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Competition Policy Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

By email: Contact@CompetitionPolicyReview.gov.au

Dear Review Secretariat

Review of National Competition Policy

CANEGROWERS welcomes the Government's review of Australia's competition policy including the *Competition and Consumer Act 2010* (CCA).

This review presents an important opportunity to inform the government of the importance CANEGROWERS places on Australia having an effective competition policy framework. Unlike our competitors, the Australian Government does not provide price or income support to agricultural industries. In this context, a robust, equitable and transparent national competition policy framework supported by sound legislative structure is essential to ensuring the international competitiveness of the largely export-oriented agricultural sector. The growth, development and vibrancy of Australia's rural and regional communities depend on the success of these industries.

Like many other agricultural industries, Australia's sugar industry faces several challenges in its operating environment. It is important that Australia's national competition policy framework addresses competition issues confronting agriculture in both its outputs and inputs markets. CANEGROWERS is an active and strong advocate for competition policies that address issues wherever they occur across the supply chain. Of particular concern are issues relating to levelling the playing field by addressing the imbalance in market power between cane growers and the milling company they supply and the application of national competition policy principles by State Government agencies that enable the extraction of monopoly rents from essential State-owned infrastructure in the name of competitive neutrality.

CANEGROWERS supports and endorses the issues and concerns raised by the National Farmers' Federation (NFF) in its submission to the enquiry.

CANEGROWERS is available to expand on any of the issues raised in this submission. If you have any further questions, do not hesitate to contact me on (07) 3864 6444.

Yours faithfully

Brendan Stewart
CHIEF EXECUTIVE OFFICER

CANEGROWERS submission to the Review of National Competition Policy

Levelling the playing field

In each of the sugarcane producing regions, the local cane growing community must deal commercially with a highly concentrated raw sugar miller. In most regions, a single company owns all mills in the district; there is no feasible alternative market for cane; and there are few if any worthwhile alternatives to sugarcane production. With one exception, the mill owner is either a large multinational or linked to a large multinational in which Australian sugar accounts for a small part of their total business activities. There is a clear imbalance in economic strength favouring the milling community.

This imbalance, characteristic of sugar industries around the world and recognised by governments in all sugar producing counties, has resulted in a suite of regulations governing the commercial relationship between millers and growers in each of those countries.

The imbalance was first recognised in Australia in the early years of the 20th century, when in the absence of effective competition laws, the federal government appointed a Royal Commission to review the sugar industry. In its report the Royal Commission expressed concern about the imbalance in market power in the industry and mills' ability to "squeeze the primary producer". In light of this finding a single channel marketing system was introduced that ensured the risks and rewards flowing from the marketing of raw sugar were shared. The regulations also enabled cane growers to come together to bargain collectively with mills to negotiate the terms and conditions for the supply of cane to the mill.

With the advent of Australia's national competition policy framework the marketing structures evolved, becoming voluntary rather than compulsory. Nonetheless the continuing imbalance in negotiating power was recognised with growers authorised in the Queensland *Sugar Industry Act* to collectively bargain with the mill for the supply of cane.

Systems were introduced to enable mills and growers to manage their raw sugar price risk independently of the physical sale. In 2013, in response to mills seeking the ability to sell their share of the sugar produced on their own account, with CANEGROWERS agreement, structures were changed to enable this to occur should mills choose to do so. With this change, growers' share of sugar production continued to be marketed through the longstanding export channel and, in this way, growers' interests were protected.

In April 2014, exploiting the relatively weak provisions of the *Competition and Consumer Act 2010* (Cth) (CCA) which prohibit a corporation with a substantial degree of power in a market (in this case combining regional milling monopoly power with marketing) from taking advantage of that power to eliminate or substantially damage a competitor (in this case QSL, the marketer of grower economic interest sugar) and prevent market entry or deterring or preventing a person from engaging in competitive conduct (in this case denying growers the ability to determine who markets their share of the sugar produced), Wilmar issued a public statement indicating its intention to exit the current sugar marketing arrangements from the end of the 2016 season.

By denying growers real choice in how their sugar of sugar production is marketed, this misuse of market power is designed to undermine the stability and integrity of the industry's marketing structures and alter the way in which risks and rewards are share across the industry in favour of the mill. These anti-competitive actions will have ramifications across the whole industry, affecting all milling companies and their supplying growers.

Unconscionable Conduct

CANEGROWERS agrees with the NFF assessment that the unconscionable conduct provisions of the CCA have not been a helpful source of protection to producers in the agricultural sector and supports their proposed reforms to provide transparency in the supply chain. This includes recognition that certain classes of suppliers such as sugarcane producers are predisposed to suffering from a special disadvantage because of their production of sugarcane, a perishable good, and exposure to a regional monopoly buyer of that product.

Misuse of Market Power

When considering the misuse of market power, the legal framework must effectively:

- level the balance of market power in negotiations for the intermediate product (in the case of the sugar industry sugarcane) between contracting parties, primary producers and the regional monopoly mill they supply.
- ensure transparency in the transmission of market prices along the supply chain and does not allow for final market risks to be borne by the primary producer when the market rewards are captured by the processor of the primary product.
- provide transparency of contract processes to allow for compliance and enforcement "audits" to ensure there has been no misuse of market power.

CANEGROWERS supports the NFF proposal that an "effects test" into section 46 that shifts the onus of consideration from what a company's purpose in undertaking any conduct was to what effect that conduct has had on any given marketplace.

A process that gave the ACCC greater power to regulate anti-competitive behaviour and impose penalties where anti-competitive behaviour has been found would shift the decisions framework from the judicial system to a regulatory system, making it more accessible to small producers facing large multinational adversaries.

Collective Bargaining

Collective bargaining is used widely in the sugar industry to negotiate the terms of cane supply and related agreements. Authority for sugarcane growers for collective bargaining groups is contained in the Queensland government's *Sugar Industry Act*. This act stipulates that there will be four separate regions within which there may be collective bargaining. However with recent changes in ownership of Queensland sugar mills three of the seven sugar milling companies in Queensland operate across more than one these region and, obviously, have the benefit of full transparency of negotiations with their growers. However, suppliers to these three companies in one region cannot negotiate collectively with suppliers in other regions. This imbalance can be corrected by defining Queensland as a single region for the purposes of collective bargaining.

Aimed at preventing the lessening of competition, the CCA restricts the use of either collective bargaining or collective boycott. The Act does allow for exceptions, such as those authorised by the Queensland government. Although this has been effective, the alternative mechanism through TPA/ACCC authorisation/notification approvals is costly and limited and does not really offer an alternative. This is an areas which needs to be explored to find an alternative which allows for effective collective bargaining.

A process for collective bargaining approvals that recognises the unique characteristics of agricultural industries would be worthwhile. In the case of the sugar industry a threshold for primary production bargaining of $5 million is too restrictive. The value of Australian sugar production regularly exceeds $2 billion annually. The value of cane comprises approximately two-thirds of this value. To be effective, amendments to the CCA should enable peak bodies such as CANEGROWERS to commence and progress collective bargaining with mills on behalf of their members.

In those cases where there is market failure and imbalance in negotiating power between regional mill monopolies, in many cases large multi-national companies, and individual growers who have limited worthwhile commercial uses for their land, collective bargaining is essential. However, collective bargaining alone does not level the playing field sufficiently and there needs to be a mechanism for resolving deadlocks in the cane supply contract negotiating process.

Application of *Competitive Neutrality* to essential services

Competitive neutrality reform was undertaken to ensure that publicly owned businesses did not enjoy any net competitive advantage simply because of public ownership. In response, state and territory governments corporatized government owned commercial entities and imposed full taxes or tax equivalents and debt guarantee fees to offset advantages from government debt guarantees.

By imposing taxes and charging corporate debt and equity rates, the benefits of public ownership have been removed from state owned corporations. The removal of the competitive advantages were designed to encourage private sector investment and to build a competitive market for previously monopolistic services. In the provision of essential services (particularly electricity and water), there have been mixed outcomes following the application competitive neutrality to publicly owned corporations.

Competitive Neutrality and competitive markets

For electricity generation, the application of competitive neutrality to publicly owned generation assets has resulted in a proliferation of new and diverse generation capacity. In the National Energy Market (NEM), generators and retailers interact freely and competitively, with the result being lower wholesale energy prices for consumers. In this instance, the market for energy generation has become a competitive marketplace and competitive neutrality reform has benefited consumers.

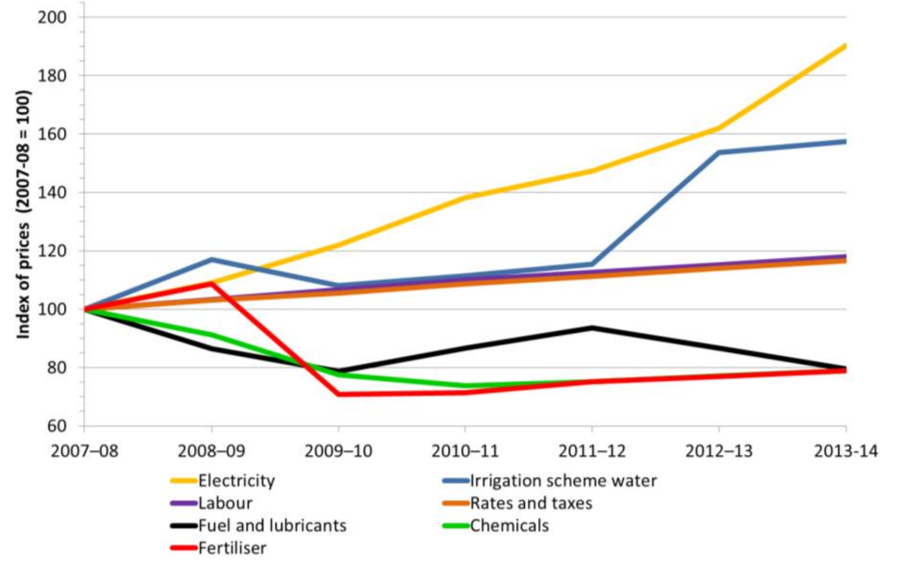
Competitive Neutrality and natural monopolies

There are instances where competitive neutrality reforms have had a perverse outcome for consumers. Applying competitive neutrality provisions to natural monopolies has resulted in artificial increases in price of essential services while delivering super profits to government (as 100% shareholders in publicly owned companies) and incentivised anti-competitive, monopoly rent seeking behaviour. The competitive neutrality principals also incentivise governments to engage in non-commercial policy delivery through its infrastructure companies, rather than having those companies provide essential services at lowest cost.

The lived experience of competitive neutrality principles to natural monopolies has been higher prices for consumers, super profits for shareholders and inefficient monopoly service delivery. Of particular relevance is the charging of corporate debt and equity rates for the provision of monopoly infrastructure (electricity poles and wires, water distribution schemes), the imposition of tax equivalents to income and non-commercial policy delivery through natural monopolies.

Compared to the price of other farm inputs, the prices of goods supplied by government owned natural monopolies (electricity and water) have increased at a faster rate than any competitively priced farm input (figure 1).

Figure 1: Index of farm input prices



Source: QCA, ABARES

Competitive Neutrality providing super profits to natural monopoly shareholders

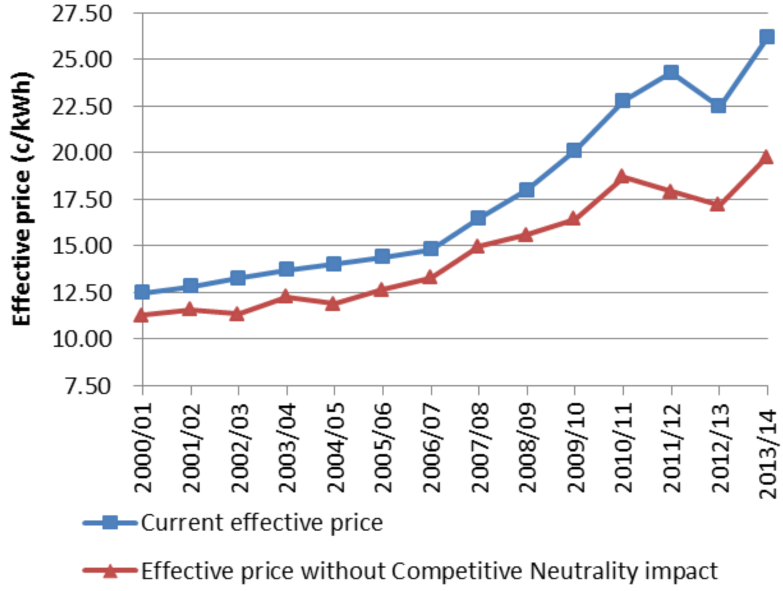
The competitive neutrality provisions of national competition policy require publicly owned natural monopolies to charge commercial debt and equity rates, as well as debt guarantee fees to mitigate any competitive advantage associated with public ownership. These provisions, enabling the government to shift the risk of investment decisions from the asset owner to consumers through higher prices, encourage over investment in infrastructure assets and underutilisation of those assets.

In markets characterised by natural monopolies (particularly essential service infrastructure), the artificial increase in the Weighted Average Cost of Capital (WACC) due to the application of competitive neutrality provisions, as well as the imposition of full business tax equivalents has increased the cost of supplying goods and services to consumers. Irrespective of the cost of debt and equity or the amount of income tax paid, utility service providers will continue to be natural monopolies and will operate without competition in relatively low risk environments. Regulations governing these businesses should recognise the operating environment and not charge prices more applicable to businesses operating in a higher risk environment.

The impact of increases in the cost of supplying essential goods and services by monopolistic providers has been twofold.

First, the application of competitive neutrality provisions to natural monopolies has come at the expense of higher prices to consumers for monopoly utility services (figure 2). Higher prices for monopolistic goods such as electricity and water are a dead-weight on the international competitiveness of all energy users, particularly trade exposed industries such as agricultural irrigators.

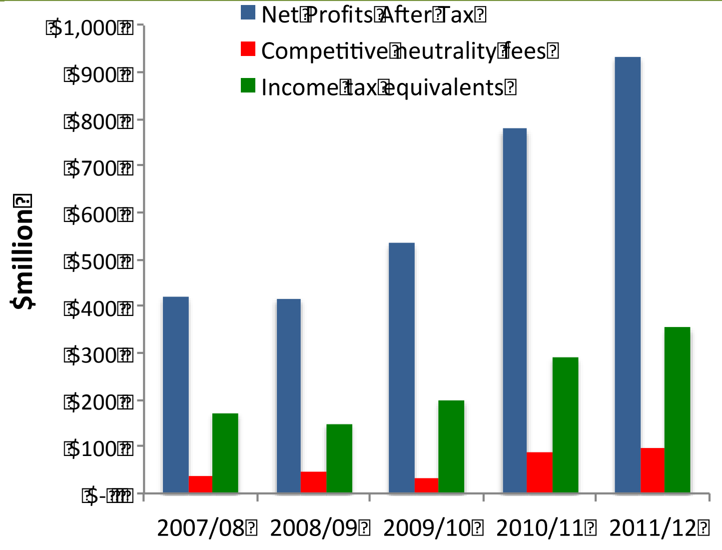
Figure 2: Impact of competitive neutrality provisions on prices of monopoly services



Source: CANEGROWERS analysis

Second, government owners of natural monopoly services receive super profits from the application of competitive neutrality principles to natural monopolies. Payments to state governments from the difference between the risk-free government debt and equity rates, debt guarantee fees and business tax equivalent payments are growing at an ever-increasing rate (figure 3).

Figure 3: Pecuniary benefits provided by competitive neutrality principles



Source: CME analysis

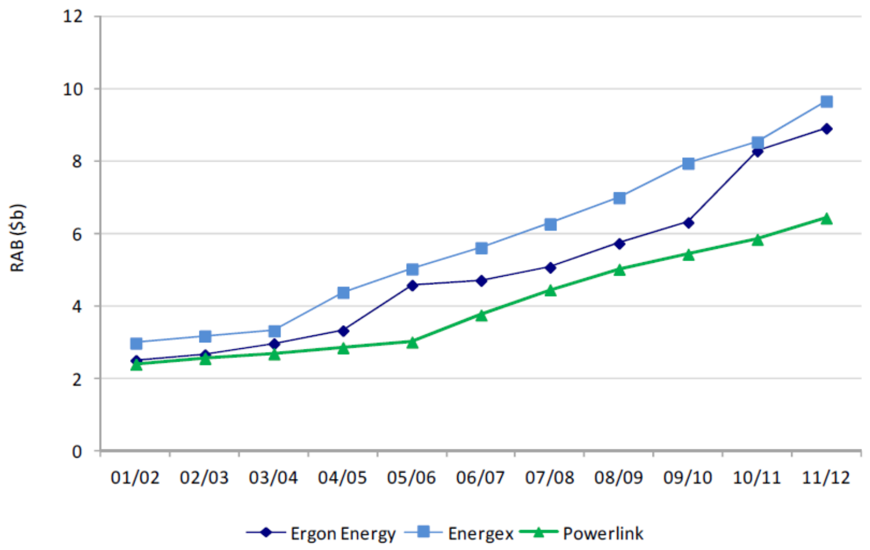
Non-commercial policy delivery

National Competition Policy principles provide an incentive for state governments to require their natural monopolies to deliver non-commercial policies. A clear example of non-commercial policy delivery though natural monopolies in Queensland is in the electricity sector where network service providers are required to implement an N-1 Security Standard.

Example : N-1 security standard

The Queensland government has a legislated N-1 security standard for electricity network service providers. The mandatory N-1 security standard has resulted in an excessive growth in the Regulated Asset Bases (RAB) of monopoly electricity network service providers (figure 4).

Figure 4: Growth in the asset base of monopoly network service providers



Source: Independent Review Panel on Network Costs

The security standard is non-commercial and is overly prescriptive. It has resulted in over-engineering of the network with excessive redundancy being installed into the monopoly electricity networks as overall demand falls. The inflated RAB (which has grown at 13% year-on-year in the current regulatory control period) is currently delivery a large wind-fall gain to the Queensland Government at the expense of consumers.

All of the excess redundancy is expected to be rolled into the RAB (and paid for by consumers), despite the non-commercial nature of the investment. Due to a reduction in total demand in Queensland, it is almost certain that investment made to meet the N-1 security standard will be neither “used nor useful” in the foreseeable future.

Without the competitive neutrality principles providing large windfall gains to the Queensland Government (as shareholders), it could be argued that there would be no incentive (beyond reasonable commercial supply of electricity) to over-engineer the electricity network as a means of increasing returns of monopoly assets.

Proposed solution

CANEGROWERS suggests the removal of the application of competitive neutrality provisions to natural monopoly essential services. Of highest priority are state-owned natural monopolies with access to risk-free debt and equity.

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