Australian Sugar Milling Council (ASMC) submission to the Review of the Sugar Code of Conduct

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Introduction

The most important relationship within the Australian sugar industry is that between a sugarcane grower and their mill.

Without the support of local growers, mills would have no sugarcane to mill to produce raw sugar, and without local mills, sugarcane growers would have no market for their product.

Australia's sugarcane growers and sugar millers are facing clear and considerable challenges to their future viability, not least because global prices for sugar are well below costs of production.

Australia exports almost 90% of the raw sugar it produces. The global market is saturated with an oversupply of sugar, in part due to favourable climatic conditions, but predominantly as a result of distortive subsidies in some competitor countries. Depressed market conditions are forecast to remain for the foreseeable future.

Closer to home, the industry faces a raft of community-driven challenges to its social licence to operate. Health and nutrition issues regarding obesity levels and sugar consumption are top of mind in the community, as are environmental concerns.

The future growth and stability of the industry is also challenged by restrictive regulations including the Sugar Code of Conduct (Code) and its mirroring Queensland state marketing legislation. Competition for land use from alternative forms of agriculture and alternative energy sources (e.g. solar power developments), high electricity prices, urban encroachment, and access to affordable skilled labour all threaten the long term viability of the sector.

It is against this backdrop that the Australian Sugar Milling Council (ASMC) calls for repeal of the Code. Now is the time to empower the industry to embrace a commercial, collaborative and profitable future.

Summary

The Sugar Code of Conduct has added uncertainty, complexity and cost to sugar industry operations. It has deterred investment, and undermined competitiveness.

Unless repealed, the Code will continue to limit investment, innovation and growth, and negatively impact the economic and social contribution of Australia's second largest agricultural export industry.

Of greatest concern are the provisions in the Code imposing mandatory and enforceable ***pre-contract*** arbitration on growers, millers and marketers. This runs counter to a key objective of sugar industry deregulation in 2006.

That the Code has not been invoked by any party since its introduction does not in any way diminish the negative impact it has, and will continue to have.

The Code was put in place without due process or formal consultation with milling-sector stakeholders, and a public benefits test was not conducted. We maintain there was no demonstration of market failure in the sugar industry, and that sufficient regulatory and commercial mechanisms already addressed competition issues, including collective bargaining and the requirement for contractual supply agreements between cane growers and millers.

The Australian sugar industry has one of the strongest and most transparent set of commercial arrangements of any agricultural industry in the world. Price discovery for raw sugar is completely transparent and grower price exposure can be managed independently of sugar millers.

As a direct result of innovation flowing from deregulation, cane growers have access to numerous and flexible pricing mechanisms, including through third parties, that determine the price they are paid for cane, and many growers have taken advantage of these options.

The role of Australian governments must be to allow normal commercial negotiation to advance marketing arrangements for raw sugar. It is in no one's interests to send the Australian sugar industry back to the days of reliance on others to adjudicate these normal commercial negotiations.

Once the industry is again deregulated, all stakeholders can work together to tackle the challenges and opportunities that face this great Australian industry. This should include development of a whole-of-industry vision and strategy to drive the industry's international competitiveness.

Viability, competitiveness and growth will only come with investment, and investment will only come with confidence. The Code discourages both.

ASMC Recommendations

1. The Code should be repealed, allowing industry to focus on commercial relationships and mechanisms to manage the production and marketing of sugar.

2. Industry bodies should collaborate on the development of a whole-of-industry strategic plan, through wide consultation with industry participants, to provide a roadmap towards a more sustainable and profitable Australian sugar industry.

The strategic plan should outline priorities and provide direction to government and research bodies to help address industry opportunities and challenges, including:

- Improving access to international markets, and reducing trade distortion in the global sugar industry.
- Enhancing the Australian sugarcane industry's social licence to operate.
- Positioning the industry positively, and marketing products to the best advantage of the entire supply chain.
- Diversifying the range of products produced from Australian sugarcane, and ensuring the most sustainable return from the crop.
- Investing in research, development and adoption programs that add value to all industry participants and the broader community.

About ASMC

The Australian Sugar Milling Council (ASMC) represents the interests of six milling member companies that purchase sugarcane from growers and mill it to produce raw sugar and a range of co-products, including electricity and molasses.

ASMC's focus is on advocating policy outcomes related to trade, energy, deregulation, marketing, research and social licence to operate issues that create opportunities for a more profitable and sustainable industry.

The members of ASMC are Bundaberg Sugar, Isis Central Sugar Mill, Mackay Sugar, MSF Sugar, Tully Sugar, and Wilmar Sugar Australia.

ASMC members produce more than 95% of all raw sugar manufactured in Australia and 99% of Australian raw sugar exports. Our sector supports more than 4,000 direct jobs and more than 16,000 total local and skilled jobs across regional communities in Queensland.

While individual milling companies are responding differently to the increased regulatory environment, all wish to see an environment more conducive towards supply chains operating commercially for mutual benefit.

Our members span the spectrum of large and small; Australian and foreign-owned; export and domestic-focused; grower, private and listed ownership structures. All are united in their opposition to this Code.

Reasons to repeal

There are five compelling reasons to repeal the Sugar Code of Conduct:

1. There has been no market failure, and the Code is not required to regulate the conduct of growers, mill owners and marketers.
    a. The Queensland Productivity Commission and the federal Productivity Commission found no evidence of market failure or monopoly conduct, and both recommended against any form of legislative intervention.
    b. There are legal and commercial mechanisms that otherwise effectively govern process and conduct.

2. Prior to the introduction of the Code, no regulatory impact statement or cost-benefit analysis was undertaken to determine impact on the entire industry or Australian community. Since introduction, the Code has not delivered measurable net benefit to the Australian community. It has however, had a significant negative impact on investment confidence.

3. The Code confuses the issues of price exposure, with the ownership and marketing rights of sugar, usurping millers' rights.

4. Millers do not support pre-contractual arbitration of agreements for the supply of cane or the on-supply of sugar. These provisions add risk and inhibit future investment and expansion of an industry that supports regional communities and employment within regional Queensland.

5. Together with the Queensland legislation, the Code has promoted mistrust, at a time when all sectors need to focus on charting a positive strategic direction for the industry, to address the current and future threats and opportunities.

1. No market failure

Deregulation in 2006 was supported by all sectors because the industry was in decline and its viability was at risk. Deregulation delivered immediate improvements to sector confidence and attracted significant investment.

Deregulation delivered innovative forward pricing and price and currency risk management tools; concepts now embraced by most Queensland cane growers. Most in the sugar industry would agree that forward pricing has been one of the most important innovations for the sugar industry in recent memory.

There is a misinformed perception that mill owners and growers have separate pathways to profit and sustainability. However, the economic interest of miller and grower in each sugarcane growing region is inextricably linked.

The sugarcane industry depends upon the mutual reliance of regional canegrowers and sugar millers.

This is evidenced by the significant financial contributions made by milling companies to not only sugarcane productivity, research and development, but also to the transportation of sugarcane from farm to sugar mill.

Sugar milling companies contribute more than half of the industry funds towards Sugar Research Australia (SRA), the industry-owned research and development company. Milling companies collectively have considered the highest priority for SRA to be improved industry productivity, predominantly through new sugarcane varieties and plant technology (66% of SRA research funding is directed to four key focus areas related to farming).

In addition, milling companies invest more than $4 million annually to industry-owned productivity service organisations. These organisations deliver plant health and extension services to enhance productivity in the cane farming sector.

Processors of other agricultural commodities make zero, or relatively minor contributions in cash terms to industry research and adoption efforts to enhance the productivity of their suppliers. In general, sugar mills also pay for the transportation of sugarcane on mill-owned cane railways or via road transport from agreed delivery points to mills; another rarity in Australian agriculture.

In addition, while sugar mills can only process sugarcane, growers are able to diversify into other crops and in some cases into other land uses (including urban and industrial). A small change in the land under sugarcane or in the productivity of cane land can have a significant impact on the profitability of a sugar mill. Therefore there is strong motivation for mills to negotiate fairly with growers and to provide incentive to them to keep growing sugarcane.

The Australian sugarcane supply chain has a highly developed, clear and transparent system of documentation and contractual arrangements between growers and mills, including cane supply agreements (appendix 1). These arrangements already meet, and in parts surpass, protections offered through other industry codes of conduct (appendix 2).

The system includes collective bargaining approved under existing regulation. There is no lack of transparency, or lack of clear pricing signals in the contractual relationship between growers and millers.

The milling sector acknowledges that ongoing effort and focus is needed to maintain trust and confidence within supply chains, however there is no economic or commercial evidence or analysis that demonstrates market failure or justification of continued government intervention.

2. Lack of due process and no net benefits

The Code was introduced for political expediency, and without due process or consultation with all affected stakeholders. No regulatory impact assessment was undertaken to determine the costs and benefits to individual sectors, or the community as a whole.

When considering the 2015 Queensland legislation on which the code is based, the Queensland Productivity Commission concluded:

"…there was no evidence to support a case of market failure in the Queensland sugar industry that would indicate the need for additional Government intervention; and the benefits of regulation, as proposed by the Bill, do not outweigh the costs. The Decision RIS concludes that retaining the existing regulatory framework – with no additional regulation – will provide the greatest net benefit to Queensland."

In a 2016 report, the federal Productivity Commission stated that:

"re-regulating the Queensland sugar industry is likely to constrain investment and structural adjustment, and should be repealed."

Subsequent developments have clearly highlighted that both the Queensland legislation, and the Code, have failed to deliver financial benefits to the industry or community as a whole, rather they have added supply chain costs and increased uncertainty that has inhibited the industry's confidence and future investment.

3. The Code confuses pricing with marketing

Raw sugar prices are determined by global market supply and demand, and are transparent to all via ICE 11 futures contracts. These contracts are traded globally by sugar producers, consumers and other market participants (Appendix 3). Market participants use these futures contracts to hedge their sugar price exposure and/or to speculate on the future price of sugar.

Deregulation of the sugar industry provided the opportunity for millers to market the sugar they produce. This was an agreed move to attract investment and achieve marketing efficiency.

Post deregulation, and in recognition that growers may opt to manage their sugar price exposure independently of their miller, millers developed and offered growers a range of

mechanisms to manage individual sugar price exposure. Tools including third-party managed pricing pools and forward pricing managed directly by growers. These mechanisms provided a means for growers to manage their sugar price exposure independently from their miller, in effect decoupling a grower's cane price from the sugar price risk management strategies of their miller.

Under the terms of cane supply agreements, grower ownership of the sugarcane ends with its delivery to the miller at an agreed point. From there all responsibility and risk in the supply chain lies with the miller. At no stage is a cane grower an owner of raw sugar manufactured by a mill. The miller is the owner of all the physical sugar it produces.

In recent years, including in the lead-up to the introduction of the Code, relatively new terms were created to identify the relative portion of sugar to which millers and growers have price risk exposure. These terms have become confused and conflated with the very different concept of ownership of sugar.

The Queensland legislation and the Code, have subsequently introduced a new concept whereby sugarcane growers have a right to direct how sugar mills choose to sell the mills' raw sugar. This usurps the millers' legal rights and title of the physical sugar they have produced.

One member milling company has obtained legal advice confirming this to be a prime facie breach of Australia's obligations under an international trade agreement in relation to expropriation of property rights without just compensation.

ASMC members support cane growers having access to transparent mechanisms to manage their price risk exposure, including from third parties. We also support education initiatives to build awareness and understanding of these mechanisms. However these opportunities were already in place prior to the introduction of the Code and Queensland legislation, both of which have usurped the millers' legal rights and title of the sugar they produce, impacting the value of those businesses.

4. Pre-contract arbitration adds risk and inhibits investment

Deregulation of the Australian sugar industry occurred after decades of inquiries, reviews and reports, and associated financial assistance measures.

A key objective of deregulation was the removal of compulsory mechanisms for dispute resolution, including pre-contract arbitration. The reviews in the lead up to deregulation found that arbitration was blocking productivity gains and was a deterrent to normal, healthy commercial relationships, resulting in Australian sugar not being able to compete as effectively on a global basis.

It was and continues to be ASMC's view that including pre-contractual arbitration in the Code was a retrograde step that has damaged investor confidence and threatens industry competitiveness.

Following a period of strong investment post deregulation in the 2000s, it is estimated by milling companies that the recently re-regulated environment has seen a reduced level of

discretionary capital investment by up to 90%. As a further example, Mackay Sugar's efforts to secure urgent financial investment to re-capitalise its business have been impacted by the existence of the Queensland legislation and the Code, with potential bidders wary about the impacts of the re-regulation on their future ability to operate in a normal commercial manner.

There is no Industry Code in Australian agribusiness that prescribes arbitration as a measure to establish contracts between a supplier and processor, manufacturer, merchant or other receiver of goods. There is no case to support the retention of such regulatory intervention in the Australian sugar industry.

A robust, commercially-based dispute resolution mechanism is highly desirable in a modern contractual arrangement, however compulsory arbitration does not have a role in the negotiation of those contracts.

The Code also includes pre-contract arbitration for the terms of sugar sales agreements between millers and marketers. It therefore exposes millers to commercially unreasonable terms in these contracts, terms that go beyond price-related items to areas of title, risk and liability. Examples of unreasonable terms include:

- Requiring mills to transfer title to sugar to the marketer before the marketer has paid for the sugar
- Providing for the marketer to determine the price paid to the miller for the raw sugar
- Providing for the marketer to determine the amount and timing of payments made to the miller for raw sugar
- Requiring the mill to sell to the marketer at a particular sugar price or sugar price basis that may be inconsistent with the sugar price basis on which the miller is required to pay for cane
- Requiring mills to meet unrealistic quality parameters with marketers having the right to reject sugar if it does not meet certain specifications and obligating mills to re-process sugar at their cost
- Requiring mills to forecast sugar production and provide indemnities for hedging and other losses incurred by marketers in the event that these forecasts are inaccurate

A number of factors will influence investment decisions by individual companies, and milling companies will continue to make investments to ensure optimal efficiency of ongoing operations or where the risk on the return on capital is lower.

However the Code has amplified uncertainty, risk, and cost for the milling sector, and jeopardised future investment and growth, by introducing mandatory pre-contract arbitration.

This must be reversed.

5. Industry distraction and mistrust – lack of strategic direction and competitive focus

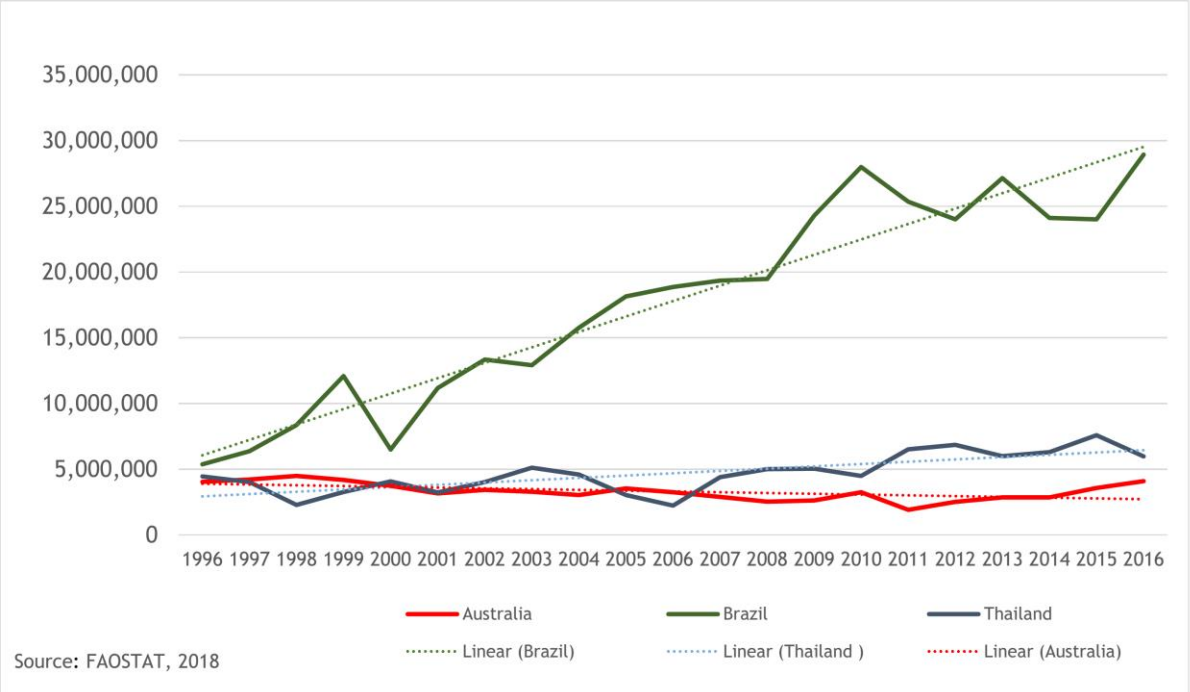
The industry was deregulated in 2006 after exhaustive consultation and consideration, with clear commercial purpose, and government financial support including $444 million in a package of adjustment measures.

The subsequent period of rationalisation and re-investment in the milling sector coincided with a period of recovery and relative prosperity in the industry, aided by stronger global sugar prices.

However, the Australian sugar industry's competitive position internationally is now under challenge, as other countries develop clear long-term plans across all sectors, and investment in new infrastructure.

Chart 1 shows the raw and refined sugar exports of Australia, Thailand and Brazil between 1996 and 2016. During this time, Brazil's exports and global market share has grown strongly, Thailand's has grown moderately, and Australia's has declined. Both Brazil and Thailand have growth strategies that are supported and driven collectively by industry and government stakeholders.

Chart 1: Raw and refined sugar exports



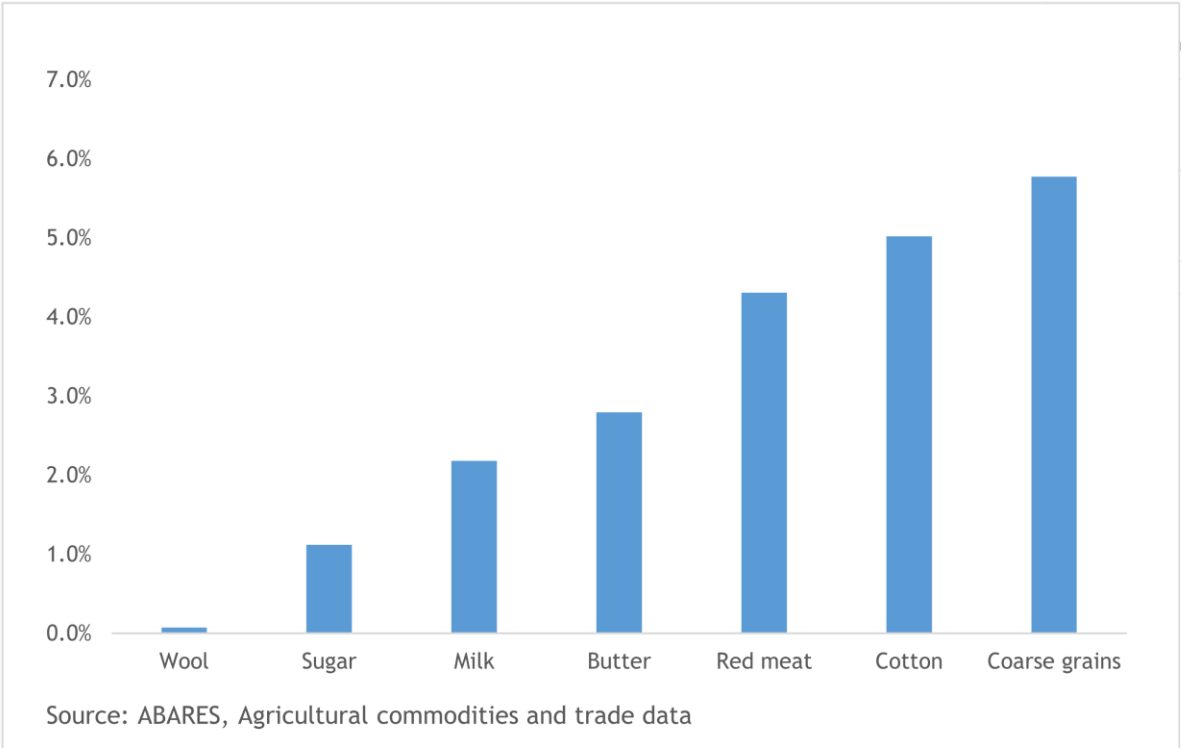
Conversely the Australian sugar industry in recent years has been characterised by cross-sectoral tension and the re-regulation of the industry through the Queensland legislative amendments in 2015 and the federal Code of Conduct in 2017.

This has inhibited the investment and innovation that is required to take the Australian sugar industry forward.

In recent years, other Australian agricultural industries have demonstrated the benefits of unity of purpose and forward strategic planning to overcome hurdles to greater prosperity.

Chart 2 shows by value of production (VoP) compound average growth rates (CAGRs) of various Australian primary industries between 1994 and 2016. It demonstrates that the Australian sugar industry achieved a VoP CAGR of 1.1% during these years, compared to milk (2.2%), butter (2.8%), red meat (4.3%), cotton (5%) and coarse grains (5.8%).

Chart 2: Growth of Australian primary industries between 1994 and 2016



It is clear the Australian sugar industry needs to unite around a clear strategy for the future, requiring trust and goodwill between sectors, and a regulatory environment conducive to increased innovation and investment.

Recently, in the context of the possible introduction of additional reef protection regulations, Queensland canegrower organisation CANEGROWERS stated that it "sees regulation as a blunt instrument which leads to minimum compliance at the cost of continuing innovation and pursuit of excellence."

Those sentiments could equally apply to marketing regulations.

Appendix 1 - Contractual Arrangements in the Sugarcane Industry

The Australian sugarcane supply chain has a highly developed, clear and transparent system of documentation and contractual arrangements between growers and mills (Cane Supply Agreements or CSAs). Supplementing the Cane Supply Agreements are Pricing and Marketing agreements that allow growers to participate in forward pricing pools and arrangements, either as schedules or separate agreements to the CSAs.

The negotiation of Cane Supply Agreements typically occurs between identified bargaining agents on a mill area basis, with growers participating in a collective bargaining process as allowed under the *Sugar Industry Act 2006 (Qld)*.

The CSAs typically roll over each year without significant changes because they include a wide range of provisions as would be expected from a mature supplier/processor relationship.

There is no market failure, or lack of transparency, or lack of clear information in the contractual relationship in the sugarcane supply chain as evidenced in the explanation of current arrangements below.

Current arrangements

A remaining provision in the *Sugar Industry Act* is that supply contracts must be in place for cane to be supplied by a grower for processing by the miller as follows:

Supply contract

1. *A grower may supply cane to a mill for a crushing season only if the grower has a supply contract with the mill owner for the season.*
2. *A supply contract may be for 1 or more than 1 crushing season.*
3. *A supply contract may be either an individual contract or a collective contract.*
4. *An interested third party may be a party to a supply contract between a mill owner and a grower.*
5. *Each of the parties to a supply contract must sign the contract.*

The critical interdependent relationship between sugar mills and their growers is formalised through these contracts known as Cane Supply Agreements (CSA).

Growers and millers are dependent on one another for the supply of sugarcane to the mills and the milling of sugarcane into raw sugar for sale.

At a local level growers either become part of a collective to negotiate the terms and conditions of individual cane supply contracts, or negotiate directly with the mill on their own behalf, to form an individual contract.

In essence, the CSA or supply contract provides certainty for mills that sugarcane grown on nominated land will be sold to that mill for crushing, and at the same time provides certainty for growers that sugarcane grown on nominated land will be purchased by the mill for crushing.

The CSAs are typically rolling contracts ranging from three to five years in duration. The longer term of the contracts has evolved to provide greater certainty for mills and their growers along with opportunities for forward pricing that is underpinned by the supply contracts.

CSAs provide for:

- determination of the starting date for the crushing season
- payment for cane
- arrangements for the harvest and transport of cane to the mill
- delivery points for the cane where the risk and title in cane passes to the mill from the grower
- weighing the supplied cane
- sampling and analysis of the juice from the cane to determine CCS
- mapping of the blocks on farms from which cane is harvested and supplied to the mill
- harvesting group allotments to ensure growers receive equitable access to the crushing capacity of mills
- consignment information about the cane supplied including block and paddock information and the variety and class of the cane
- cane quality provisions and encouragement around good farming practices
- dispute resolution – in general the agreements describe a stepped process that involves mediation between the parties with scope to move to arbitration if the dispute can't be settled through the mediation

The long-standing virtually unchanged arrangements between mills and their growers that continue to be agreed in today's CSAs are a clear demonstration of a mature supplier/processor relationship that works.

The commercial, functional operation of these CSAs demonstrates there is no need for government intervention in the contractual arrangements between mills and growers.

Appendix 2: Codes of conduct in other industries

There are a number of examples of food and agriculture related codes of conduct administered by the ACCC.

Three Codes administered by the ACCC address specific issues, namely:

i. **The Horticulture Code of Conduct** is mandatory between growers and traders to improve clarity and transactions between growers and wholesalers of fresh fruit and vegetables. The Code sets out that there must be a written agreement, with terms of trade and delivery arrangements, and it specifies the point at which ownership passes from grower to the party purchasing the produce.

ii. **Food and Grocery Code of Conduct** is a voluntary code between suppliers and grocery retailers and wholesalers to ensure 'fair and transparent commercial dealings'. The Code aims to deliver more contractual certainty between suppliers and supermarkets, to better share the risk and to reduce inappropriate use of market power across the value chain.

iii. **Port Terminal Access (Bulk Wheat) Code of Conduct** is a mandatory code to ensure access to critical infrastructure for grain exporters regardless of who owns the terminal. It also provides for 'fair and transparent access to port terminal services' and is currently under review.

The logic for introduction of codes of conduct in other cases in Australia is not present in the case of the sugarcane industry. Table 1 on the following page outlines the intent of key aspects of other Codes of Conduct which were already achieved through existing commercial arrangements in the sugar industry, including through collective bargaining and cane supply agreements to address the issues of bargaining power and price transparency respectively.

Table 1

Prior to the introduction of the Code, commercial protections in the sugar industry already met, and in part surpassed, other Industry Codes.

CODE OF CONDUCT PROVISIONS	**Horticulture** Code	**Food and Grocery** Code	**Oil** Code	**Wheat Port** Code	**Franchising** Code	**ALREADY EXISTED IN SUGAR INDUSTRY**
Dispute resolution within commercial contracts	✓	✓	✓	✓	✓	✓
Transparency provisions to protect suppliers from discrimination	✓	✓	✓	✓	✓	✓
Pricing disclosure	✓	✓	✓	✓	✓	✓
Mandated commercial contracts between parties	✓	✓	✓	✓	✓	✓
Collective bargaining for suppliers	✓	✗	✗	✗	✗	✓
Supplier control rights over processed products ('choice')	✗	✗	✗	✗	✗	✗
Pre-contract arbitration	✗	✗	✗	✓ [1]	✗	✗

[1] Arbitration in the Wheat Port Code deals specifically with infrastructure access disputes. There is no Industry Code in Australian agribusiness that prescribes arbitration as a measure to establish contracts between a supplier and processor, manufacturer, merchant or other receiver of goods.

Appendix 3 – Sugarcane payment formula and grower exposure to sugar price

The method by which mills pay growers for cane is determined in the negotiated Cane Supply Agreement. The actual payments made by millers to growers are calculated by the cane payment formula.

The cane payment formula

All growers are paid according to the following formula except Mackay Sugar's three central region mills. The following formula has been in place since the early 1900s.

Pc = 0.009 x Ps x (CCS-4) + $0.608[2]
Where:
Pc = price of cane (what the grower receives)
0.009 = Co-efficient of Work (mill efficiency factor)
Ps = price of sugar per tonne IPS (net returns for raw sugar)
CCS = commercial cane sugar (how much sugar is in the cane)

General Aspects of the formula at the time of inception:

- CCS of cane was generally 12 and the mills Coefficient of Work (COW) was around 90. COW is a measure of mill performance compared to the CCS.
- The formula provided 2/3rd of revenue to growers at 12 CCS and 90 COW.
- Grower's costs were about twice those of the mills.
- Grower's capital investment was about twice that of the mills.
- At standard performance of 12 CCS and 90 COW, the cane price to growers would be 2/3 of the sugar revenue.
- It rewards growers for CCS increases greater than 12.
- It rewards mills for improvements in factory efficiency.
- The value of molasses was included indirectly in obtaining the cane price.

Ps - A grower's underlying exposure to raw sugar value

There are 2 components to Ps:

- The sugar price component determined by the actively traded electronic raw sugar futures market, the ICE 11 contract
- The net result of marketing premiums and costs

The total value of sugar is determined by the futures price plus premiums minus costs. Premiums and costs are a relatively small portion of the grower's underlying raw sugar value, however must be managed professionally and with transparency as part of the physical sugar sale process.

[2] The constant used in this example ($0.608) is indicative and can be different (in the order of cents) from one mill area to the next. It, in the main, represents the outcome of a series of adjustments made over time since the early 1900s to ensure the formula reflected changed conditions since its introduction

Following is an explanation and example of how each of these components (ICE 11 – the futures component, premiums (pol premium, physical premium), and costs (storage and handling, marketing, and financing) contribute to the sugar price pools that determine a grower's sugar price component of the cane payment formula.

It is important to note that while published QSL figures have been used for the purpose of this example, it is acknowledged there are other sugar marketers, including some milling companies.

Components of Ps

ICE 11

Typically, the ICE 11 represents in the order of 85% of the gross sugar price (price paid by the purchaser of physical sugar), and can be between 95% and 105% of the net sugar price (price used in the cane payment formula for payment by mills to growers for purchase of sugarcane). The ICE 11 is fully transparent, and importantly, the ICE 11 component of sugar price can be determined by growers independently of their miller, and is therefore effectively decoupled from the physical sugar sale process. The worked example uses an ICE 11 price of $390.09 per tonne IPS drawing from the information shown on Page 6 of the 2015/2016 QSL Annual Report.

POL premium

The pol premium represents the difference in physical quality attributes of the raw sugar versus the standard quality specification set by the Sugar Association of London (SAL) rules for the ICE 11 contract. The major element of the physical quality attributes is polarisation. Given the rules around determining this premium, it is identifiable and auditable.

International Pol Scale

Min degrees	Max degrees	Percentage pro-rata for each degree
96.00	97.00	1.50%
97.00	98.00	1.25%
98.00	99.00	1.00%
99.00	99.30	0.30%

NB: The IPS table has since changed however was applicable at the date of this example.

Physical premium

The physical premium is determined on a contract-by-contract basis by direct negotiation with a customer for raw sugar and by market forces. The value of the physical raw sugar above the ICE 11 futures market price will mainly reflect the freight differential and a regional premium.

The freight element of the physical premium is determined by location of both the supplier and customer for the raw sugar and the location of the next potential supplier of sugar to the customer. This last element is also the major determinant of the regional

premium. The relative quality of a supplier's sugar to the next available sugar along with some consideration of shipping flexibility can also contribute to the physical premium. The lack of in-season storage capacity in Brazil is also a factor in the availability of the regional premium.

The net value of the physical premium in the worked example is $15.54 per tonne IPS, made up of a Cost and Freight Premium (CFR) of $38.98 less freight and execution costs of $23.54. The CFR premium is the value invoiced to the customer over and above the ICE contract. Freight and execution costs are the payments made to ocean transport companies for the collection and delivery of product to the end port destination. This is mostly made up of the voyage charter costs, but also includes dispatch earnings and demurrage payments. In the worked example, the net physical premium of $15.54 is 4.00% of the final sugar price used in the cane payment formula. While this is probably the least auditable of the components of sugar price, there are independent information sources available to provide some daily visibility in relation to an indication of the market value of the physical premium.

Storage and handling

During the 2015/16 period, storage and handling costs were equalised for QSL exported sugar such that the same costs were allocated by QSL to each tonne of raw sugar that was exported via any of the bulk sugar terminals. Storage and handling costs in the worked example are shown at $20.88 per tonne IPS (5.37% of the final sugar price used in the cane payment formula).

Marketing costs

QSL's total marketing costs in 2015/2016 were in the order of $3.7 million translated to $1.69 per tonne IPS of sugar sold. This is not a large element of the final price.

Financing costs

The cost of the advances program is also a small component of the overall price. These costs for 2015/2016 were $9.35 million or $4.29 per tonne IPS. Marketing and Financing Costs in the worked example are 1.54% of the final sugar price used in the cane payment formula.

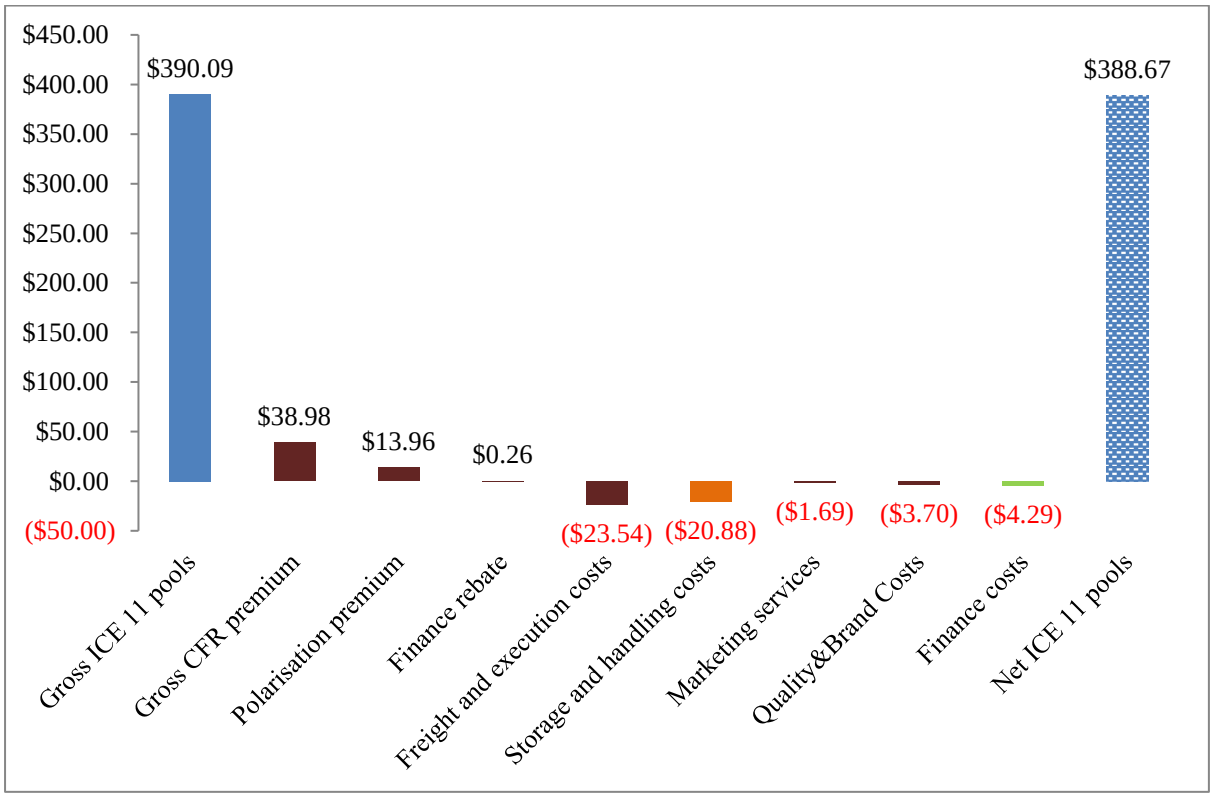
Quality and Brand Costs

In the QSL example, Quality and Brand Costs are listed as $3.70 (0.95% of the final sugar price used in the cane payment formula). This is the cost of procuring specific brands of sugar from suppliers to meet the specific market requirements of the customers. This includes the raw sugar quality scheme payments and the premium for making Japanese specification raws. The raw sugar quality scheme was managed by QSL as part of the centralised marketing arrangements, and was shared across export marketing participants.

The following graphic depicts the values attached to the components as discussed previously and shows how each of them influences the final sugar price that feeds into a grower's cane payment formula. This example is drawn from QSL's 2015/16 published marketing and pricing outcomes. In this example, the net difference between the starting

gross ICE 11 price for sugar (the futures price component) and the net sugar price after premiums have been added and costs deducted is -$1.66 per tonne IPS.

An Example of Components of Sugar Price



* The Gross CFR Premium when combined with the freight and execution costs amount to the net physical premium of $15.54.

** Given that this $0.26 has such minimal impact it has not been referred to in the section preceding the graph.

The cane payment formula was outlined earlier. The actual payments made by millers to sugarcane growers are calculated by this cane payment formula which takes into account the CCS content of the grower's sugarcane combined with a sugar price, determined through the pooling arrangements and a grower's price and currency risk management strategy.

Applying the net sugar price used in the example of $388.67 and using an indicative CCS of 13.75 enables calculation of the sugarcane price as follows:

Pc = 0.009 x $388.67 x (13.75-4) + $0.608
$34.74 per tonne of sugarcane

If you applied the ICE Futures component of the price of $390.09, it would deliver the following result in terms of the price to be paid for sugarcane:

Pc = 0.009 x $390.09 x (13.75-4) + 0.608

$34.84 per tonne of sugarcane

Sensitivity Analysis Cane Payment Formula

The variable components of the cane payment formula are managed through normal commercial arrangement between growers and mills.

- The CCS measurement and allocation to growers is undertaken by the mill, often with some form of audit process or oversight by grower collectives.
- Growers' access to pricing tools to manage the ICE11 component is managed either through marketing and pricing agreements separate to the cane supply agreements, or within the cane supply agreement.
- Payment of the net result of marketing costs and premiums is managed under the same arrangement, via net proceeds to pool arrangements.

Attachment 1 provides a sensitivity analysis of the various components of the net sugar price. The analysis looks at three variable elements of the cane payment formula that directly impact grower revenue: CCS plus the two elements of net sugar price - ICE11, and net result of marketing costs and premiums.

The sensitivities around marketing premiums move through a range of $5 per tonne of sugar movement, the range identified by QSL's CEO[3] as a typical range for the net outcome of marketing premiums and costs at the 2015 Senate Inquiry public hearings in Mackay. The range of impact on the payment made per tonne of sugarcane is from $0.08 per tonne at a $1.00 net premium on sugar price, through to $0.40 per tonne sugarcane for a $5.00 net premium on sugar price.

CCS has a much greater influence on the price of sugarcane than marketing premiums, the difference between a CCS of 13 and 15 is over $8 per tonne of sugarcane.

As an example of ICE11 movement, the average price of the prompt futures contract each year from 2010 to 2014 varied from $406 per tonne sugar, to $533 per tonne sugar. Applying this to the sugar price component in the cane payment formula translates to a movement of up to $10.29 per tonne of sugarcane for a grower.

While the marketing premium determined from the physical sugar sale process is an important element in the payment made to growers for sugarcane, it is vastly outweighed by the impact of variation in ICE11 movement and CCS variability.

Given that the ICE 11 accounts for the majority of sugar price and can be determined by growers independently of their miller, there is no reason why the marketing premium element of the payment for sugarcane (i.e. the only component associated with the physical sale of sugar) should be subject to special government intervention rather than continuing to be managed by normal commercial means.

[3] Hansard, 12 March 2015, Senate Inquiry into the current and future marketing arrangements for the marketing of Australian sugar, Public Hearings, Mackay

In other words, provided growers have access to price risk management mechanisms and can determine their price risk management strategies independently, there is no commercial justification for regulation of physical marketing of sugar.