated value of net premiums to growers?
- Does the concept of GEI implied in the Cane Price Formula imply a property right that is not being appropriately recognised?

⁸³ Queensland Treasury (2013) Regulatory Impact Statement System Guidelines, page 53

- Do millers in the Queensland sugar industry have market power?
- Is there evidence that market power is being abused?
- Is there insufficient transparency between millers and growers that would give rise to millers not distributing net premiums to growers in accordance with the CSAs?
- Is there evidence that the dispute resolution arrangements in the Queensland sugar industry are not being effective in balancing the interests of growers and millers?

Each of these issues is considered below.

3.3 Value of premiums

A key objective of the Bill is to ensure that Queensland growers are receiving their share of the net premiums that arise from the sale of raw sugar. Net premiums form part of the CSA arrangements.

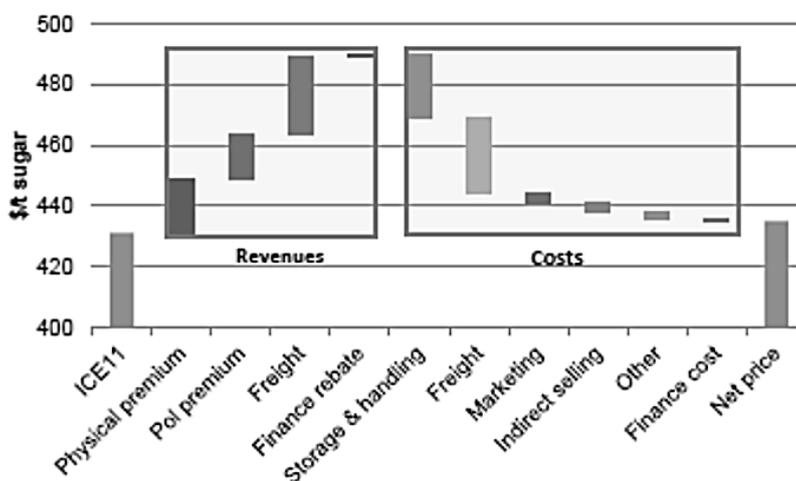
As discussed in section 1.6 the globally traded ICE No.11 contributes at least 95 per cent to the net sugar price, with Wilmar estimating it has been closer to 99 per cent over the last five years.

The component of the net sugar price which is linked to the world sugar price (and has the greatest impact on the price growers receive for sugar cane under the cane price formula) does not appear to change irrespective of who owns or markets the raw sugar (although some growers are concerned that a change of marketer may affect trading returns. This is further discussed in section 4.2.1).

While premiums are an important component of the net sugar price and ultimately returns to the industry (comprising approximately 8 per cent of the net sugar price),⁸⁴ 'net premiums' (premiums less marketing costs) are likely to comprise around one and perhaps up to five per cent of the net sugar price. We do note however that premiums are likely to be considered more important to smaller cane farming operations than larger operations.

CANEGROWERS and ACFA noted that all revenues and costs associated with QSL's marketing activities are, in addition to the raw sugar futures price, shared between both growers and millers through the operation of 'shared pools.' In addition, they state that 'the shared pool receives in excess of \$250 million in revenue and defrays a similar amount in costs each year'.⁸⁵ Figure 3 shows how market premiums offset the costs of exporting raw sugar.

Figure 3 QSL Shared Pool



⁸⁴ Wilmar (2015). Submission to Queensland Productivity Commission, page 6

⁸⁵ CANEGROWERS and ACFA (2015). Submission to the Agriculture and Environment Committee, page 9

Source: CANEGROWERS and ACFA, 2015

Millers consider that the recent net premiums achieved above the global sugar price, were small in comparison to the net sugar price. MSF considers that the

Year on Year difference between the ICE11 raw sugar price and P_{sugar} [net sugar price] will be plus/minus \$5 per tonne of raw sugar.⁸⁶

If the range provided by MSF is correct, based on estimated production of 4.2 million tonnes of raw sugar per annum⁸⁷, net premiums represent (in aggregate across the industry) a range of plus or minus \$21 million per annum. Assuming that this is distributed between growers and millers at a ratio of 2:1, the value of the net premium to growers is approximately \$14 million per annum.

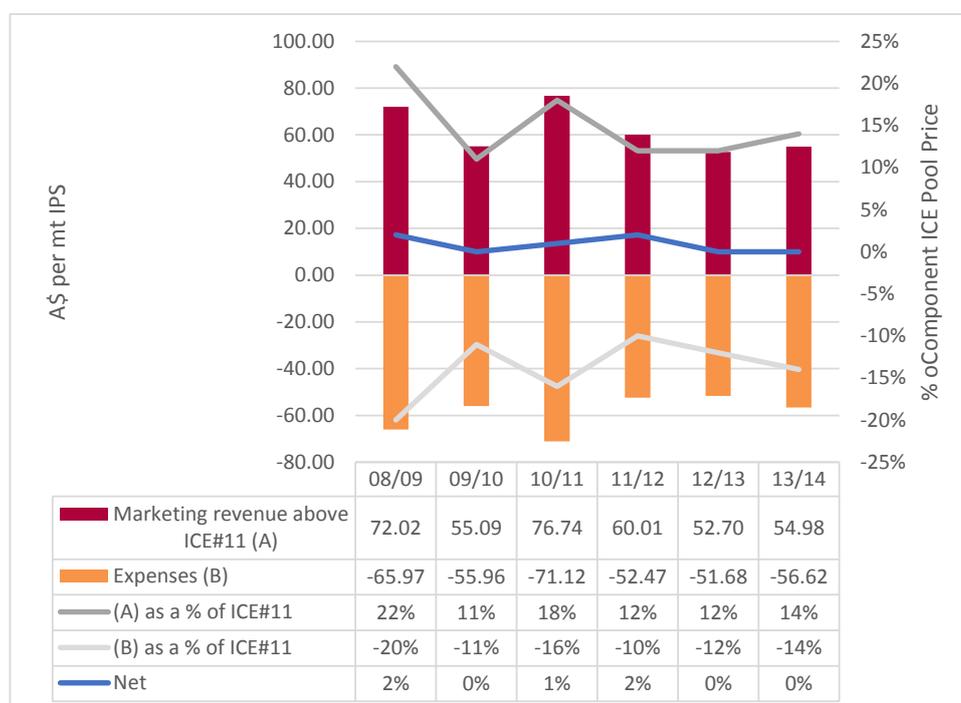
Table 4 Estimated value of net premiums to growers based on 2014 raw sugar production

Raw sugar production (tonnes)	4,200,000
Net premium per tonne	\$5.00
Total value of net premium	\$21,000,000
% of grower return	66.67%
Value of grower net premium	\$14,000,000

Figure 4 shows QSL’s marketing revenue above ICE No.11 for the period 2008-09 to 2013-14.⁸⁸ It shows the variability in net premiums over the period has ranged between \$7.54 per tonne raw sugar and (\$1.66) per tonne raw sugar over the period 2008-09 to 2013-14:

- at \$7.54 per tonne raw sugar, the net premium is approximately \$31.67 million, with growers share being (2:1) \$21.1 million⁸⁹
- at (\$1.66) per tonne raw sugar the net premium (loss) is approximately (\$6.97) million with growers share being (2:1) (\$4.65) million.

Figure 4 QSL marketing revenue above ICE No, 11 2008-09 to 2013-14



⁸⁶ MSF (2015). Submission to Agriculture and Environment Committee, page 14

⁸⁷ Based on an estimated 4.2 million tonnes of raw sugar produced in Queensland in 2014

⁸⁸ QSL (2014). Supplementary submission to the Senate Select Committee on Rural and Regional Affairs and Transport, page 4

⁸⁹ This is based on 100 per cent of raw sugar production of 4.2 million tonnes of raw sugar (both domestic sales and exports) and could be considered an ‘upper bound.’

Source: QSL submission to Senate Inquiry

QSL has noted that given the size of recent marketing revenue and costs (with marketing revenue ranging between \$52.70–\$76.74 above the ICE No. 11 price and expenses of between \$51.68–\$71.12 per tonne of raw sugar):

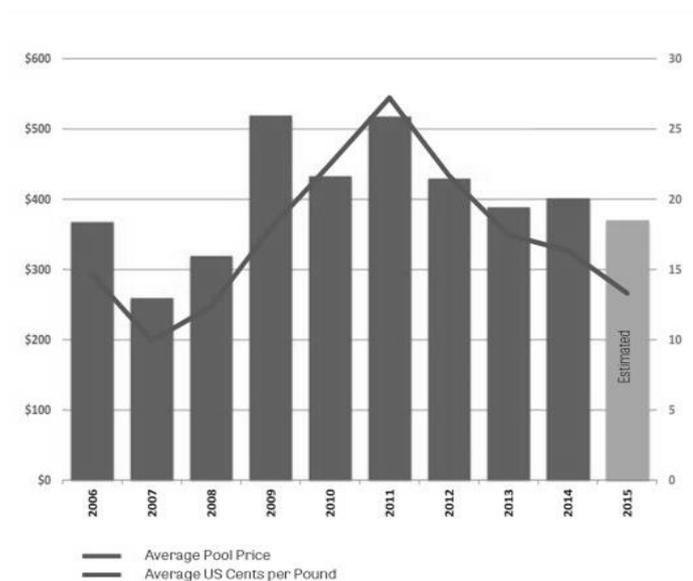
that marketing performance and costs can have a substantial influence on the ultimate return achieved by growers.

However, ASMC’s submission to us states that

while the marketing premium is an important element of the payment made to growers for sugarcane, it is vastly outweighed by the impact of variation in ICE11 and CCS variability⁹⁰

While under the net sugar price formula a \$1 movement in net premiums will have the same effect as a \$1 movement in ICE No. 11 prices, we note that the variations of the ICE No. 11 price (**Figure 5**) are likely to be larger than net premiums.

Figure 5 World Sugar Prices 2006 - 2014



Source: CANEGROWERS Australia⁹¹

This variability, combined with the fact that net premiums comprise a small percentage of the net sugar price, is likely to result in changes to the net premium having less of an impact on returns to growers and mills compared to other factors such as the ICE No. 11 price.

This is demonstrated from the results of our analysis of the sensitivity of key variables to the returns to both growers and millers. Compared to an initial baseline⁹² we have estimated that, under the cane price formula, a 1 per cent (refer to table below):

- Change in net premium, from \$7.54⁹³ per tonne to \$7.6154 per tonne, would increase aggregate grower returns by approximately \$0.19 million per annum.
- Increase in ICE No. 11, from \$423.40⁹⁴ per tonne to \$427.63 per tonne, would increase aggregate grower returns by approximately \$10.56 million.

⁹⁰ ASMC (2015). Submission to Queensland Productivity Commission, page 15

⁹¹ http://www.canegrowers.com.au/page/Industry_Centre/industry-focus/statistics-facts-figures/ accessed 13 October 2015

⁹² Assuming a baseline scenario of ICE No. 11 = \$423.40, Net premium = \$7.54, CCS = 13 and constant = 0.608.

⁹³ A \$7.54 net premium achieved by QSL in 2011-12 appears to be the largest between 2008-2009 and 2013-2014

⁹⁴ ICE No.11 based on March 2016 futures contract price, as stated on QSL website 6 October 2015.

- Appreciation of the Australian dollar against the US dollar (which then impacts the ICE No. 11 price ultimately passed through to the net sugar price) would reduce aggregate grower returns by approximately \$10.46 million while a 1 per cent depreciation would increase grower returns by approximately \$10.67 million.
- Change in CCS, from 13 to 13.13, will increase aggregate grower returns by approximately \$15.53 million.
- Increase in annual cane production, from 30.8 million tonnes to 31.108 million tonnes, will increase aggregate grower returns by approximately \$10.94 million.

These results are summarised in **Table 5**.

Table 5 Sensitivity of returns from sale of export raw sugar

Variable	Baseline value	Amended value	Difference in returns (\$M)
Net Premium (per tonne)	\$7.54	\$7.6154	0.19
ICE NO. 11 (per tonne)	\$423.40	\$427.63	10.56
Appreciation in AUD/USD (converted to ICE No. 11 price, per tonne)	\$423.40	\$419.21	(10.46)
Depreciation in AUD/USD (converted to ICE No. 11 price, per tonne)	\$423.40	\$427.68	10.67
CCS	13.00	13.13	15.53
Annual Cane Production (m tonne)	30.8	31.108	10.94

Source: Queensland Productivity Commission

Questions

- 3.2 Have we made the correct assumptions about the average net marketing premium (premiums less marketing costs) that are being achieved by QSL compared to the ICE No. 11 benchmark price?

3.4 Does GEI imply a property right not being appropriately recognised?

The title to Queensland cane and raw sugar products is agreed though the terms of commercial contracts. Under the existing contracts, growers pass title of cane to millers at point of delivery to the mills. Millers pass title of the raw sugar to QSL at the point of delivery to QSL under the RSSAs and QSL sells raw sugar to international buyers, with title transferring on delivery. The existing relationships are shown in **Figure 6**.

Figure 6 Title transfers across the sugar supply chain



In some instances, mills purchase back raw sugar from QSL for their own marketing. The first step toward millers marketing raw sugar has been for some millers to amend the contract arrangements

with QSL in order to purchase that proportion of the raw sugar produced in their mills and that they derive their profits from, back from QSL.

The AEC noted that Wilmar had termed this sugar Miller Economic Interest (MEI) sugar – which it had defined as raw sugar for which it has nominal price exposure. The defining of MEI has resulted in the consequential development of the phrase GEI sugar to refer to raw sugar that is not MEI sugar. The AEC also noted Wilmar’s position that the concept of GEI sugar does not imply any transfer of rights to any party.⁹⁵

We understand that the term ‘GEI’ has been used to express recognition that the Cane Pricing Formula works in a way so that growers obtain approximately two thirds of the final price and the millers one third of the final price. It is recognition that the grower's actual revenue is a proportion of the final price.

However, we have not seen anything to suggest that legal title does not transfer to the miller and that the miller produces a different product than that delivered to it by the growers. That is recognising that they have an interest in the final price is neither a legal title nor ownership interest.

Of course the contractual arrangements between growers and millers post 2017 may be different in respect of legal title. It is by no means certain that a collective negotiation will result in the growers providing 100 per cent of the legal title to the millers. However, all the material we have received suggests that this is the most likely outcome.

In almost all other industries, a product is sold (and title transferred) at the time that the person who will process that product takes possession of the product. The courts have recognised this general principle. For example:

- In *Clough Mill Ltd v Martin*⁹⁶ the court found that a clause which purported to retain legal title in yarn that was supplied by the mill had been incorporated, or used as material for, other goods and that despite the attempt to retain title, title in the newly manufactured goods are owned by the manufacturer of those goods,⁹⁷ and
- In *Borden (UK) Ltd v Scottish Timber Products*⁹⁸ the court found that absent a specific contractual term to the contrary the supplier of resin which was used in manufacturing chipboard had no legal title to the chipboard.⁹⁹

It is necessary to consider whether the use of the concept of GEI in the pricing formula had a clear intent for the parties to actually vest legal title in the growers. In our view, the use of the concept of GEI was not intended to vest legal title in the growers but merely to recognise that the price the growers obtain is dependent on the price obtained for the ultimate product.

To change this position would require the industry to convert to a pure ‘tolling’ structure. We consider that would require a significant re-writing of CSAs, including the pricing provisions. In tolling circumstances, pricing is usually determined by a cost build up with a return on processing and related assets. As the entity who undertakes the tolling does not have any legal or property interest in the product being tolled, it takes no price risk in respect of the product. In the circumstances of the sugar industry, this would require the growers to take all of the risk in respect of the final price, and indeed on the costs of processing.

⁹⁵ Agriculture and Environment (2015), page 9

⁹⁶ [1984] 3 All ER 982.

⁹⁷ Ibid at 989.

⁹⁸ [1979] 3 All ER 961.

⁹⁹ Ibid at 966, 970, 973, 974.

We are not aware that a tolling arrangement is being proposed by growers, although this has been indicated as an option by QSL. Nor are we aware of any legal or regulatory impediments that would prevent such a contracting arrangement being negotiated between relevant parties.

Based on the information we have, and on the existing contractual arrangements, we see no evidence of market failure due to there being absence of legal title for growers for the control of sugar for which there is a GEI.

3.5 Do millers have 'market power'?

One of the key issues underlying the Bill is the clear concern of growers that millers have 'market power' and that this power is either being abused (or has the potential to be abused).

To make our assessment of market power, we have considered Section 46 of the CCA which prohibits a corporation, which has a substantial degree of power in a market from taking advantage of that power for the purpose of:

- eliminating or substantially damaging a competitor
- preventing the entry of a person into any market; or
- deterring or preventing a person from engaging in competitive conduct in any market.

Section 46 sets out a number of provisions, to identify the nature of market power. Relevantly, section 46(3C) provides that a corporation may have market power even though:

- it does not substantially control the market; or
- the corporation does not have absolute freedom from constraint by the conduct of competitors or persons to whom or from whom the corporation supplies or acquires goods or services.

The concept of market power is, in essence, the power to behave in a market not constrained by competitors who can often be observed by the ability to increase prices or decrease service levels.¹⁰⁰ A common example of a corporation with market power is where the corporation is able to provide contracts or agreements on a 'take it or leave it' approach.

Table 6 shows the 21 Queensland sugar mills and the extent to which there may be an alternative.

Table 6 Milling companies and mills

<i>Milling company</i>	<i>Ownership</i>	<i>Mills</i>	<i>Alternative</i>
Wilmar International Limited	Private - Wilmar	Macknade Victoria Invicta Pioneer Kalamia Inkerman Proserpine Plane Creek	Some growers in Proserpine and Plane Creek seem to be close enough to supply grower cooperatives such as Farleigh or Marian
Mackay Sugar Limited	Grower Co-operative	Mossman Farleigh Marian Racecourse	
MSF Sugar Limited	Private - Mitr Phol Sugar Corporation (Thai)	Tableland Mulgrave South Johnstone Maryborough	Some Tableland and Mulgrave growers could supply Mossman Maryborough could supply Isis

¹⁰⁰ Queensland Wire Industries Pty Ltd v Broken Hill Pty Co Ltd (1989) 167 CLR 177 at 188; Melway Publishing Pty Ltd v Robert Hicks Pty Ltd (2001) 205 CLR at [67].

<i>Milling company</i>	<i>Ownership</i>	<i>Mills</i>	<i>Alternative</i>
Tully Sugar Limited	Private - COFCO (China)	Tully	
Bundaberg Sugar Limited	Private - Finasucre (Belgium)	Bingera Millaquin	Some Bingera and Millaquin growers could supply Isis
Isis Central Sugar Milling Company Limited	Grower owned cooperative	Isis	
Heck & Sons Limited	Family owned miller	Rocky Point	

Due to the fact that the quality of sugar cane declines from the time that the cane is cut and must be processed as soon as possible¹⁰¹, combined with transportation costs making longer distance travel uneconomical, it is generally thought that sugar cane can only be transported for approximately 100 kms. In fact there is evidence that competitive substitution can happen over this range as the Tableland growers moved their mill from Tablelands to Mossman which was over 100 kms away.¹⁰²

Therefore it seems that there are only nine privately run mills where the growers close to that mill do not have a competitive alternative which is run by a grower cooperative. It follows that growers in 12 mill areas have a competitive alternative run by a grower cooperative. In addition, substitution can occur between South Johnstone and Tully. Although both of these mills are privately owned, the ability to substitute introduces a level of competition between the two privately owned mills. Therefore, there are 10 mills where there is no competitive alternative.

Both BSL and ICSM have indicated their view that in some regions competition for cane supply can be high.

The growers are concerned that the inability to choose their milling company gives rise to market power. However, even in respect of the 10 mills which have no competitive alternatives, we consider that this potential market power is mitigated by a number of factors:

- The relationship between growers and millers is co-dependent. Mills need a certain supply of cane to be viable. Mills are also constrained to largely source from their local area. Our understanding is that mills have excess capacity so it is in their interest to encourage growers to continue to grow sugarcane. Growers have demonstrable alternatives for land use.¹⁰³ Once land is lost to other activities it may be difficult to get it back for sugar cane production. Due to the co-dependency it is difficult to see that mills can act without constraint in the way which is usually seen in true monopsony situations.
- Growers are statutorily authorised under the SIA to collectively negotiate with the mills. Several grower collectives negotiate on behalf of growers. Statutory authorisations are effective to authorise conduct that would otherwise be 'exclusionary conduct'.¹⁰⁴ 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 the growers.

We have also considered that there have been a number of previous reviews which have almost unanimously formed the conclusion that the relationship between the growers and millers is interdependent and co-dependent. The Hildebrand Report concluded:

¹⁰¹ See, for example, Canegrowers Cairns Region (2015), *Submission to the Agriculture and Environment Committee*, page 1 .

¹⁰² Canegrowers Tableland (2015), *Submission to the Agriculture and Environment Committee*, page 1.

¹⁰³ MSF Sugar (2015), *Submission to the Agriculture and Environment Committee*, page 7

¹⁰⁴ This is unlike authorisations that are available from the ACCC. The ACCC in authorising conduct which might otherwise be cartel conduct has generally refused to authorise "exclusionary conduct".

Millers and farmers are therefore jointly reliant in each mill area for profitable outcomes, and each must be profitable for economic sustainability of the mill area.¹⁰⁵

Our conclusion is that some millers have a degree of market power, but not all millers have market power. In some areas there appears to be an alternative mill option, with a level of competition. We also noted an interdependent and co-dependent relationship between growers and millers, which should act as a countervailing balance against the misuse of market power.

The presence of market power by itself does not imply that there is a need to regulate. Instead, policy makers need to consider the degree, if any, that market power is being abused as part of the case for considering additional regulation.

3.6 Is there evidence of abuse of market power?

3.6.1 Claims by growers

The growers have made a number of claims that there have been, or may be, abuses of market power. Examples which have been raised in previous submissions include the following:

- failed negotiations between Mitr Phol owned Tableland Mill and the growers in that region¹⁰⁶
- the finding of Chesterman QC in 1997 that the miller in a particular dispute offered too little and had not taken into account the difficulties facing the grower¹⁰⁷
- the Rocky Point negotiations which were only settled after input from a mediator and covered a range of issues including the Miller being non-transparent as to the deal that they had done with Golden Circle, not paying the growers on time, not providing enough time for growers to respond to an offer and the Miller not sharing the premium with the growers¹⁰⁸
- the Tully cane growers state that there was a difficult negotiation for the CSA expiring at the end of the 2013 season and that Tully Sugar refused to honour its agreement in relation to dispute resolution and left the growers in a position where they were not able to get a Collective Cane Supply Contract and the individual growers had to sign an Individual Cane Supply Contract.¹⁰⁹ The submission states that there is an imbalance in the market power, however it does not explain how the Individual CSAs were less desirable than the Collective CSAs;
- Burdekin District Canegrowers states that Wilmar Sugar, on 16 August 2012, presented as a fait accompli a contractual document which changed the net sugar price and that Wilmar Sugar stated that it was 'not proposing to negotiate the new FPPA'.¹¹⁰ The submission further states that Wilmar Sugar only 'begrudgingly' agreed to some amendments after persistent requests.¹¹¹ Burdekin District Cane Growers state that the new FPPA does not have any transparency in relation to the calculation of the net sugar price.¹¹²

To form a view about whether there is evidence of abuse of market power, and by extension evidence of market failure, we have considered each of these claims.

¹⁰⁵ Hildebrand, Clive (2002), page 13.

¹⁰⁶ Canegrowers Tableland (2015). Submission to the Agriculture and Environment Committee, page 1

¹⁰⁷ Canegrowers Rocky Point (2015). Submission to the Agriculture and Environment Committee, page 2

¹⁰⁸ Canegrowers Rocky Point (2015). Submission to the Agriculture and Environment Committee, page 3

¹⁰⁹ Tully Cane Growers Limited (2015). Submission to the Agriculture and Environment Committee, page 3

¹¹⁰ Burdekin District Cane Growers Limited (2015). Submission to the Queensland Productivity Commission, page 6

¹¹¹ Burdekin District Cane Growers Limited (2015). Submission to the Queensland Productivity Commission, page 6-7

¹¹² Burdekin District Cane Growers Limited (2015). Submission to the Queensland Productivity Commission, page 7

3.6.2 Consideration of miller behaviour

Previous negotiations on the Wilmar Proposal

There have been numerous negotiations over the years in the sugar industry. One example is the 2013 negotiations around a proposal put forward by Wilmar.

On 30 July 2013 Wilmar issued a document titled 'Wilmar's Grower Choice Marketing Proposal' (Wilmar Proposal). The key elements of that proposal included the following:

- provide growers choice on a year-by-year basis about whether to nominate all or a portion, of their notional sugar exposure to be sold from QSL to Wilmar for marketing by Wilmar
- for any grower-nominated volume which is marketed by Wilmar, Wilmar would pay growers an additional premium of US 0.15c per lb (which is approximately AU\$3 to \$3.50 per tonne of sugar) over and above the 'Shared Pool Element' achieved by QSL
- all grower pricing and pooling options to remain unchanged
- subject to the Wilmar Proposal receiving enough support by industry stakeholders to enable its adoption for the then 2014 season Wilmar will increase the term of its RSSA with QSL from 3-4 years to 5-6 years.

As we understand, the Wilmar Proposal did not affect a number of other functions that QSL provides for the industry, including:

- storage and handling at the bulk sugar terminals
- management of the pooling and pricing options available to millers and growers
- facilitating financing for the industry and paying advances. To facilitate this function the Wilmar Proposal continued with the current structure whereby Wilmar would continue to supply QSL with 100 per cent of the RSSA export sugar which it mills. The purpose of this was to allow QSL to take title, and therefore have the collateral to raise financing for the industry. This last element seems to be a significant benefit to the industry.

The Wilmar Proposal included an element of Wilmar paying the growers a 'Premium' of approximately AU\$3—AU\$3.50 per tonne of sugar. The Wilmar Proposal contains a slide which shows the history of the Shared Pool Element (also referred to as the premium) as having moved over the last 5 years between \$1 and \$6.50 per tonne of sugar. The premium reached its peak in 2011 at \$6.50 and has been in significant decline from 2011–2013. At the time of the Wilmar Proposal there was a forecast premium of negative \$1 per tonne. Therefore, the offer of an additional premium of between \$3 and \$3.50 would seem to have been reasonable.

Wilmar's presentation on proposed model dated 25 June 2015

Wilmar proposed another model on 25 June 2015 which would apply to the post 2017 contractual arrangements.

The essential elements of the 2015 Proposal are as follows:

- the recognition of GEI in the pricing formula
- growers can continue to use QSL to forward price their cane, or other appropriately qualified third party pricing manager
- dispute resolution provisions in the CSA incorporating final and binding arbitration
- pre-contract mediation to assist in commercial negotiations
- price reports to growers showing what price the downstream product was sold for

- sales reports for growers showing them the product was sold, to whom it was sold, how much was sold and at what price;
- seasonal audit of all sugar sales to deliver transparency. Audit to be conducted by one of the big four accountancy firms with a right for growers to review the audit with the auditors.

We note that the main concerns raised by growers in respect of this Wilmar Proposal are the lack of transparency, conflicts of interest and lack of choice in marketing the grower's economic interest in the crop.¹¹³

The Wilmar proposal does not provide for grower choice of marketer, however we do not see evidence of the growers claim that there remains a lack of transparency and there are conflicts of interest (essentially arising because the private miller may sell it to a related body corporate).

In respect of the absence of grower choice in the proposal, we are not aware of anything that would prevent growers and Wilmar agreeing a different form of property rights for the CSAs, and a tolling arrangement being entered into. We have not seen evidence that growers are seeking to transition to tolling arrangement.

We do not consider that the absence of choice for growers in marketing in the Wilmar Proposal (2015) to be evidence of an abuse of market power by Wilmar.

MSF Sugar pricing model

MSF Sugar has established a Grower Pricing Reference Panel which has visibility and transparency of all of the physical marketing activities undertaken by MSF Sugar. MSF Sugar states that the pricing can be independently audited.¹¹⁴ MSF Sugar also state that in the Maryborough and Mulgrave areas, when given a choice to nominate QSL or MSF, 91 per cent elected to stay with MSF.¹¹⁵

MSF Sugar has an 'Improved Pricing and Pooling Model' which is described in some detail in its submission to AEC¹¹⁶. Therefore the submission by growers that MSF Sugar has provided no visibility on its pricing model does not seem to be correct. Importantly, all pools run by MSF Sugar are open to audit and the Grower Pricing Reference Panel has input into the scope of the audit, the choice of the auditor and is able to view sales premiums, freight, sales timing, sales customer choice and futures allocation.¹¹⁷

3.6.3 Conclusion on evidence of an abuse of market power

There is clearly a degree of distrust between the growers and the millers and negotiations are difficult. However, the absence of trust is not an indication of an abuse of market power. There are however, other measurable indications that there is no existing abuse of market power as follows:

- no evidence that for those mills without competitive alternative, that the growers are not being paid in accordance with the same formula as prior to deregulation¹¹⁸
- no evidence that the current contractual arrangements for private mills and grower cooperative mills are different. If there was a current abuse of market power in respect of contractual arrangements, we would expect to see a difference in the contractual arrangements between private and cooperative mills. Although this is not directly relevant to contractual arrangements beyond 2017, it is relevant to the extent that there is no observable abuse of market power

¹¹³ CANEGROWERS and ACFA (2015). Submission to Queensland Productivity Commission, Attachment 3, pages 18-19

¹¹⁴ MSF Sugar (2015). Submission to the Agriculture and Environment Committee, page 10

¹¹⁵ MSF Sugar (2015). Submission to the Agriculture and Environment Committee, page 10

¹¹⁶ MSF Sugar (2015). Submission to the Agriculture and Environment Committee, page 17

¹¹⁷ MSF Sugar (2015). Submission to the Agriculture and Environment Committee, page 17

¹¹⁸ MSF Sugar (2015). Submission to the Agriculture and Environment Committee, page 5

currently and in light of the elements of the MSF and Wilmar proposals particularly around transparency, it is not clear that an assumption should be made that there will be an impending abuse of market power

- the 2013 Wilmar Proposal seems to have been a reasonable proposal on the basis that it provided growers with a choice on a year-by-year basis about whether to nominate QSL or Wilmar, it provided a premium level which seems reasonable when the variation in premiums is taken into account and assisted the industry in broader ways such as continuing to sell the raw sugar to QSL to enable QSL to raise finance and provide premiums; and
- the MSF Sugar pricing model and the Wilmar Proposal 2015 seem to be a reasonable balance and, for example, seem to provide for almost complete transparency in respect of the premium. A number of the submissions from growers make the allegation that they are concerned that private millers may engage in ‘price transfer’ meaning that they will sell the raw sugar to their affiliated refiners not at market price. The MSF Sugar pricing model and the Wilmar Proposal 2015 seem to address this issue.

Despite the evident absence of trust, our conclusion is there is no evidence of an abuse of market power.

This conclusion does not preclude an abuse of market power in respect of the post 2017 contractual arrangements. However, based upon the various proposals that have been put to growers it is clear that there is a co-dependent relationship between the growers and the millers and that the millers are aware that this is the case.

Even if there were an abuse of market power in the future there are a number of current regulatory options available to growers. For example, it is clear that the unconscionable conduct provisions of the CCA apply to circumstances of business-to-business contracts. There is also section 46 of the CCA which prohibits an abuse of market power. These options would be open to the growers should contractual arrangements post 2017 be either unconscionable or constitute an abuse of market power.

3.7 Is there sufficient transparency for growers?

It appears that one of the reasons underlying the proposal for grower choice of marketer is concern about the future of QSL and its role in providing transparency. The AEC’s Report cites the ACFAs evidence to the Parliamentary hearing, specifically:

*We need QSL to be there as a benchmark, as an alternative pricer and marketer of our sugar.*¹¹⁹

In section 2.2.2, we noted grower concerns that a move to miller marketing could mean that:

- transparency about marketing risks, costs and premiums could effectively be removed – to the benefit of the milling company
- lack of transparency leading to millers increasing their ‘slice of the pie’ at the expense of the growing sector in situations where foreign mill owners also own their own refineries and facilities overseas.

There can be a case for government regulation where there is evidence of information asymmetry and the absence of sufficient information means that participants in a market are at a disadvantage in their dealings compared to the other party.

¹¹⁹ Agriculture and Environment Committee (2015), page 9

We have carefully considered whether there is evidence of market failure in the provision of information to growers, which would suggest the need for a regulatory intervention to increase transparency.

In sections 3.5.3 and 3.5.4 we set out the information that Wilmar and MSF are proposing to provide to growers in their mill regions. This information appears to be comprehensive and would appear to 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. It would also allow comparison of the premium and cost performance from year to year.

We also note the views of Bundaberg Sugar Limited, one of the three millers who intend to remain with QSL, that it is possible to develop appropriate transparency arrangements with growers. Specifically:

we have a good working relationship with local growers and have developed over recent years a mechanism to provide transparency to the determination of a domestic sugar price which is a component in deriving a final cane price for growers. The issues involved were very similar to those being debated by Wilmar and their growers, given the lack of transparency on pricing of 'GEI' sugar passing through the refining process.

By negotiation with our growers, we developed a system which mirrors the export sugar price determined by QSL. Should QSL cease to exist in the future, then transparent mechanisms similar to those existing with QSL could be implemented with a new marketer of export sugar. Further, should it eventuate that there is no export sugar, then it is believed that transparency could be achieved utilising some proxy (agreed with growers) for the physical marketing returns which currently are a component of sugar price. Other components of the sugar price are transparent and auditable. Alternatively, some other method of determining a cane price for growers could be possible.¹²⁰

Based on the information available, there seems to be no strong evidence that millers are not, or will not, provide the information that growers need to make informed decisions regarding marketing risks, costs and premiums, and to show that growers are indeed being paid net premiums in accordance with the CSAs.

We also note the Australian Tax Office's transfer pricing rules, which use internationally recognised methods to discourage international profit sharing. They require all multinational businesses operating in Australia to:

price related party international dealings according to what truly independent parties acting independently would reasonably be expected to have done in the same situation. Pricing for international dealings between related parties should reflect a fair return for the activities carried out in Australia, the Australian assets used (whether sold, lent or licensed), and the risks assumed in carrying out these activities¹²¹.

There needs to be a proper allocation of income and expenses between Australia and other countries.

¹²⁰ Bundaberg Sugar Ltd (2015). Submission to Agriculture and Environment Committee, page 5

¹²¹ Australian Tax Office – International Transfer Pricing – Introduction to concepts and risk management

<https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Transfer-pricing/International-transfer-pricing---introduction-to-concepts-and-risk-assessment/>

Questions

- 3.3 Is it correct that CSAs for mills without competitive alternatives are the same or similar to CSAs with grower cooperatives? If not, what are the differences and are they advantageous or disadvantageous to growers?
- 3.4 Is there information that miller marketers should be providing but are not?
- 3.5 In terms of transparency, are there any aspects of the MSF's Pricing Model that are insufficient? If so, what aspects and why?
- 3.6 In terms of transparency, are there any aspects of the Wilmar 2015 Proposal that are insufficient? If so, what aspects and why?

3.8 Are the existing dispute resolution arrangements effective?

An effective dispute resolution process is important given the potential market power within the sugar industry. Sugar The Way Forward (2003) noted that these arrangements

*provide a mechanism to ensure that market failure cannot occur in a monopoly buyer situation and unfair agreements cannot be forced.*¹²²

Some growers have indicated that the existing dispute resolution arrangements are insufficient protection against misuse of market power and there needs to be a mechanism for resolving deadlocks in the negotiation of CSAs.¹²³¹²⁴

They note that the current dispute resolution mechanism, which is a requirement of CSAs under the SIA, is post contractual and so only applies once a contract has been signed. It does nothing to ensure that a grower, with little market power, can negotiate on equal terms with a mill.¹²⁵

We also note that pre-contractual dispute resolution was removed from the sugar industry regulatory framework as part of the 2004 reforms. The Hildebrand Review (2002) found that arbitration was costly and impeding investment and innovation and noted that

*It is not desirable that arbitration becomes a customary way to avoid the responsibility that should accompany local leadership in genuine negotiation at the mill area level, for the good of participants in that mill area.*¹²⁶

The 2002 Memorandum of Understanding between the Federal and Queensland Governments identified the statutory bargaining system as one of the areas that appear to:

*impede increased competitiveness and efficiency, and are detrimental to cultural change and innovation.*¹²⁷

We note that some growers have pointed to the failure of millers to agree to grower choice of marketer as evidence of failure of the dispute resolution mechanisms. Given the legal title in the CSAs, we do not consider that millers having not agreed to provide choice in marketing of sugar in which they hold title is an indication of an ineffective dispute resolution mechanism.

Despite the evident lack of trust amongst some stakeholders, since deregulation there has been no significant developments that would alter these conclusions on the potential negative impacts of statutory arbitration.

¹²² Queensland Government (2003), page 48

¹²³ CANEGROWERS and ACFA (2015). Joint submission to the Queensland Productivity Commission, page 4

¹²⁴ Tablelands Canegrowers Ltd (2015). Submission to the Queensland Productivity Commission, 2-3

¹²⁵ CANEGROWERS and ACFA (2015). Joint submission to the Queensland Productivity Commission, page 4

¹²⁶ Clive Hildebrand (2002), page 14

¹²⁷ Memorandum of Understanding between the Federal and Queensland Governments, *The Commonwealth and Queensland Working Together for the Sugar Industry and Communities* 2002.

Given our conclusion that there is currently no evidence of an abuse of market power occurring in Queensland in the sugar industry, we consider the current dispute resolution mechanisms are adequate in terms of addressing any imbalance in market power. Therefore, we consider that there would need to be a strong case to justify introducing more arbitration beyond the existing arrangements, especially given the potential high costs involved. These costs are discussed in Section 4.3.5.

Questions

- 3.7 Is there any further information and evidence we could take into account that would suggest existing dispute resolution mechanisms are ineffective and are giving rise to market failure?

3.9 Conclusion

As we set out in Section 3.1, we consider that the regulatory arrangements for the sugar industry should be able to meet the objectives of:

- ensuring a pricing framework where there is an appropriate balance of risk and reward between growers and millers
- ensuring that there are appropriate protections for growers and millers to prevent against the abuse of market power
- ensuring a regulatory framework that supports investment and innovation in the sugar industry and supports the long-term economic sustainability of the sugar industry.

We have considered a range of issues that have been raised by stakeholders that there is a market failure within the industry that is preventing the achievement of these objectives. Having addressed each of these concerns we have not been able to identify specific evidence of market failure which would point to a conclusion of a need for additional regulation.

4 ASSESSMENT OF POTENTIAL OPTIONS



The purpose of a RIS is to assess the potential impacts of a regulatory proposal on different groups within business, community and government, to identifying whether the net change in welfare associated with the recommended regulatory proposal means the community as a whole would be better off with a regulatory proposal compared to the 'do nothing' option.¹²⁸

The RIS Guidelines indicate that where possible, and appropriate, a RIS should assess the benefits and costs of a regulatory proposal quantitatively. This allows for a clearer comparison both across and between options, and supports independent validation of results. However, in some circumstances it may not be possible to assign a monetary value to some benefits and costs and when benefits and costs cannot be considered quantitatively, the benefits and costs of regulatory options should still be compared and assessed using a qualitative framework.

For this RIS, we have sought to quantify impacts as far as possible. However, there is a limited amount of publicly available quantitative data, so we have applied a more qualitative approach to the impact assessment process. Given the nature of the regulation being considered, our view is that a cost benefit assessment (even if the data was reliable) would not change the qualitative assessment we have made of the costs and benefits.

4.1 Why is assessment of options important?

A RIS must consider all relevant options to allow the decision maker to make an informed decision as to whether the benefits of the proposed regulation outweigh the costs, and to understand how stakeholders are impacted. This comparison is always made in comparison to the 'do nothing' option.

For this RIS, we are considering the impacts on growers, millers, QSL, STL and the broader economic and employment impacts of the Bill. We have also assessed the other options which could achieve the same policy objectives.

4.1.1 Public benefit assessment required for authorisation of anti-competitive conduct

The Competition Principles Agreement includes an agreement that regulation should not restrict competition unless it can be demonstrated that:

- the benefits of the restriction as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

This assessment is essential where a regulatory proposal seeks to authorise anti-competitive conduct which, without a legislated exemption or other legal authority, would contravene Part IV of the CCA.

Use of a legislation exemption under section 51 of the CCA must be supported by evidence that there is a clear public benefit and that there are no other ways the policy objective can be achieved. Without this justification, a regulation may be overturned by the Commonwealth Government.

¹²⁸ Department of Prime Minister and Cabinet (2014), The Australian Government Guide to Regulation

In this instance, clause 8 of the Bill specifically authorises anti-competitive conduct that would occur if parties were to comply with provisions of the Bill. A statutory authorisation is necessary to prevent the ACCC taking action against any parties that may engage in anti-competitive conduct in complying with legislation.

4.1.2 Options for consideration

The Bill is one of a number of options that have been proposed by stakeholders to deal with the impasse that seems to be evident in the Queensland sugar industry.

We note that under any option, the Queensland sugar industry will continue to be a price taker in the internationally competitive sugar market, with the price for raw sugar produced in Queensland determined by external factors. Between 95-99 per cent of the price of the sugar is determined by the international market.

Marketers of Queensland produced raw sugar have the ability to negotiate premiums, although these still are negotiated within the international market, so are influenced by global factors of supply and demand. Marketers also have the capacity to manage costs. In this respect, any option needs to ensure that marketers have the commercial flexibility and incentive to maximise net premiums.

The options being considered for this RIS are those that have been proposed by stakeholders either to the Queensland Parliament or considered at the Australian Government level.

Table 7: Options in respect of regulation of the Queensland sugar industry

<i>Option</i>	<i>Description</i>
Option 1: Do nothing – no legislative change	No change to the regulatory framework that was implemented at the time of the 2006 industry deregulation. This means that legal title to raw sugar is determined by the commercial agreements, as are pricing negotiations for the supply of cane In the absence of any changes the nature and form of CSAs, millers would make the commercial decision to market the raw sugar they produce themselves, or enter into a market agreement with alternative market (which may include QSL or another marketer(s)).
Option 2: Legislative change, as set out in the Bill	The legislative changes set out in the Bill are: (a) providing growers (and their representatives) with a new right to a statutory arbitration process to resolve contractual and pre-contractual disagreements related to supply contracts (adding a new section 33A). This trigger would not be available to mill owners or other affected parties such as QSL (b) prescribing terms that must be included in a grower, miller supply contract (c) establishing growers economic interest (GEI) (proportion of raw sugar for which they bear a sale price exposure) (d) allowing growers to nominate their choice of marketing entity for their proportion of GEI sugar. We note that the State LNP has proposed the <i>Sugar Industry (Facilitating Grower Choice) Amendment Bill 2015</i> ¹²⁹ , which has a similar set of objectives.
Option 3: Sugar Industry Code of Conduct Regulation Mandatory Code of Conduct (Australian Government Taskforce)	Burdekin District Cane Growers Ltd has proposed a Sugar Industry Code of Conduct Regulation with detailed drafting. The Australian Government’s Sugar Industry Code of Conduct Taskforce proposed a mandatory code created under the CCA. The matters proposed for inclusion are: (a) a mechanism to distribute relevant interests in the quantities of sugar obtained from cane between growers and millers (b) a link between the price paid for cane and the selling price of sugar

¹²⁹[http://debfrecklington.com.au/documents/Exposure%20Draft%20Sugar%20Industry%20\(Facilitating%20Grower%20Choice\)%20Amendment%20Bill%202015.pdf](http://debfrecklington.com.au/documents/Exposure%20Draft%20Sugar%20Industry%20(Facilitating%20Grower%20Choice)%20Amendment%20Bill%202015.pdf)

<i>Option</i>	<i>Description</i>
	(c) the ability to choose marketing services (d) non-discriminatory provisions (e) a mechanism to resolve disputes
Option 4: Tolling	Some stakeholders have suggested a tolling arrangement, where growers contract with millers for processing and retain responsibility for marketing raw sugar. It has also been proposed that miller processing could be made subject to a third party access regime.

4.2 Option 1 – Base case – no additional legislation

Option 1 would see no changes to the SIA meaning that legal title to raw sugar is determined by the outcome of commercial agreements. The current regulatory framework reflects the regulatory parameters developed as part of the 2006 deregulation arrangements.

These parameters, aspects of which reflect the recommendations of numerous reviews commissioned by both the Queensland and Australian Government, include:

- while a grower may only supply cane to a mill if the grower has a CSA with the mill, growers and mills are free to commercially negotiate the CSA's terms
- the ability (and authorisation for competition legislation) for growers to collectively negotiate with a miller in the making and varying of a CSA
- a CSA must state a process for dispute resolution and that the parties must attempt to resolve the dispute by using the process
- final offer arbitration is prohibited
- millers can choose who markets raw sugar they produce (that is, there is no single desk).

Given the announcements of Wilmar, MSF and Tully Sugar not to renew their RSSAs with QSL beyond 1 July 2017, the base case for consideration is in two parts.

Wherever possible, we have sought to make an assessment of the base case for stakeholders pre and post 1 July 2017. As agreements are still to be reached between some growers and some millers beyond 1 July 2017, we have assumed that the proposals that have been presented by the relevant millers to growers become the base case.

A description of the relationship between the various parties is reflected in **Table 8**.

Table 8: Assumed roles of Queensland supply chain participants – pre and post 1 July 2017

<i>Stakeholder</i>	<i>Pre 1 July 2017</i>	<i>Post 1 July 2017</i>
Growers	CSA arrangements with millers. Title transfers on delivery of cane to mill. Growers paid for sugar on the terms set out in CSAs. Most CSAs include the Cane Price Formula which provides for a roughly 2:1 distribution between growers and millers.	CSA arrangements with millers. Title transfers on delivery of cane to mill, unless growers and millers negotiate alternative agreement. We are unaware of any alternative agreements. Growers paid for sugar on the terms set out in CSAs. Most CSAs include the Cane Price Formula which provides for a roughly 2:1 distribution between growers and millers. ¹³⁰ Growers continue to have the ability to manage their sugar price exposure
Millers	Millers contract with QSL for marketing of raw	Millers make the commercial decision to market

¹³⁰ We note Wilmar's submission to the QPC, October 2015 (page 3) indicates that Wilmar is not seeking to change how cane growers are paid for the product they supply to mills, it is not seeking to change the process by which cane supply agreements are negotiated and it is not seeking to change the existing mechanisms which provide growers with the ability to make decisions that determine 99 per cent of the net sugar price on which the price of their cane is based.

Stakeholder	Pre 1 July 2017	Post 1 July 2017
	sugar. Some millers have commenced the purchase of raw sugar from QSL and commenced the marketing of raw sugar. MSF has marketed a proportion of its raw sugar since 2006	the raw sugar they produce themselves, or enter into a market agreement with alternative marketer (which may include QSL or another marketer(s)). Wilmar has announced plans to market raw sugar directly. MSF and Tully have yet to indicate an alternative marketer. ISMC, Mackay Sugar Limited and Bundaberg Sugar Limited have indicated they will remain with QSL for the 2017 season.
QSL	QSL provides the following services: <ul style="list-style-type: none"> acquiring raw sugar intended for bulk export from Queensland millers under RSSAs selling the raw sugar acquired to international customers chartering shipping for the raw sugar acquired financing and hedging activities related to raw sugar (with growers having a choice to use QSL or alternative arrangement) sub-leasing, operating and providing storage and handling services at STL. 	QSL would continue to provide the following services: <ul style="list-style-type: none"> acquiring a proportion of raw sugar intended for bulk export from the three millers for the 2017 season selling the raw sugar acquired to international customers chartering shipping for the raw sugar acquired financing and hedging activities related to raw sugar (with growers having a choice to use QSL or alternative arrangement) sub-leasing, operating and providing storage and handling services at STL.
STL	Terminals managed by QSL, based on a cost recovery only basis.	STL has a number of options including: <ul style="list-style-type: none"> continuing to engage QSL to manage the terminals under the sublease operating the terminals itself – achieved by purchasing equipment from QSL and employing QSL’s terminal employees. Alternatively, STL could engage another terminal operator individual terminals could be sold or subleased to milling companies

4.2.1 Option 1 – base case millers

Under the CSAs, returns to growers and millers are determined by the Cane Price Formula. As millers receive a share of the net premiums, millers have a strong incentive to maximise the net price for raw sugar, including minimising marketing costs.

In Chapter 3, we estimated an average net premium range for Queensland’s sugar of \$21 million per annum, of which \$7 million would be earned by millers and \$14 million earned by growers, based on a net premium of \$5.

For the base case (particularly post 1 July 2017) we have assumed that millers who have made the decision to cease using QSL for the marketing of raw sugar have done so because they have made a commercial decision that an alternative marketing strategy would increase the overall net premiums earned from raw sugar produced by their mills.

We have sought to consider the potential implications for millers marketing their own raw sugar and millers who have indicated that they plan to continue holding RSSAs with QSL, at least for the 2017 season.

Millers marketing their own raw sugar

Wilmar has indicated its primary reason for making the decision to market 100 per cent of the raw sugar it produces is to increase the returns that both it and growers receive. Wilmar says that in marketing its MEI in the 2012 and 2013 seasons:

*Wilmar's net sugar price, including marketing premiums, was \$45 per tonne higher than on average was achieved for growers under the QSL system. Wilmar's marketing premiums were approximately 60 per cent higher than QSL returned over the same period, about \$11 better per tonne of sugar... and that its growers would be around \$36 million per year better off post 1 July 2017.*¹³¹

CANEGROWERS and ACFA have indicated their concerns to us that Wilmar's proposed marketing arrangements, as provided to growers in their 'New Marketing Partnership' information update dated 8 April 2014, will 'dilute the returns growers will receive from trading profits'.

We have been provided with an Ernst and Young (EY) audit report on Wilmar's actual returns. This confirms Wilmar's statements that it was able to achieve higher returns than in the QSL system in the 2012 and 2013 years. We note that there may be different risk profiles between Wilmar and QSL. However, we have no reason to consider that Wilmar has not achieved the indicated returns and in the future would not have the commercial incentive to maximise the returns from marketing of raw sugar.

In response to the claim that Wilmar's proposed marketing arrangement will negatively affect grower returns, it appears, based on supplementary information provided by Wilmar to us that the 50 per cent referred to by CANEGROWERS is based on arbitrage returns rather than either net premiums or ICE No.11 returns that are currently paid to growers. Whilst we note that only 50 per cent of these arbitrage returns appear to be distributed to growers, rather than the usual two-thirds distributed to growers on the basis of cane payment arrangements, Wilmar states that 'these benefits are not available to growers in the current QSL system, because QSL does not trade any material quantity of other origin sugar'.¹³²

Assuming this is correct, and that all the elements included in net premiums (including spread gains on Australian sugar) under the proposed framework are the same as under QSL, there is no evidence to suggest that net premiums would be any lower than QSL, and could well be higher under a Wilmar marketing scenario.

Neither MSF nor Tully have made public estimates about the net premiums they might achieve, although we note that MSF has been marketing at least some proportion of its raw sugar since 2006. We can only assume that this decision was made because MSF considered the net premiums it could generate would be in excess of those that QSL (or an alternative marketer) might have been able to achieve.

Millers selling raw sugar to QSL for marketing

Three millers (ICSM and Mackay Sugar Limited) have indicated they will remain with QSL as their marketer, at least for the 2017 season. None of these millers in submissions either to us or the AEC have indicated concerns that their net premiums in the 2017 season will be impacted. We note millers appear to have been silent on the matter.

Accordingly we have assumed that the net premiums will be at least comparable to the pre-1 July 2017 base case. We would, however, welcome any additional evidence from millers that this is not the case.

Overall, we conclude that under the base case, the millers will be no worse off from 1 July 2017 and may well be better off if they are able to outperform QSL in net premiums.

¹³¹ Wilmar (2015) Submission to Queensland Productivity Commission, page 13

¹³² Wilmar (2015) Supplementary Information to Queensland Productivity Commission, page 2

4.2.2 Option 1 – base case growers

Some growers have expressed concern they will be worse off if the raw sugar, for which they have price exposure is marketed by a miller and they have no choice of their marketer. Chapter 3 estimated that 95-99 per cent of the net sugar price is impacted by the world price for sugar.

We note that Queensland growers have the ability to manage their price risk through a variety of pricing pools. As far as we are aware, this arrangement will not change post 1 July 2017. Wilmar Sugar has indicated that its growers will still have the choice to hedge their pricing exposure either through:

QSL or any suitably qualified third party pricing manager, for 99% of their net sugar price.¹³³

From this perspective we consider the base case provides growers with considerable autonomy to manage their revenues according to their appetite for price risk, irrespective of the ultimate marketer of their product.

We consider that the world sugar price, along with input prices, are the largest contributors to the viability of cane production and the net premiums, while important, are not likely to be the major contributor to a growers investment decision in cane production.

In respect of the net premiums we note Wilmar's submission to us saying it is not seeking to change how cane growers are paid for the product they supply to mills, it is not seeking to change the process by which cane supply agreements are negotiated, and it is not seeking to change the existing mechanisms which provide cane growers with the ability to make decisions that determine 99 per cent of the net sugar price on which the price of their cane is based.

Given our conclusion that millers should be no-worse off pre and post 1 July 2017, we can only conclude that growers will be no worse off post 1 July 2017. If marketers (including miller marketers) are able to market in a manner that increases net premiums then growers may be slightly better off.

4.2.3 Option 1 – base case QSL

Under its constitution, QSL is required to act in the best interests of the sugar industry. Its' main activities include:

- acquiring raw sugar intended for bulk export from Queensland mill owners under RSSAs
- selling and chartering shipping for that raw sugar to international customers
- financing and hedging activities related to the raw sugar
- sub-leasing, operating and providing sugar storage and handling services at the six bulk sugar export terminals
- other initiatives considered to be in the best interests of the Queensland sugar industry.

As it is owned by grower and millers, QSL works on behalf of growers and millers to export raw sugar to international refineries.

Marketing

QSL consider, over the past few years that Wilmar has been looking for ways to remove it from the marketing of Queensland raw sugar. For example, it was initially proposed that QSL should subcontract Wilmar to conduct all of its marketing operations. QSL says that having failed to convince other mill owners of that position, Wilmar has threatened on numerous occasions to provide a notice to terminate its RSSA.¹³⁴

¹³³ Wilmar (2015). Submission to Queensland Productivity Commission, pages 16-17

¹³⁴ QSL (2015). Submission to Senate Select Committee on Rural and Regional Affairs and Transport, pages 10-11

In 2017, QSL will see a portion of its marketing function transfer to the following mills who have indicated a preference to find an alternate marketer for their raw sugar: Wilmar, MSF Sugar and Tully Sugar.¹³⁵

Some stakeholders have noted concern for the viability of QSL as a result.

Tully Sugar commented that it assessed the impact of the withdrawal of the largest suppliers to the QSL export marketing system and determined that the loss of major suppliers would fundamentally change the QSL offering. In announcing its decision to withdraw, Tully Sugar noted that the withdrawal of Wilmar and MSF Sugar meant that QSL:

loses more than seventy per cent of its critical export mass and its competitive advantage. This represents unacceptable risks to our business and our growers.

In addition, Tully Sugar submitted that it is seeking to replace the services that are currently being provided by QSL.¹³⁶

Further, CANEGROWERS noted that Bundaberg, Isis and Mackay Sugar Limited, the millers remaining with QSL for the 2017 season have delayed their decision of whether to continue with QSL until 15 December 2015 and that there is a risk that the continuing mills will withdraw from QSL at the conclusion of the 2017 season.¹³⁷

The AFCA requested a speedy resolution to the state and federal processes due to a concern over the future of QSL as there has been a history in the industry of neglecting organisations until they fall.¹³⁸

Three mills have chosen to remain with QSL. We note ICSM and Bundaberg Sugar do not support the Bill.¹³⁹ Further, neither mill has noted concern respecting QSL's ability to market its raw sugar with the loss of the three other mills.

Mackay Sugar notes that despite other sugar suppliers giving notice to withdraw supply from QSL, Mackay Sugar has opted to remain with QSL as a joint exporting marketing body of the growers, Bundaberg Sugar and ISCM.¹⁴⁰

We consider that QSL provides a different value proposition in its approach to raw sugar marketing, in comparison to other raw sugar marketers such as Wilmar. QSL notes that growers value its approach as it can offer a more cautious approach to managing downside risks; whereas global agribusinesses (which are heavily exposed to trading risks) have very different appetites for risk.¹⁴¹ Mills are provided with a choice to pursue the marketing option which matches their risk appetite.

We note Tully Sugar's comment that QSL has lost its critical export mass and its competitive advantage. Given thirty percent of the market have chosen to remain with QSL, it is difficult to conclude whether the 'critical mass' threshold has indeed been met. While it is difficult to predict whether the three remaining millers will choose to remain with QSL after the 2017 season, we consider that for the 2017 season, there is reason to believe QSL's marketing function will remain viable given the choice of the three remaining mills to form a joint exporting body.

Non-marketing functions

Given some mills' choice to pursue alternate marketing arrangements, it is apparent there will be a change in QSL's servicing model with respect to raw sugar marketing.

¹³⁵ QSL (2015). Submission to Senate Select Committee on Rural and Regional Affairs and Transport, page 3

¹³⁶ Tully Sugar. Submission to Agriculture and Environment Committee, page.3

¹³⁷ AEC (2015) page 4

¹³⁸ AEC (2015) page 4

¹³⁹ Bundaberg Sugar, page.1; ICSM, page.1-2;submissions to Agriculture and Environment Committee (2015)

¹⁴⁰ Mackay Sugar Limited (2014). Submission to Senate Select Committee on Rural and Regional Affairs and Transport, page 1

¹⁴¹ QSL(2014), Supplementary submission to Senate Select Committee on Rural and Regional Affairs and Transport, page.16

QSL notes that as a result of its structure, purpose and not for profit nature, it has opened up competition in the raw sugar industry in a way that a purely profit driven entity in its position would not have. For instance QSL notes it has:

- structured the RSSAs as relatively short term arrangements, with three year rolling terms
- provided open access to the six bulk sugar terminals that it operates, at cost-recovery rates to all raw sugar mill owners, irrespective of whether the relevant raw sugar is being marketed by QSL, ensuring that access to storage and handling facilities is not a barrier to entry while QSL is the operator of the terminals
- agreed to amend the RSSAs that it had entered with mill owners, to give mill owners the option to market their 'supplier economic interest sugar' from the 2014 Season onwards.¹⁴²

Given QSL’s functions of sub-leasing, operating and providing storage and handling services at the six sugar terminals, it holds that a single operator not-for-profit function may still provide industry benefit. However, given deregulation, there are other functions performed by QSL, in addition to marketing which are also open to competition.

In **Table 9**, we set out how reduced marketing volumes may result in changes to the remainder of QSL’s functions.

Table 9: Comments regarding QSL’s non-marketing service functions

<i>Service function</i>	<i>Stakeholder comments</i>	<i>QPC comments</i>
Storage, handling and logistics	QSL notes that it can provide storage, handling and logistics services without the customer mill supplying it information about the ultimate customer for the raw sugar (ie marketing). QSL also notes that the industry (with the exception of Wilmar), supports QSL continuing to provide storage and handling services at the bulk sugar terminals ¹⁴³	We consider it’s unlikely that a loss of marketing volumes will necessarily result in a change to QSL providing storage, handling and logistic services.
Access to Bulk Sugar Terminals	QSL notes that it currently provides and will continue to provide open access to the sugar terminals for entities that compete with it in export markets. ¹⁴⁴ Tully Sugar notes that it does not believe changes to marketing arrangements will impact on access to essential infrastructure. ¹⁴⁵	We understand there is a threshold volume of sugar that is to be handled and stored at each terminal for QSL to retain its sublease with STL to the six sugar refineries. If STL terminates the sublease, it may negotiate with other parties to provide the service at the terminals.
Pricing and price risk management <ul style="list-style-type: none"> • QSL provides pricing products to millers and growers • Includes QSL managed pools, individual forward pricing and miller managed pricing pools. 	Mackay Sugar notes that to a large degree, growers and millers are able to manage their own risks relating to the underlying sugar futures price as well as currency. This is achieved via a range of market based products that are provided by a range of service providers, including banks, QSL and millers. ¹⁴⁶ The deregulation of sugar marketing has seen a number of cane pricing mechanisms being developed to allow individual or smaller collective groups of growers to directly price their cane by pricing on the	It appears that QSL is one of many players capable of providing pricing and price risk management. Should QSL continue to add value to customers in providing pricing, and price risk management, it will likely remain competitive in this space.

¹⁴² QSL (2014). Submission to the Senate Select Committee on Rural and Regional Affairs and Transport, page. 11

¹⁴³ For example, QSL says the MSF have not had a contract to provide raw sugar to it and MSF continues to benefit from QSL’s other services at cost. In addition, QSL notes that the industry (with the exception of Wilmar), supports QSL continuing to provide storage and handling services at the bulk sugar terminals. QSL (2015). Supplementary submission to Senate Select Committee on Rural and Regional Affairs and Transport, page.5

¹⁴⁴ QSL (2015), Supplementary submission to the Senate Select Committee on Rural and Regional Affairs and Transport, page.5

¹⁴⁵ Tully Sugar (2014). Submission to the Senate Select Committee on Rural and Regional Affairs and Transport, page 5

¹⁴⁶ Mackay Sugar (2014). Submission to the Senate Select Committee on Rural and Regional Affairs and Transport, page. 2

Service function	Stakeholder comments	QPC comments
	international raw sugar market (ICE No, 11). However growers have also had the choice to remain in a large collective pricing pool if that is their wish (as was the situation in the regulated environment). ¹⁴⁷	
Financing <ul style="list-style-type: none"> • QSL provides payment to millers on receipt of sugar at the bulk sugar terminal and is often in advance of sugar being sold, or being paid for by the customer. 	QSL is accessing its syndicated facility agreement to fund the industry's advances program. Wilmar exiting from QSL's marketing function lead to an immediate \$1 M increase in financing costs due to the necessity of using the syndicated debt facility. ¹⁴⁸	We note that QSL's submission to the AEC did not raise concerns about the impact of financing costs on the operation of the business.

We have not been able to identify any direct evidence that suggests QSL will not remain a viable entity beyond 1 July 2017, noting:

- its remaining mill customers are supportive of QSL and have not expressed concern over its ability to market their respective raw sugar despite a reduction in volume
- corollary functions such as financing and pricing will be buoyed by the retention of the marketing function (albeit if reduced)
- provision of logistics and port access, should STL retain this agreement, will continue to provide industry value.

As noted above, the remaining millers have yet to indicate if they will continue their relationship with QSL after 2017. Should the remaining mills choose alternate marketing agents, it's likely that QSL's service functions may be limited to the provision of logistics, and potentially provision of access to the bulk sugar terminals if:

- the threshold volumes have not been breached resulting in a sublease termination
- the sublease agreement can be renegotiated on different terms between QSL as a single operator and STL.

4.2.4 Option 1 – base case STL

Growers and QSL have indicated concerns that a move to miller marketing, and away from QSL marketing could give rise to STL ceasing to use its existing cost recovery model i.e. no returns included in current storage and handling provision services. Ultimately the pricing arrangements for STL will be an STL shareholder decision, with millers, growers and QSL as shareholders.

We also note there are already protections through the QCA Act and the CCA that would prevent misuse of monopoly power in restricting access to the service provided by these facilities.

4.2.5 Option 1 –economic base case

As the economic base case, we have assumed the following:

- Cane production, both pre and post 1 July 2017, is most likely to be influenced primarily by world sugar prices (as this flows through to cane prices under the cane price formula), inputs costs (such as electricity, water and fuel), and environmental conditions (such as favourable weather and crop quality). This is unlikely to change, post 1 July 2017, as net premiums appear unlikely to be significant enough to make any major impact on a decision to invest in cane production.

¹⁴⁷ Mackay Sugar (2014). Submission to the Senate Select Committee on Rural and Regional Affairs and Transport, page 3

¹⁴⁸ QSL Media Release "QSL Retracts Standard & Poor's Rating", Friday 4 July 2014 (<http://www.qsl.com.au/news-media/qsl-retracts-standard-poors-rating>)

- Raw sugar production is expected to be heavily influenced by cane production, the quality of the cane delivered to the mill, and the efficiency of the miller. A change of marketer is unlikely to have any discernible impact on raw sugar production. This is unlikely to change materially, post 1 July 2017.
- World raw sugar prices, both pre and post 1 July 2017, will continue to be set by the world market (predominantly the globally traded ICE No. 11).
- Net premiums currently move between a range of approximately plus or minus \$5 per net tonne. Average net premiums are presumed to be at least maintained under either QSL or an alternative marketer. Some millers may be able to achieve a higher net premium from alternative marketing of raw sugar.
- Investment in cane production (a new grower or a grower planning to expand cane production) will be influenced primarily by world sugar prices (as this flows through to cane prices under the cane price formula), inputs costs (such as electricity, water and fuel), and whether there is suitable cropping land available, close to a mill. A change of marketer post 1 July 2017 is considered unlikely to have any discernible impact on investment in cane production.
- Investment in mills, both pre and post 1 July 2017, is most likely influenced by forecast world sugar prices, input costs, the level of cane production within an appropriate radius of the prospective mill area, world sugar consumption and broader economic conditions.
- Employment in the sugar industry is estimated to be 16,000 people. Post 1 July 2017, no material change in employment is expected.

This is summarised below in **Table 10**.

Table 10 Base case assumptions for sugar industry

	<i>Pre 1 July 2017</i>	<i>Post 1 July 2017</i>
Cane production	Most likely influenced by forecast world sugar prices, input costs, and environmental conditions and mill availability.	Change of marketer is unlikely to change the influences of cane production.
Raw sugar production	Most likely influenced by cane production volumes and quality, mill availability and miller efficiency	Change of marketer likely to have minimal impact on raw sugar production
World raw sugar price (ICE No.11)	Set by world market	Set by world market
Net premiums	Average range of plus or minus \$5/net tonne raw sugar	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Some millers may be able to achieve a higher premium from alternative marketing.
Investment in cane production	Most likely influenced by forecast world sugar prices, input costs and availability of suitable cropping land	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land
Investment in mills	Most likely influenced by forecast world sugar prices, input costs, and cane production in mill area	Continue to be influenced by forecast world sugar prices, input costs, and cane production in mill area
Employment	Estimated 16,000	No material change in employment expected under any marketing changes

Questions

- 4.1 Have we correctly described the likely impacts on stakeholders under Option 1?
- 4.2 Is there any further information and evidence we should consider as part of the base case of no additional legislation?
- 4.3 Are there any returns to growers under the QSL model that are not provided to growers under the millers' proposed marketing models?

4.3 Option 2 – Sugar Industry (Real Choice in Marketing) Amendment Bill

4.3.1 Description

The explanatory notes, tabled with the Bill in May 2015 stated the policy objectives of the Bill were to provide cane growers with the right to have real choice in who sells and prices GEI sugar and addresses the imbalance of market power between mill owners and growers.

In July 2015, replacement explanatory notes were tabled, broadening the objectives as follows:

- to ensure a grower has a real choice in terms of nominating the marketing entity for on-supply of sugar in which they have an economic interest
- to facilitate a fair and final resolution of any commercial disputes that arise between a grower or bargaining representative and a mill owner including by arbitration.

Table 11 describes how the Bill would change the way parties do business if enacted.

Table 11 Impacts of the Amendment Bill on key stakeholders in the sugar industry

Stakeholder	Base Case	Bill
Growers	<p>CSA arrangements with millers. Title transfers on delivery of cane to mill.</p> <p>Growers paid for sugar on the terms set out in CSAs.</p> <p>Most CSAs include the Cane Price Formula which provides for a roughly 2:1 distribution between growers and millers.</p>	<p>A new section is proposed that outlines the mandatory terms that must be included in a contract between the growers and mill owner, including:</p> <ul style="list-style-type: none"> • terms establishing GEI in the proportion of raw sugar for which they have price exposure • growers provided a choice to nominate their preferred marketing entity for their GEI. <p>A new section is proposed which provides growers, or their representatives, the right to trigger a statutory arbitration process to resolve contractual and pre-contractual disagreements about supply contracts.</p>
Millers	<p>Millers contract with QSL for marketing of raw sugar.</p> <p>Some millers have commenced the purchase of raw sugar from QSL and commenced the marketing of raw sugar.</p>	<p>The Bill introduces statutory pre-contractual arbitration for growers to trigger in negotiation of supply contracts. Millers will not be able trigger the pre-contractual arbitration.</p> <p>See above section on mandatory terms that must be included in a supply contract between growers and miller.</p>
QSL	<p>QSL provides the following services:</p> <ul style="list-style-type: none"> • acquiring raw sugar intended for bulk export from Queensland millers under RSSAs • selling the raw sugar acquired to international customers • chartering shipping for the raw sugar 	<p>The Bill does not propose changes to the service functions performed by QSL</p>

Stakeholder	Base Case	Bill
	acquired <ul style="list-style-type: none"> financing and hedging activities related to raw sugar (with growers having a choice to use QSL or alternative arrangement) sub-leasing, operating and providing storage and handling services at STL. 	
STL	Terminals managed by QSL, based on a cost recovery only basis.	The Bill does not propose changes to the service functions performed by QSL

4.3.2 Option 2 legal impacts – interference with property rights

Millers have expressed concern that the Bill will have the effect of vesting the title to raw sugar in somebody other than the mill owner that produced it¹⁴⁹ due to the fact that millers may lose the right to determine where they market raw sugar.

For example millers note that provisions of the Bill will force a miller to enter into an agreement with a marketing body¹⁵⁰ and is thus inconsistent with the voluntary marketing arrangements that have existed since 2006.

Section 4 of the *Legislative Standards Act 1992* sets out the meaning of fundamental legislative principles and includes the following:

- does not adversely affect rights and liberties of individuals;¹⁵¹ and
- does not compulsorily acquire property unless there is fair compensation.¹⁵²

To the extent that the Bill limits the ability of the millers to sell any raw sugar to which it has legal title then the Bill interferes with the property rights of the millers.

One complexity which arises in the current circumstances is that it is not clear what the post 2017 contractual arrangements will look like. To the extent that the Bill only implies a new term into future contractual arrangements then it is arguable that there has not been an 'acquisition' of a previously held property right. This is because at the time that the contract would be entered into there would be an additional term required by legislation.

However, based on the information we have reviewed it is likely that future CSAs will still provide millers with legal title to the sugar cane. Assuming that, the Bill, if enacted, will have the effect of removing one of the legal rights attached to property.

4.3.3 Option 2 legal impacts – Singapore-Australia Free Trade Agreement (SAFTA)

Millers have expressed concern that aspects of the Bill may be in possible contravention of aspects of the SAFTA. Specifically, Wilmar's submission to us and the AEC, provided legal opinion that the Bill could be a possible contravention of Chapter 8 of the SAFTA:

as such, re-regulation of the Queensland sugar industry affect the ownership rights of millers over their manufactured product, could result in a need for effective and adequate compensation under the terms of the SAFTA.¹⁵³

¹⁴⁹ Agriculture and Environment Committee (2015), page 23

¹⁵⁰ Agriculture and Environment Committee (2015), page 23

¹⁵¹ Section 4(2)(a) of the *Legislative Standards Act 1992*.

¹⁵² Section 4(3)(i) of the *Legislative Standards Act 1992*.

¹⁵³ Wilmar (2015). Submission to Agriculture and Environment Committee, page 23

Wilmar's rights under the FTA

Chapter 8 of the FTA protects and promotes investments of investors of each country. Australia must provide certain protections to investments made by Singapore investors.

Article 11 prohibits expropriation or nationalisation without compensation. It provides:

"Neither Party shall nationalise, expropriate or subject to measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as "expropriation") the investments of investors of the other Party unless such a measure is taken on a non-discriminatory basis, for a public purpose, in accordance with due process of law, and upon payment of compensation in accordance with this Article."

In addition to this, Article 4 sets the minimum standard of treatment in customary international law which includes fair and equitable treatment and full protection and security.

We have set out our views on the key criteria below to determine whether the enactment of the Bill is likely to offend each of these provisions below.

Our initial view is that, on balance, Wilmar may not be able to demonstrate that the enactment of the Bill has resulted in a breach of the FTA because there has been no expropriation of its investment, nor has there been a breach of fair and equitable treatment. Having said that, Wilmar may still commence a claim against Australia if it believes that it has an arguable case under the FTA.

4.3.4 Option 2 legal impacts – authorisation of anti-competitive conduct under the CCA

Subsections 47(6) and (7) of the CCA prohibit third-line forcing. For example, s 47(6)(a) prohibits a corporation from supplying goods to a person on the condition that the person will acquire goods or service of a particular kind from another person. Conversely, s 47(7)(a) prohibits a corporation from refusing to supply goods to a person because the person has not agreed to acquire goods of a particular kind from another person. The Bill can be said to have the effect of a grower(s) supplying sugar cane to a miller on the condition that the miller acquires marketing services from a particular person (being the nominated marketer).

Another potential competition law issue would arise if the growers agreed amongst themselves that each of them would nominate the same marketer. This is because section 45 of the CCA prohibits a corporation from entering into a contract, arrangement or understanding which contains an exclusionary provision.

An 'exclusionary provision' is defined in section 4D of the CCA as an agreement, arrangement or understanding between competitors which contain a provision that has the purpose of preventing, restricting or limiting:

- (a) the supply of goods or services to, or the acquisition of goods or services from, particular persons or classes of persons; or
- (b) the supply of goods or services to, or the acquisition of goods or services from, particular persons or classes of persons in particular circumstances or on particular conditions;

by all or any of the parties to the contract.

It is at least arguable that the Bill is facilitating an agreement between the growers (some of whom are competitive with each other) which has the purpose of limiting the supply of sugar cane to millers in particular circumstances (that is, where the miller has not agreed to accept the nomination of the growers).

Exclusionary provisions are cartel conduct and are considered a serious breach of the CCA.

It is also a criminal offence under section 44ZZRF to make an agreement between competitors which has the purpose of limiting the supply of goods or services to a third party. It is also arguable that the

Bill is facilitating conduct which would otherwise be in breach of this provision. [This provision has criminal consequences including jail terms for parties to the agreement.]

Finally, section 45 prohibits contracts, arrangements or understandings which have the purpose or effect of substantially lessening competition. A collective agreement between growers which forces a miller to acquire marketing services from a nominated marketer is likely to substantially lessen competition if the agreement is between a significant number of the growers. For example, if all of the growers agreed that all (or a significant proportion) of raw sugar should be marketed by the same entity then this is likely to prevent a new entrant into the market for the marketing of raw sugar. When there is only one market participant, the raising of barriers to entry so that no other person is likely to enter the market, is likely to have at least the effect of substantially lessening competition.

Section 51(1)(b) states that in deciding whether a person has contravened Part IV, anything done in a State that is specifically authorised by a State Act must be disregarded. The same provision of the Competition Code is to the same effect. In reliance on both the CCA and Competition Code provisions, clause 8 of the Bill would insert a new section 238 which would authorise things to be done in relation to supply contracts under proposed section 33B.

As set out in Section 41.1. use of a legislation exemption under section 51 of the CCA must be supported by evidence that there is a clear public benefit and that are no other ways the policy objective can be achieved. Without this justification, a regulation may be overturned by the Commonwealth Government and there is nothing to prevent the ACCC taking action against any parties that may engage in anti-competitive conduct in complying with legislation.

A public benefit assessment of the net benefits of authorising the proposed anti-competitive conduct was not undertaken prior to introduction of the Bill.

4.3.5 Option 2 legal impacts – pre-contractual arbitration

Pre-contractual dispute arbitration could provide growers with added protection against misuse of market power during negotiations of cane supply agreements. It helps to redress any imbalance in market power by resolving deadlocks during negotiations.

However, the degree of benefit to be gained will depend on the extent of the misuse of market power. Given our conclusion that there is currently no evidence of an abuse of market power occurring in Queensland in the sugar industry, we consider it is likely that the benefits of pre-contract arbitration, over and above the existing mediation arrangements, are likely to be modest.

However, it is likely that canegrowers and millers would face additional financial and time costs associated with arbitration disputes. Given the evident lack of trust between the parties, numerous disputes are possible, especially if growers pursue individual cases.

We have taken into consideration that disputes could be related to the distribution of net premiums. However as previous studies (undertaken pre-deregulation) indicate arbitration may impact on costs and productivity and so could have a negative impact on the overall size of returns to all industry stakeholders (especially given there will be no capacity to influence the world sugar price).

We note that arbitration cases can be costly to administer. We understand that an arbitration process has an average time frame of between twelve and eighteen months and the likely legal costs for each party could be in the range of \$1.2 million and \$1.5 million (not taking into account discounted rates).

This assumes that the parties would appoint only one arbitrator and that the *Commercial Arbitration Act 2013* would apply. If the growers commence the arbitration as a group, similar to the concept of a class action, and they are represented by the same lawyer. The estimate may be higher if the applicants have slightly different individual positions which would need to be considered. Unless

there is already an arbitration agreement in place, the parties could agree upon a fast tracked timetable, which would on average be around nine months.

We note that in the telecommunications industry a negotiate/arbitrate process was adopted by Parliament and then abandoned. The reasons for abandonment included: the extensive amount of arbitrations which were being run by the owner, Telstra, the processes were time consuming (sometimes taking years), in the later years, judicial review had been sought in respect of almost all final arbitration determinations made by the ACCC and there were multiple steps at which procedural matters could be challenged.

The Hildebrand report (2002) considered pre-contract negotiations and noted that:

... time spent in aggressive conflict between co-dependent parties as sheer waste.

Overall, we consider that the potential benefits of pre-contractual arbitration are likely to be outweighed by the costs.

We consider that if there was an abuse of market power in the future, there are a number of existing regulatory options available to growers. For example, it is clear that the unconscionable conduct provisions of the CCA apply to circumstances of business-to-business contracts and section 46 of the CCA prohibits an abuse of market power. However, if in the future significant evidence emerged of abuse of market power the adequacy of the available dispute resolution process would need to be reassessed.

4.3.6 Option 2 economic impacts – millers

The Bill introduces sovereign risk for millers to the extent that it has the effect of removing one of the millers' rights to property for the raw sugar it produces that is currently conferred by way of a contractual agreement.

It is impossible to estimate the economic impact that this sort of change would have on miller investment, including future confidence to invest in Queensland. Queensland would be considered a safe, stable economy in which to invest as evidenced by the increase in investment since deregulation. Given the three largest millers have a global presence, we consider that a legislative change in this way would make Queensland a less desirable investment destination, compared with other jurisdictions.

Should the Bill proceed, we would expect to see a reduction in mill investments (including mill improvements), relative to the base case. It would be reasonable to assume that in a capital constrained environment these companies would move capital into other parts of their firms particularly if they had the capacity to control all other aspects of their supply chain.

There are some millers who consider they will be able to get a better financial outcome than QSL, and with the operation of the Bill may lose this ability. Wilmar has estimated the potential loss of value at being \$46 million per annum above the returns currently achieved from the export of raw sugar.¹⁵⁴ We note that some of this additional value is attributable to changing trading behaviour in the world sugar price and would be able to be captured if the Bill is enacted.

It is difficult to predict what the marketing behaviour of millers and marketers would be if the Bill is enacted. If these potential benefits of marketing are as Wilmar suggests, it would be anticipated that millers would still have an incentive to compete for market share. However, making marketing choice available to growers (as opposed to marketing choice for millers) would not be costless. Having marketers compete for the business of 4,000 cane producers would increase marketing costs of attracting and retaining customers, and combined with higher transaction costs, would be costly.

¹⁵⁴ Wilmar (2015) Submission to Queensland Productivity Commission, page 22

To the extent that premiums are still capped by global factors, at least some of the additional benefits of having growers choose a marketer could be offset by higher costs to manage the system, and depending on grower and marketer behaviour, the sugar industry could be worse-off.

4.3.7 Option 2 economic impacts – growers

Growers in their submissions to both QPC and AEC have largely expressed support for being provided the choice to nominate their preferred marketing entity for GEI, as expressed in the Bill.

While growers would consider the choice of marketer as a benefit, there is the potential scenario that their preferred marketing entity may not maximise the amount received from a miller's raw sugar production. While we have estimated the value of average net premiums to growers at around \$14 million per annum, any additional premiums are likely to be considered important to smaller cane farming operations.

There is a potential opportunity cost of growers receiving a lower premium than what could be achieved by the miller choosing the form of marketing.

In section 3.7 we noted that transparent information on marketing risks, costs and premiums assists growers making an informed decision on choice of marketing entity.¹⁵⁵

4.3.8 Option 2 economic impacts – QSL

Implementation of the Bill would result in QSL gaining the opportunity to compete in the market for the grower's economic interest. The addition of more marketing volume would act to reduce the risk that QSL has reached a 'critical mass' as coined by Tully Sugar, wherein it no longer enjoys economies of scale in its financing and potentially pricing and price risk management functions.

Additional marketing volume may also lend leverage to QSL that it retains its sublease with STL as it will be less likely to breach the volume threshold wherein STL can consider termination.

4.3.9 Option 2 economic impacts – STL

STL has a number of options including:

- continuing to engage QSL to manage the terminals under the sublease
- operating the terminals itself – achieved by purchasing equipment from QSL and employing QSL's terminal employees. Alternatively, STL could engage another terminal operator
- individual terminals could be sold or subleased to milling companies.

It is difficult to determine the particular impacts on STL, as the potential composition of marketers of raw sugar is unknown.

4.3.10 Option 2 – economic impacts for sugar industry

The likely impacts of the Bill on the sugar industry are set out below. As discussed earlier, the largest impact is likely to be on future milling investment as it would be anticipated that the Bill would reduce future incentives for investment.

¹⁵⁵ Under the Bill, all prospective marketing entities, including QSL, would need to provide this information to growers to ensure that premiums were not reduced.

Table 12 Summary of impacts of the Bill

	<i>Option 1 - Base Case — Do nothing (Post 1 July 2017)</i>	<i>Option 2 — Bill</i>
Cane production	Change of marketer is unlikely to change the influences of cane production.	Change of marketer is unlikely to change the influences of cane production.
Raw sugar production	Change of marketer likely to have minimal impact on raw sugar production in the short term. May increase production longer term if marketing improvements if yields higher return.	Perceptions of sovereign risk may lower mill investment leading to lower mill availability and raw sugar production.
World raw sugar price (ICE No.11)	Set by world market	Set by world market
Net premiums	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Some millers may be able to achieve a higher premium from alternative marketing.	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Some millers may be able to achieve a higher premium from alternative marketing.
Investment in cane production	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land
Investment in mills	Influenced by forecast world sugar prices, input costs, and cane production in mill area	May result in reduction in mill investment if millers perceive better returns on capital from other parts of international businesses.
Employment	No material change in employment expected	Potential reduction if reduced mill investment

Questions

- 4.4 Have we correctly described the likely impacts on stakeholders under Option 2?
- 4.5 Is there any further information and evidence we should consider as part of our impact assessment of Option 2?

4.4 Option 3 –Code of Conduct

An alternative to legislative change to the SIA, would be the implementation of a Code of Conduct. Two alternatives have been proposed:

- Sugar Industry Code of Conduct Regulation¹⁵⁶; or
- Mandatory Code of Conduct – under Section 51AE of the CCA. Mandatory codes set out the responsibilities and expectations of participants in a market through a set of principles or guidelines.

Mandatory codes can be more efficient than legislation and may improve the public image of an industry. Mandatory codes prescribed under the CCA, do not require additional legislation to develop. There are mandatory codes in place for Horticulture, Bulk Wheat Port Terminals, Franchising, Fuel and Unit Pricing.

The Burdekin District Cane Growers Ltd has provided detailed drafting for a Sugar Industry Code of Conduct, and as discussed in Section 2.5, the Senate recommended the development of a mandatory industry code, and the Australian Government’s Sugar Industry Code of Conduct Taskforce subsequently indicated a number of matters that could be included in a Code.

The Sugar Industry Code of Conduct, and the Mandatory Code include:

¹⁵⁶ Burdekin District Cane Growers Ltd (2014). Submission to Agriculture and Environment Committee – Appendix 2

- a mechanism to distribute relevant interests in the quantities of sugar obtained from cane between growers and millers
- a link between the price paid for cane and the selling price of sugar
- the ability to choose marketing services
- non-discriminatory provisions
- a mechanism to resolve disputes – the Sugar Industry Code of Conduct proposes both mediation and pre-contract arbitration.

In practice, a Sugar Industry Code of Conduct or Mandatory Code of Conduct could include any number of matters to provide a framework for the negotiation between stakeholders. However, in this circumstance, we have assumed that the provisions in the Sugar Industry Code of Conduct would be applied.

While the legal mechanisms for implementation of the Code(s) are different, the practical effect of the Sugar Industry Code of Conduct is essentially the same as the Bill. For this RIS, we have assessed the legal and economic impacts of a Code of Conduct to be similar to those presented for the Bill (see Section 4.3).

In comparison to the passage of a Bill, we note that a Mandatory Code of Conduct is likely to result in larger initial costs to industry to develop. However over the longer term a mandatory code is likely to be less costly to adopt and administer than legislation as well as being easier to amend in the event of unforeseen circumstances. A mandatory code under the CCA would also see the ACCC acting as an arbitrator in any dispute resolution cases that arise.

The impacts of a mandatory code of conduct are summarised in **Table 13**.

Table 13: Impacts of code of conduct

	<i>Option 1 - Base Case — Do nothing (Post 1 July 2017)</i>	<i>Option 3 — Code of Conduct</i>
Cane production	Change of marketer is unlikely to change the influences of cane production.	Change of marketer is unlikely to change the influences of cane production.
Raw sugar production	Change of marketer likely to have minimal impact on raw sugar production in the short term. May increase production longer term if marketing improvements if yields higher return.	Perceptions of sovereign risk may lower mill investment leading to lower mill availability and raw sugar production.
World raw sugar price (ICE No.11)	Set by world market	Set by world market
Net premiums	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Some millers may be able to achieve a higher premium from alternative marketing.	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Some millers may be able to achieve a higher premium from alternative marketing.
Investment in cane production	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land
Investment in mills	Influenced by forecast world sugar prices, input costs, and cane production in mill area	May result in reduction in mill investment if millers perceive better returns on capital from other parts of international businesses.
Employment	No material change in employment expected	Potential reduction if reduced mill investment

Questions

- 4.6 Have we correctly described the likely impacts on stakeholders under Option 3?
- 4.7 Is there any further information and evidence we should consider as part of our impact assessment of Option 3?

4.5 Option 4 – Tolling agreement between growers and millers

Option 4 is for growers to contract with millers for toll crushing services, where growers would take ownership of all raw sugar and pay millers for the full cost of crushing services and have full control of the marketing of raw sugar products.

To protect against the potential abuse of market power, QSL has suggested the following options to allow for a regulatory body to set the toll crushing prices:

- amend the third party access regime under Part 5 of the *Queensland Competition Authority Act 1997* and Part IIIA of the CCA.
- provide for a specific access regime in the SIA.

QSL noted the intent of its proposed alternatives is to ensure that the terms of access to the crushing services of the mills (and related transport and logistics services) – which are in a monopoly position – can be regulated.¹⁵⁷

4.5.1 Option 4 legal impacts – no impediments to negotiating a commercial agreement

In Chapter 3, we noted there are no legislative or regulatory impediments to parties negotiating a toll crushing agreement. However, a toll crushing arrangement would change the relationship between growers and millers and the contractual arrangements would need to change to reflect the different risk and pricing arrangements.

4.5.2 Option 4 legal impacts – declaration of mills for third party access not an option under existing legislation

We note that QSL has proposed declaring the mills, in order to provide third party access to the ‘cane crushing services’. Under section 72(2)(b) the QCA Act – Meaning of a service – a service does not include:

...the use of intellectual property of intellectual property or a production process (except to the extent that the use is an integral, but subsidiary, part of the service.

We consider ‘cane crushing’ to be a production process, which falls outside the long established definition of a service eligible for declaration under the QCA Act. Similarly, under the CCA definitions, ‘service’ means a service provided by a facility, but does not include the supply of goods, or the use of intellectual property, or the use of a production process (except to the extent that it is an integral but subsidiary part of the service).

Amendment to these acts to allow for processing process to be regulated would represent a major move away from the established third party access arrangements.

¹⁵⁷ QSL (2014) Submission to Senate Rural and Regional Affairs and Transport Committee, page 29

4.5.3 Option 4 economic impacts – millers

The introduction of a tolling arrangement would likely lead to millers negotiating a charge to growers on a per tonne of cane basis, to cover the operating cost of processing and a commercial return on the assets employed in crushing.

We note Wilmar's position that a commercial tolling arrangement may see the costs to growers increase.¹⁵⁸ We have not undertaken a regulatory analysis of the numbers presented by Wilmar, however, it is not an unreasonable assumption that the costs borne by growers would increase. Specifically, a tolling price would be expected to remain stable from year to year, as millers would neither receive the upside returns from high sugar prices or the downside risks and would need to earn returns solely from crushing activities.

Current or prospective mill owners are also likely to consider the amount of tolling charges received from growers in determining whether to invest in new and existing mill infrastructure. If these charges are not sufficient to earn a commercial return, this could reduce mill investment. This may limit increases in raw sugar production and mill innovation. On the other hand, well designed contractual arrangements could continue to provide mill owners with the incentive to innovate.

While we have noted that the existing State and Commonwealth third party access arrangements would not capture mill production, we also consider that the co-dependent relationship between millers and growers would provide a natural limit on the prices that could be charged for crushing.

4.5.4 Option 4 economic impacts – growers

Option 4 would see growers take on all price, marketing and cost risks, including the costs of toll crushing. Growers would continue to have the revenues set through world prices, so any gains to growers would need to come from improving marketing premiums relative to those earned by the existing marketing arrangements or reducing costs of production across the raw sugar supply chain.

A toll crushing arrangement would see a move away from the Cane Price Formula and require the negotiation of a cost contract with each of the mills involved – and potentially means 21 separate arrangements and cost arrangements.

We would expect the implementation costs for new toll crushing arrangements to be high, given the need to agree efficient operating and maintenance costs, assets values and returns. There are well established methods for establishing these estimates, however, it is noted that where they are regulated it can be a costly and time consuming process to have stakeholders agree what is the efficient base.

Option 4 is likely to impose significantly higher transaction costs than either the existing arrangements or the Bill/Code options and require either new intermediaries to manage the supply chain or growers to become more actively involved in the management of all aspects of their supply chains.

4.5.5 Option 4 economic impacts – QSL

The introduction of a tolling arrangement would likely see QSL continue to have an opportunity to compete in the market for raw sugar. There is the potential that QSL would gain additional marketing volume compared to the base case provided it is able to offer an attractive marketing product compared to alternative marketers. QSL may also take on a more active supply chain management role, although this would need to be a commercial decision of the growers.

¹⁵⁸ Wilmar (2015) Submission to Queensland Productivity Commission, pages 26-27

The addition of more marketing volume would act to reduce the risk that QSL had reached a ‘critical mass’ as coined by Tully Sugar, wherein it no longer enjoys economies of scale in its financing and potentially pricing and price risk management functions.

Additional marketing volume may also lend leverage to QSL that it retains its sublease with STL as it will be less likely to breach the volume threshold wherein STL can consider termination.

4.5.6 Option 4 economic impacts – STL

Terminals are currently managed by QSL under a cost recovery only basis. Under a tolling arrangement, QSL could still negotiate with STL for the sub-leasing and operating of terminals.

Other options are available to STL however including the operating the terminals itself or engaging an alternative terminal operator (marketing entity or otherwise).

4.5.7 Option 4 economic impacts – sugar industry production assumptions

Our assumptions on the economic implications of Option 4 are set out in **Table 14**.

Table 14: Impacts on sugar industry production under tolling option

	<i>Option 1 - Base Case — Do nothing (Post 1 July 2017)</i>	<i>Option 4 — Tolling</i>
Cane production	Influenced by forecast of world sugar prices, input costs and environmental conditions and mill availability.	Influenced by forecast of world sugar prices, input costs and environmental conditions and mill availability.
Raw sugar production	May increase production longer term if miller marketing improvements prove to yield consistently higher return, noting that this is still a small proportion of the final price.	Raw sugar production unlikely to change unless the tolling arrangements lead to a reduction in mill investment relative to the existing model where millers make the commercial decision to invest.
World raw sugar price (ICE No.11)	Set by world market	Set by world market
Net premiums	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Some millers may be able to achieve a higher premium from alternative marketing.	Average net premiums are presumed to be at least maintained under either QSL or alternative marketer. Millers may exit marketing sugar, which would reduce competition in marketing.
Investment in cane production	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land	Continue to be influenced by forecast world sugar prices, input costs and availability of suitable cropping land Returns to cane production are likely to be more volatile from year to year as cane crushing costs would be largely fixed (although linked to the volume of production) and sector would face higher transaction costs.
Investment in mills	Influenced by forecast world sugar prices, input costs, and cane production in mill area.	The level of mill investment would depend on the commercial terms negotiated with growers.
Employment	No material change in employment expected	Potential reduction if reduced mill investment

Questions

- 4.8 Have we correctly described the likely impacts on stakeholders under Option 4?
- 4.9 Is there any further information and evidence we should consider as part of our impact assessment of Option 4?

5 CONSULTATION



Public consultation is a critical part of any regulatory development process. In line with regulatory best practice principles, there should be effective consultation with affected key stakeholders at all stages of the regulatory cycle.

In Queensland, the development of a RIS is a two stage process, consisting of a:

- Consultation RIS – is a draft RIS publicly released to provide interested stakeholders with information to allow informed debate
- Decision RIS – which considers the submissions received during consultation and is designed to inform and recommend a final policy decision.

In developing this RIS, we called for initial submissions from stakeholders. Submissions from ten organisations were received as part of this process.

We have also taken into account the information provided by stakeholders as part of recent inquiries into these matters by both the Queensland Parliament Agriculture and Environment Committee and the Australian Senate's Regional and Rural Affairs and Transport References Committee.

Due to the urgency attached to inform the Queensland Parliament's consideration of the Bill, submissions to the Consultation RIS will close on **13 November 2015**. We will also be happy to meet with stakeholders within this consultation period to discuss any of the issues raised further.

These submissions will be published on our website and be considered in the development of a Decision RIS. We will provide the completed Decision RIS to the Government by **25 November 2015**.

6 SUMMARY OF IMPACTS AND PREFERRED OPTION



Good practice regulation would suggest that the regulatory option that provides the greatest net benefit to the community overall, including the consideration of the option of no additional intervention, should be implemented. Further, if regulation restricts competition or authorises anti-competitive conduct, it must be demonstrated that:

- *the benefits of the restriction as a whole outweigh the costs; and*
- *the objectives of the legislation can only be achieved by restricting competition.*

Use of a legislation exemption under section 51 of the CCA must be supported by evidence that there is a clear public benefit and that there are no other ways the policy objective can be achieved. Without this justification, a regulation may be overturned by the Commonwealth Government. Clause 8 of the Bill specifically authorises anti-competitive conduct. A statutory authorisation is necessary to prevent the ACCC taking action against any parties that may engage in anti-competitive conduct in complying with legislation.

Our conclusions on the net benefits of the options that would meet the objectives of the Bill are set out below.

6.1 Summary of impacts and assessment of net benefits

In **Attachment 1**, we have provided an assessment of the likely impacts of each option considered on growers, millers, QSL, STL.

6.1.1 Option 1 – Base case – no additional legislation

For the Consultation RIS, the base case is to make no additional changes to the SIA, with protections from anti-competitive behaviour included in the CCA. In Chapter 3, we concluded that there was no evidence of market failure in the Queensland sugar industry, having specifically considered the appropriate recognition of property rights, market power and the potential abuse of market power by mill owners, and whether growers and millers have sufficient transparency about pricing and premiums to provide for balanced negotiations.

We have concluded that the regulatory arrangements for the Queensland sugar industry should be able to meet the objectives of:

- ensuring a pricing framework where there is an appropriate balance of risk and reward between growers and millers
- ensuring there are appropriate protections for growers and millers to prevent against the abuse of market power
- ensuring a regulatory framework that supports investment and innovation in the sugar industry and supports the long-term economic sustainability of the sugar industry.

There is evidence the existing regulatory framework has supported investment in the Queensland sugar industry, including investment to improve mill availability. It also supports the development of new models of marketing export raw sugar, as was envisaged prior to deregulation.

The most likely impact of the no change scenario is that growers and millers will be no worse off, and with some millers pursuing models that could increase the returns to the sector. To the extent that these improvements increase raw sugar production and/or increase net premiums these benefits are generally distributed to growers on a 2:1 ratio, consistent with the Cane Price Formula.

While concern has been raised about QSL's potential viability by some growers, this has not been raised by the millers who have indicated they will remain with QSL for the 2017 season. These millers have not supported a change to the existing arrangements. STL would continue to provide bulk storage facilities, although we note that STL has not formed a view on the future arrangements that would apply.

Given our conclusion that there is no evidence of market failure that would indicate a need for additional regulation, our draft conclusion for the Consultation RIS is that retaining the existing regulatory framework — with no additional regulation — will provide the greatest net benefit to Queensland.

6.1.2 Option 2 - Regulation as proposed by the Bill

The Bill's objectives are:

- to ensure a grower has a real choice in terms of nominating the marketing entity for on-supply of sugar in which they have an economic interest
- to facilitate a fair and final resolution of any commercial disputes that arise between a grower or bargaining representative and a mill owner including by arbitration.

The Bill's stated intent is to prevent anti-competitive behaviour and promote pro-competitive outcomes and to ensure economic viability for both growers and mill owners, among others, in the Queensland sugar industry.

Our assessment is that the Bill has a number of legal and economic impacts that would mean that any benefits from offering grower (rather than miller) choice of market, are outweighed by the cost. Specifically, the Bill

- interferes with the property rights of millers, assuming the existing structure of CSAs is retained. This is likely to reduce the profitability of future sugar mill investment and dampen longer term innovation and productivity compared to no additional regulation
- could reduce the overall returns to the sugar industry. The larger millers have made commercial decisions that they can improve financial outcomes by marketing export raw sugar – the remaining millers have made the commercial decision to market export raw sugar through QSL. There is nothing to suggest that millers – with a commercial incentive to improve returns from their production of raw sugar are not well equipped to make this decision. Further, to the extent that returns are distributed to growers – it is difficult to see how growers are disadvantaged and the proposals by MSF and Wilmar seem to have sufficient transparency that if a disadvantage were to arise, it would be identifiable to the growers
- could reduce the returns to the industry by adding extra costs. Marketers would need to compete for the business of 4,000 cane producers with costs to attract and retain customers and additional transaction costs. As marketing premiums are still capped by global factors, it is possible that any additional competitive benefits of having growers choose a marketer could be offset by higher costs

- re-introduction of pre-contract arbitration may lead to both financial (legal) and time loss costs for the industry. Legal costs for an average arbitration are estimated to range between \$1.2 and \$1.5 million per dispute, with the time to resolve disputes estimated at 12 – 18 months, with a ‘fast track’ of 9 months. It is not clear that pre-contract arbitration adds additional benefits above the mediation arrangements
- could leave parties exposed to action by the ACCC, if the Australian Government does not accept that there is a net benefit from the authorisation of anti-competitive conduct included in the Bill. Clause 8 of the Bill would authorise some additional anti-competitive behaviour. If the Queensland Parliament legislates for a restriction on competition, it must advise the ACCC within 30 days. The Australian Government can disallow the authorisation if the benefits of the anti-competitive conduct do not outweigh the costs. A cost benefit assessment was not completed prior to introduction of the Bill and there is the risk if the Australian Government is not satisfied by the public benefit justification that parties engaged in anti-competitive conduct would not have the protection of an authorisation.

From an economic perspective, relative to the base case, we have assumed that average premiums are at least maintained comparative to the pre 1 July 2017 case.

The economic analysis indicates the Bill is unlikely to have material impacts on most parts of the sugar industry in Queensland — the notable exception being investment in the milling sector. The impact on property rights implied in the Bill introduces sovereign risk into the sector. We consider this will make Queensland a less attractive investment than alternative options, particularly for companies with the option to invest across a range of countries and agri-businesses.

We consider the potential benefits of the Bill to growers are marginal at best in comparison to the costs and risks that would be faced by millers and the industry from potential loss of future investment. It is also not apparent that policy objectives implied by the Bill cannot be achieved without additional legislation, particularly legislation that includes the authorisation of anti-competitive conduct under the CCA.

Our draft conclusion for the Consultation RIS is that potential benefits that may accrue from passage of the Bill, are outweighed by the potential costs and risks.

6.1.3 Option 3 - Code of Conduct

We have considered the option of a code, as described by the Sugar Industry Code of Conduct Regulation proposed by the Burdekin and the Sugar Industry Mandatory Code of Conduct Taskforce. A code can be developed by the industry under section 51AD of the CCA. We consider that economic impacts of a code of conduct would be of a similar to the Bill, depending on the matters included in the Code. Our draft conclusion for the Consultation RIS is that potential benefits from a Code of Conduct are outweighed by the potential costs and risk.

6.1.4 Option 4 - Tolling arrangement

A tolling arrangement, where growers take ownership of all raw sugar and pay millers for the full cost of crushing services and have full control of the marketing of raw sugar products would represent the change for the sugar industry. It would mean that growers take on all price, marketing and cost risk (including for crushing).

There is nothing to prevent a tolling arrangement being negotiated between millers and growers (noting our view that neither the QCA Act nor CCA allow for third party access regulation). However, negotiation of new arrangements would be costly. Growers and millers would need to agree the efficient costs of operating and maintain mills, the value of mill assets, the return on mill assets and a framework for investment in mill assets. This would require all parties to co-operate in the development of what would be, a very different model of sugar production in Queensland.

Moving to a tolling arrangement would need to be achieved by commercial agreement amongst the parties. Our draft conclusion for the Consultation RIS is that potential benefits from implementation of a tolling arrangement would need to be carefully considered against the additional costs and risks of negotiating new arrangements.

6.2 Conclusion

Our draft conclusion is that the case for additional regulation of the Queensland sugar industry, at this point in time, has not been established.

While there is an evident lack of trust between certain parts of the sugar industry we do not consider there is evidence of market failure, or that the existing legislative framework means that issues cannot be resolved through commercial negotiations.

We consider that retaining the existing regulatory framework, with no additional regulation, will provide the greatest net benefit to Queensland, and that there are sufficient protections already in place to protect against misuse of market power.

However, if there was a change in circumstances, particular evidence of market failure, including abuse of market power, this conclusion would need to be reviewed.

GLOSSARY

A

AEC	Agriculture and Environment Committee
ACFA	Australian Cane Farmer's Association
ASMC	Australian Sugar Milling Council

B

BSL	Bundaberg Sugar Limited
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C

CCA	Competition and Consumer Act 2010
CCS	Commercial Cane Sugar
CSA	Cane Sugar Agreements

F

FMIS	Forestry Management Investment Schemes
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G

GEI	Growers Economic Interest
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I

ICSM	Isis Central Sugar Milling Company Ltd.
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M

MEI	Millers Economic Interest
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Q

QSC	Queensland Sugar Corporation
QSL	Queensland Sugar Limited

R

RIS	Regulatory Impact Statement
RSSA	Raw Sugar Supply Agreement

S

SIA	Sugar Industry Act
STL	Sugar Terminals Limited

APPENDIX A: SUMMARY IMPACT TABLES

	Option 1 - Base Case		Option 2 - Bill	Option 3 - Mandatory Code	Option 4 - Tolling
	Pre 1 July 2017	Post 1 July 2017	(compared to post 1 July 2017 base case)		
<i>Growers</i>					
Supply agreements	CSA with millers. Most CSAs include the Cane Price Formula which provides for a roughly 2:1 distribution between growers and millers.	CSA with millers. Most CSAs include the Cane Price Formula which provides for a roughly 2:1 distribution between growers and millers.	CSA with millers. Most CSAs include the Cane Price Formula which provides for a roughly 2:1 distribution between growers and millers.	CSA with millers. Most CSAs include the Cane Price Formula which provides for a roughly 2:1 distribution between growers and millers.	Growers negotiate processing agreements with millers and retain title through the production process.
Management raw sugar price exposure	Growers have ability to manage 99% of price exposure through pools offered by QSL or third party.	Growers have ability to manage 99% of price exposure through pools offered by QSL or third party.	Growers have ability to manage 99% of price exposure through pools offered by QSL or third party.	Growers have ability to manage 99% of price exposure through pools offered by QSL or third party.	Growers have ability to manage 99% of price exposure through pools offered by QSL or third party.
Title	Title transfers on delivery of cane to mill.	Title transfers on delivery of cane to mill, unless growers and millers negotiate alternative agreement.	Title transfers on delivery of cane to mill. Growers provided a choice to nominate their preferred marketing entity for GEI. This has similar effect to providing legal title as growers control extends beyond delivery.	Title transfers on delivery of cane to mill. Growers provided a choice to nominate their preferred marketing entity for GEI. This has similar effect to providing legal title as growers control extends beyond delivery.	Growers retain title through the production process.
Net premiums	Net premiums earned through QSL shared pools	Net premiums earned through miller marketer, QSL or alternative market (at commercial decision of miller)	Net premiums earned through miller marketer, QSL or alternative market (at commercial decision of grower)	Net premiums earned through miller marketer, QSL or alternative market (at commercial decision of grower)	Net premiums earned through QSL or alternative market (at commercial decision of grower)
		Potential for increase in net premiums for distribution to growers.	Potential for increase in net premiums for distribution to growers. Likely higher transaction costs.	Potential for increase in net premiums for distribution to growers. Likely higher transaction costs	Potential for increase in net premiums for distribution to growers. Likely higher transaction costs
Arbitration			Ability to trigger both contractual and pre-contractual arbitration. Arbitration may provide benefits but increase legal and time costs. Legal costs estimated to range between \$1.2 M and \$1.5 M per dispute. Time to resolve dispute estimated at 12 – 18 months, with a 'fast track' of 9 months.	Ability to trigger both contractual and pre-contractual arbitration. Arbitration may provide benefits but increase legal and time costs. Legal costs estimated to range between \$1.2 M and \$1.5 M per dispute. Time to resolve dispute estimated at 12 – 18 months, with a 'fast track' of 9 months.	

Costs to implement				Cost to design and operate under Code	
<i>Millers</i>					
Marketing arrangements	Millers make the commercial decision to market the raw sugar they produce themselves, or enter into a market agreement with alternative marketer (which may include QSL or another marketer(s). Most millers contract with QSL for marketing of export raw sugar under RSSAs	Millers make the commercial decision to market the raw sugar they produce themselves, or enter into a market agreement with alternative marketer (which may include QSL or another marketer(s). Wilmar, MSF and Tully Sugar have announced they will manage their own marketing of raw sugar exports. ISMC, Mackay Sugar Limited and Bundaberg Sugar Limited have indicated they will remain with QSL for the 2017 season.			
Legal title	Title to raw sugar passes to QSL under RSSAs.	Title to raw sugar retained by millers marketing themselves Title to raw sugar passes to QSL under RSSAs for relevant millers	Millers would be required to enter into contracts to supply marketers with raw sugar as nominated by growers.		
		Millers make the commercial decision to market the raw sugar they produce themselves, or enter into a market agreement with alternative marketer (which may include QSL or another marketer(s). Wilmar has announced plans to market raw sugar directly. MSF and Tully have yet to indicate an alternative marketer. ISMC, Mackay Sugar Limited and Bundaberg Sugar Limited have indicated they will remain with QSL for the 2017 season.	Potentially interferes with property rights under future CSAs (if miller holds legal title) Potential costs to administer and facilitate grower’s choice in preferred marketing entity for GEI May result in reduction in mill investment Opportunity cost of potentially lower premiums Both contractual and pre-contractual arbitration, which cannot be triggered by a mill. Arbitration may lead to both financial (legal) and time costs. Legal costs estimated to range between \$1.2 M and \$1.5 M per dispute. Time to resolve dispute estimated at 12 – 18 months, with a	Costs to design and operate under Code. If Code is poorly implemented, further costs could be incurred. Potentially interferes with property rights under future CSAs (if miller holds legal title) Potential costs to administer and facilitate grower’s choice in preferred marketing entity for GEI May result in reduction in mill investment Opportunity cost of potentially lower premiums A mechanism to resolve disputes. Arbitration may lead to both financial (legal) and time costs. Legal costs estimated to range between \$1.2 M and \$1.5 M per	

			'fast track' of 9 months.	dispute. Time to resolve dispute estimated at 12 – 18 months, with a 'fast track' of 9 months. ACCC as mediator may reduce costs.	
<i>QSL</i>					
QSL services	<p>QSL provides the following services:</p> <ul style="list-style-type: none"> acquiring raw sugar intended for bulk export from Queensland millers under RSSAs selling the raw sugar acquired to international customers chartering shipping for the raw sugar acquired financing and hedging activities related to raw sugar (with growers having a choice to use QSL or alternative arrangement) sub-leasing, operating and providing storage and handling services at STL 	<p>QSL would continue to provide the following services:</p> <ul style="list-style-type: none"> acquiring raw sugar intended for bulk export from the three millers for the 2017 season selling the raw sugar acquired to international customers chartering shipping for the raw sugar acquired financing and hedging activities related to raw sugar (with growers having a choice to use QSL or alternative arrangement) sub-leasing, operating and providing storage and handling services at STL 	<p>Potential increase in supply (compared to post 1 July 2017 base case) depending on growers nominating QSL as preferred marketing entity.</p>	<p>Potential increase in supply (compared to post 1 July 2017 base case) depending on growers nominating QSL as preferred marketing entity.</p>	<p>Likely QSL provides the following services:</p> <ul style="list-style-type: none"> acquiring raw sugar intended for bulk export from Queensland growers under RSSAs selling the raw sugar acquired to international customers chartering shipping for the raw sugar acquired financing and hedging activities related to raw sugar (with growers having a choice to use QSL or alternative arrangement) sub-leasing, operating and providing storage and handling services at STL
<i>STL</i>					
Terminal management	<p>Terminals managed by QSL, based on a cost recovery only basis.</p>	<p>STL has a number of options including:</p> <ul style="list-style-type: none"> continuing to engage QSL to manage the terminals under the sublease operating the terminals itself – achieved by purchasing equipment from QSL and employing QSL's terminal employees. Alternatively, STL could engage another terminal operator individual terminals could be sold or subleased to milling companies 	<p>STL has a number of options including:</p> <ul style="list-style-type: none"> continuing to engage QSL to manage the terminals under the sublease operating the terminals itself – achieved by purchasing equipment from QSL and employing QSL's terminal employees. Alternatively, STL could engage another terminal operator <p>individual terminals could be sold or subleased to milling companies</p>	<p>STL has a number of options including:</p> <ul style="list-style-type: none"> continuing to engage QSL to manage the terminals under the sublease operating the terminals itself – achieved by purchasing equipment from QSL and employing QSL's terminal employees. Alternatively, STL could engage another terminal operator <p>individual terminals could be sold or subleased to milling companies</p>	<p>Likely that Terminals managed by QSL, based on a cost recovery only basis.</p>

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