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Re: Supplementary ASMC letter re the Sugar Code of Conduct review

Dear Andrew

The Australian Sugar Milling Council (ASMC) would like to provide some supplementary comments in relation to the consultation on the Sugar Code of Conduct (Code).

ASMC maintains the Code should be repealed to allow industry to focus on commercial relationships and commercial, rather than regulated, mechanisms to manage production and marketing of Australian sugar.

In brief, sugar millers and cane growers face significant challenges to their short and medium-term viability as a result of low prices, global trade distortions, threats to the industry's social licence, rising input costs, and regulatory imposts. Against this backdrop industry bodies need to focus on working together towards a more sustainable and profitable Australian sugar industry. The Code is a costly distraction.

In this supplementary letter, ASMC would like to touch on specific issues raised in other submissions to the review. Our initial submission is available on the review website as well as on ASMC's website.

CANEGROWERS/ACFA submission and QSL submission

Both submissions make assumptions based on what might happen should there be no Code in place. For example, the submissions assume abuses of market power will occur, even though there are already sufficient protections in competition law to address any such behaviours. And records of abuse when there was no Code in place indicate they rarely or never happened.

There is no quantitative cost/benefit analysis provided that supports the assertions that the benefits of the Code exceed the costs.

The CANEGROWERS/ACFA submission makes the claim that the Code completed the 2006 deregulation reforms. Notwithstanding the fact that neither the 2015 Queensland legislative amendments, nor the 2017 Code, were anticipated in 2006, ASMC is confused as to how additional regulation can be claimed to complete deregulation reform.

Contrary to assertions made, the capacity for growers to control their price exposure via forward pricing was available to them prior to the introduction of the Code and Queensland legislation. The price growers are paid under the cane payment formula is more reliant on CCS level or the global sugar price, than it is on marketing premiums.

Individual milling companies are best placed to assess the value of their businesses, and they strongly refute the claim in the grower submission that mill value has not been impacted by the introduction of grower choice in marketing and the Code.

It is true that most growers can only supply one mill due to the perishable nature of cut cane. In the same way, mills can only source cane from a certain geographic area, relying heavily on maximising cane throughput through a facility that only operates for 5-6 months per year. Therefore the imperative exists to negotiate fairly and incentivise growers to continue to supply cane against competing uses for the land. In short, growers have options – mills do not.

Synergies submission

In relation to the submission commissioned by various grower bodies from Synergies, we make the following comments.

The Code was not subject to a Regulatory Impact Statement when legislated.

The Synergies analysis appears to be an attempt to fill an information gap and respond to term (4) of the Terms of Reference – 'the extent to which the Code has delivered a net benefit for the Australian community'.

The Synergies finding that the Code, and specifically the provisions that support grower choice through the legislative vesting of GEI sugar are likely to accrue net benefits, is inconsistent with findings of previous economic analysis – namely Queensland Productivity Commission (QPC) (2015) and CIE and Queensland Treasury (QT) (2003) results.

Specifically:

- The QPC found the only economic benefits to be when:
    - higher marketing returns lead to re-investment and productivity gains (note - legislative vesting was not considered the right instrument to achieve higher premiums); and when
    - minimal sovereign risk investment is incentivised (note – pre-contract arbitration is seen to increase risk).

- The CIE (and Hildebrand) found that removing the formal and informal rules, and reducing perceived miller-grower inequities and antagonism would have the effect of encouraging productivity growth.

- The QT undertook economic modelling of a scenario whereby de-regulation led to a 20% increase in cane yields, a 0.75% increase in CCS, 20% decrease in harvesting costs and a 10% reduction in transport costs. The benefits were estimated to be an increase in Queensland Gross State Product by 0.42% or $491m (2003 dollars).

There are a high number of significant methodological problems and unsubstantiated statements in the Synergies document, such that it cannot be relied upon as a meaningful or credible contribution to this review process.

The methodological errors include:

- The absence of consideration of current and/or anticipated costs and benefits relative to a baseline i.e. 'what would happen if the pre Code policy and legislative arrangements were to continue'? The baseline (say the period 2012-2014) should have regard to lead and lag indicators such as:

    - Lead indicators - what was the level of disputation and disruption? What was the level of transparency and innovation in marketing (including the level of transfer pricing of vertically integrated refineries that artificially lowered grower returns)? Were grower returns above world spot prices and meeting expectations and was the area under crop increasing? What were the costs of finalising supply arrangements between mills and growers?

    - Lag indicators – what was the level of investment confidence (what did the CAPEX and OPEX project pipeline look like)? Has there been a demonstrable shift in the percentage of capital allocated to Australia from the multi-national owners of QLD mills? What were the levels of spending activity, cane and sugar produced, productivity and efficiency levels etc.? Were parties adequately sharing the risk and reward in variable market conditions? Was the industry attempting to utilise all latent capacity?

- The lack of consideration of costs and benefits as they relate to ALL affected individuals and businesses and the community in general (i.e. not just one sector being the growers).

- The need for the analysis to consider the costs and benefits of the entire Code (not just the grower choice provisions).

- The assumption that a market failure and increased market abuse and dysfunction will occur if the Code is removed (despite multiple government reports stating there is no market failure and current policy and commercial frameworks are sufficient to address market power).

- The absence in the analysis of any attempt to quantify the costs and especially the stated benefits, particularly how the Code promotes grower confidence, lowers disruption and enhances transparency and innovation.

The unsubstantiated statements include:

1. *Regulatory intervention is necessary to complete the competition reforms only partially implemented in 2006 (page 3).*

    - The submission states that because the mills withdrew from the (voluntary) commercial arrangements included in the 2005 amendments to the QLD Sugar Industry Act (SIA), and because the marketing monopoly was (simply) transferred from QSL to the mills, that the benefits of maintaining competition in sugar marketing (a key objective of the 2005 reforms) has not been completed. There is no basis for this statement.

    - In amending the SIA in 2005 and in removing regulatory encumbrances from the sugar industry, all objectives were completed and all reforms fully implemented.

    - In amending the SIA in 2005, Government did not seek to legislate for competition (i.e. maintain QSL's legislative vesting protections) in the provision of marketing services – indeed per the explanatory memorandum the 'repeal of the vesting provisions will also mean that the domestic sugar market will be fully deregulated'.

2. *There would be abuse of market power without regulatory intervention* (page 3) *and competitive marketing arrangements* (page 32).

3. *Significant value could shift from grower to miller without the Code (page 5).*

    - As previously stated, the mills are highly incentivised to maximise cane throughput. This is achieved by minimising disruptions with growers and maximising grower returns through the cane price formula.

    - There is little to no evidence of abuse of market power since deregulation. In its submission, the ACCC noted that between 2006 and 2015 there have been 21 industry-related complaints directly effecting sugarcane growers (2.1 per year), and eight between April 2017 and 2018 (5.5 per year). However, this is purely a measure of complaints with no actual breaches reported.

4. *The Code is cost effective and efficacious* (page 44).

    - According to Synergies, the code is efficient because it has increased grower confidence, lowered disruption, and enhanced transparency and innovation relative to a baseline. There is no evidence to support this.

- Under ASMC's definition of effective, there is no evidence that the Code has increased productivity, investment and/or overall economic activity in sugar regions across Queensland relative to any baseline.

- There is also no evidence that the Code represents the least-cost means to achieve any benefits (as other options have not been considered or costed). That is, a Regulatory Impact Statement, if completed, would have assessed the cost-benefit of all options (other instruments – both legislative and non-legislative). This work has not been undertaken except to say that multiple government reports (Queensland Productivity Commission and federal Productivity Commission) have found no market failure and no need for government intervention.

5. *The benefits of the Code significantly outweigh the costs* (page 59)

    - As outlined above, Synergies' analysis is flawed methodologically. It does not consider all associated costs and there has been no attempt to monetarise the costs and benefits.

The costs and benefits outlined below (Table 1) should be monetarised in a rigorous cost-benefit analysis.

Table 1: Costs and benefits to be included in a rigorous cost-benefit analysis

Costs	Benefits
Transaction costs of finalising mill-grower cane supply agreements (including complexity of defining GEI) and participating in pre-contract arbitration.	Improved cane and sugar revenues from productivity gains, higher acreage and yield volumes due to lower mill-grower disruption.
Opportunity costs of not marketing own sugar (i.e. foregone revenues of QSL marketing a portion of the sugar compared to levels the mills could have received).	
Quantity of capital now not allocated to Australia by multi-national mill owners in annual budget determinations.	

6. *Millers are no worse off because of the Code* (page 46).

    - Contrary to this statement, there is evidence that grower and miller returns are lower than might otherwise have expected had the miller been able to market the sugar themselves. There is also evidence some Australian milling investment proposals (e.g. biomass plant) were not supported, reflecting concerns about sovereign risk and the possibility of lower returns (vis-vis other global options). Both of these effects lower returns, shareholder and company values, and the attractiveness of Australia for future investment.

- There is also evidence that mills have incurred a significant increase in transaction costs (finalisation of cane supply agreements, GEI calculations and payments) and risk impost (e.g. indemnification of third party agents).

7. *By withdrawing from voluntary arrangements with QSL, millers' interests were neither aligned with those of growers, nor consistent with the achievement of improved economic efficiency in the sugar industry (page 4).*

    - By withdrawing from the voluntary arrangements and the Raw Sugar Supply Agreements (RSSAs), some milling companies were able to achieve improved efficiencies and offer a broader range of marketing products to offset pricing risk and generate higher returns. These returns were passed onto growers via the established, and broadly accepted cane price formula.

8. *The Code is a 'light handed mechanism'* (page 42).

    - Any intervention that fosters adversarial relationships, substantially increases transaction costs, adds risk in decision making, and does not incentivise operational efficiencies cannot be considered light handed.

9. *The Code improves competitiveness in sugar marketing* (page 59).

    - The Code confuses marketing choice and pricing choice. To create improved pricing outcomes the Code should not seek legislatively to instil the number of marketers, but instead it should concentrate on ensuring the marketers offer an array of pricing choices. To that end, the mills support competition in the provision of price risk management services e.g. third parties that run a pricing pools on behalf of groups of growers.

10. *Attribution of a reduction in the value of milling assets to the Code is without basis* (page 6).

    - Asset values are mainly a function of future returns. These returns are impacted by changes in revenue and costs.

    - As stated, the pre-contract arbitration and grower choice elements of the Code can substantially impact future revenues. For example, any claim by growers to receive a percentage of the returns from milling company investments in diversified products (e.g. co-generation) would reduce revenues and impact asset values. Similarly an inability of mills to market increased sugar volumes and generate benefits from scale would also reduce revenues. Increased transaction costs and risk from regulatory intervention can also have a direct impact on asset values.

Australian Consumer & Competition Commission (ACCC) Submission

In our view, the Commission's three-page submission to the review was a superficial dismissal of sugar marketing issues that are complex and have far-reaching consequences.

While it appears the ACCC's preference is for mandatory codes as a solution to perceived relationship imbalances in agriculture, each commodity is different. We believe the sugar milling sector's experience warranted more detailed consideration. We also note the ACCC's analysis on the dairy industry ran to over 500 pages.

Prior to making recommendations, we would have expected the Commission to analyse the grower/miller relationship in the context of the adequacy of existing commercial practices and current competition provisions in the sector, including price transparency, risk management and balance of market power, with or without the Code in place.

Had the ACCC performed this analysis, they may have agreed with ASMC's viewpoint that the sugar industry is a leader in the Australian agricultural sector in relation to price transparency and risk management mechanisms.

Rather, the focus of their submission appears predicated purely on number of complaints received (unsubstantiated or otherwise), coupled with a regulatory 'gap analysis'.

The submission does not analyse the issues in depth, and reaches confusing conclusions as to how the industry operates. A case in point is the reference to a potential increase in direct competition for sugarcane as a result of an equally 'potential' growth in products such as molasses and ethanol. The reference seemingly disregards the fact these products are only produced as a result of the sugar milling process.

The ACCC submission is also at odds with other government agencies including the Productivity Commission (PC), which concluded previous arrangements in the industry were sufficient and there was no need for heavy-handed government intervention. Notably the PC consulted with all sectors of industry prior to reaching its position. We are unaware of the consultation the ACCC undertook in preparing its submission to the Code review.

ASMC has written directly to the ACCC to outline our concerns with their submission.

Closing

Thank you for the opportunity to provide these additional comments. ASMC looks forward to receiving the final review and considering its findings.

Yours sincerely

David Pietsch
Chief Executive Officer