

Structural Adjustment Review Committee (SARC)

Chair's Summary

16th Meeting

Sydney Institute of Marine Science, Sydney

23-24 March 2015

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1 Introduction

The SARC met for two days in Sydney, 23-24 March 2015. This summary covers commentary from the SARC on the major issues raised and discussed at that meeting.

The major purpose of the meeting was to consider drafts of the independent economic analysis and the review of the exit grant proposal.

The SARC appreciates the ongoing uncertainty associated with the time taken to design and implement the reform process and understands the difficulties that have been created for some individuals. The complexity associated with the NSW reform, the time taken by the consultants preparing the reports and the need to deal with the large range of concerns raised by industry has presented many challenges and extended the timeline.

The meeting was again held without an industry presence due to the nature of the meeting and the need for the SARC to consider information that if provided to industry, would almost certainly result in a breach of confidentiality of fishing business information and raise conflict of interest issues. Considerable progress was made on key issues, including consideration of further analysis of linkage options taking into account industry submissions.

2 Independent Economic Report

The draft final report of the economic study by AgEconPlus was submitted on 18 March for review and comment. The consultants presented their key findings to the SARC and the Committee provided comments and requests for clarification. It was agreed that AgEconPlus should submit the final report to SARC by the end of April 2015. The following is a summary of the main findings:

- A reform program, by definition, will have an impact on individual fishers (positive or negative).
- Economic studies of other fisheries in Australia indicate that economic performance can be improved by retiring effort and shifting to output controls.
- Forty-four fishers agreed to be interviewed about the potential impact of linkage options on their businesses. Only one was prepared to provide cost data at the fishing business level, which limited the consultants' ability to estimate the impact of linkage options at the fishing business level.
- Two alternative methods were used to estimate return on investment (ROI) for each fishery. Both methods resulted in negative returns on investment on average for 4 out of 5 fisheries (exceeding minus 10%). The Ocean Haul fishery was the only fishery with an estimated positive ROI of between 8-15% due in part to the seasonal nature of the fishery and low reliance on capital equipment. This was generally consistent with the findings in the Environmental Impact Assessments (EISs) done on those fisheries in the early 2000's.
- There is a wide variety of shareholding structures within fishing businesses and hence for any linkage option, the impact will be different. Therefore general conclusions about impact at the fishing business level were not possible.
- The relative price of shares is the key driver of impact of linkage options. As the market is imperfect, there is considerable uncertainty around share pricing and

price information is insufficiently reliable to fully predict impact. Individuals may also value shares differently depending on their own expectations.

- In some cases, the economic analysis suggested that consolidation of shareholdings and sale of share classes that are not used or rarely used may reduce the financial cost of linkage options but may impact also on annual revenues.
- Interviewees reiterated the concerns and issues raised in the public submissions.

Taking into account these findings in making our final recommendations, the focus of the SARC will be on the linkage option most likely to improve rates of return on investment at a fishery level. However, as the SARC has noted previously (Chair's Summary 13th meeting) the cumulative impact on fishing businesses of the preferred linkage option, will be analysed based on data available, to ensure, in as far as it is possible that there are minimal perverse or extreme consequences or that there are mechanisms in place to address these.

3 Implications of perceived share values

The SARC notes that the Stevens Report concluded that existing shares represent a weak property right (lack of exclusivity, divisibility and flexibility) and therefore have a relatively low value. The large number of shares issued dampens the value since supply is greater than demand. However, expectations about share prices as quoted in public submissions and the media are contrary to the above, and likely to be overinflated. For example, some of the share prices quoted would suggest a market capitalisation in some share classes of two or more times the annual GVP of the share class. This is clearly unrealistic. Some of these expectations may have been fuelled by the payment of non-market prices in previous marine park buyouts. It is also likely that the 'value' of shares is artificially inflated by the fact that a relatively small number of operators derive strong returns from the use of their rights (shares) and have an expectation that these shares are somehow 'worth' more than those shares that have not been used to generate income, or have generated small returns. Any exit grant scheme needs to take account of these perceived values (see next section).

4 Review of the Exit Grant mechanism

Professor Jacob Goeree (Centre for Policy and Market Design, University of Technology, Sydney) presented his final draft report on the review of the Exit Grant. Professor Goeree, who has significant practical experience in market design, suggested a number of improvements that would lead to a more effective, transparent and equitable allocation of the \$15.5 million exit grant.

These improvements aim to address many of the key concerns with the previous proposal, including: the complexity of the process, that different prices would be received by successful sellers, insufficient flexibility of bids to reflect different fishing business structures and lack of knowledge of market prices for shares.

The report notes that a simple "buy-out" of entitlements, such as occurred with the introduction of marine parks, would not be a cost-effective use of the available structural adjustment funds.

The SARC is supportive of Professor Goeree's recommended approach to the exit grant, noting that when finalised, consideration will need to be given to obtaining endorsement for the exit grant process from the NSW Department of Trade and Investment and Treasury. The final form of the exit grant process will then need to be communicated and thoroughly explained to industry.

5 A revised approach to implementation of the reform program.

The economic analysis and the review of the exit grant program discussed in sections 2 and 4 above, were initiated in response to concerns expressed by industry about the need for reform, the share linkage options previously presented and the structure of the exit grant. As noted above, the economic analysis has reaffirmed the need for the reform program and the review of the exit grant has confirmed previous advice that a straight "buy-out" would not be a cost-effective use of the available government and industry sourced funding. However, the SARC is proposing a number of changes to the implementation of both the share linkages and the exit grant that should address a number of industry concerns about the initial design of the exit grant program.

Exit Grant

A key industry concern about the initial design of the exit grant was that it focused the available subsidy on the sellers rather than on the buyers of shares. As noted above the SARC has endorsed a revised approach to the exit grant that will, among other things, provide a mechanism to directly subsidise both buyers and sellers in the exit grant program. The SARC believes that this will help to address industry, SARC and DPI concerns about the possible financial implications of the reform program for active fishers.

Share Linkage options

In response to industry comments about the share linkage options the SARC and the Department have continued to analyse the impacts of the share linkage options and industry suggestions for variations to those. As a result of this analysis it is clear that some of the options initially considered will need to be discarded because it is unlikely that the long-term benefits of these options would outweigh the likely short-term investment in additional shares required by active operators. At the SARC's request the Department will undertake some further work on these options over the next month and provide more definitive advice for consideration by the SARC for its draft recommendations on share linkages.

Economic and ecological sustainability

The SARC has noted previously (See section 11.5 Chair's Summary 11th SARC meeting June 2014) that, while the objective of the reform program is to ensure the long-term economic viability of the industry, the biological sustainability of NSW fish resources is an issue that cannot and should not be ignored in the reform program. The SARC notes that a number of species are currently considered overfished or fully fished. Further, a number of species taken by NSW fishers are also taken in Commonwealth fisheries and are subject to tight constraints in those fisheries. The SARC believes that where appropriate, it is imperative that species-based management arrangements are introduced in the medium to long term to ensure that the total catch of these species is sustainable.

In the absence of a strongly linked right, blunt management approaches that cause inefficiencies in fishing are likely to be needed instead to control NSW catches –i.e. the same approaches which have been used by the Department in the past and criticised by industry during the Stevens Review for impeding the ability of operators to become individually more profitable.

The SARC will be taking these issues into account in forming its recommendations on share linkages by share class so that the share linkages provide an effective platform for delivering on ecological as well as economic viability.

Streamlining management arrangements under share linkage

The SARC noted that a number of proposals for streamlining management arrangements under various share linkage options had been put forward in the options papers but that there had been relatively little industry comment or support for these and, in some cases, concerns raised by non-commercial stakeholders to very specific local issues. As a result, apart from a small number of high-level proposals, the SARC does not intend to include streamlining management arrangements in its consideration of the most appropriate share linkage option on a share class by share class basis. However, the SARC believes that opportunities for streamlining management arrangements should be revisited by the Department in consultation with industry and other stakeholders where relevant, after decisions on share linkage have been taken in order to maximise flexibility of fishing operations and minimise management costs wherever possible.

Constraints on holding shares

Of the concerns that have been expressed, there has been a focus on the need to maintain a limit on maximum shareholdings in order to maintain the small-scale nature of the industry and in particular to avoid significant ownership by foreign interests. While the SARC acknowledges, and has previously discussed (See section 11.3 Chair's Summary 11th SARC meeting June 2014) that freeing up limits on shareholdings may be consistent with maximising profitability in the industry it also acknowledges that social objectives are important. The SARC is aware, for example, that in fisheries such as the Tasmanian Rock Lobster Fishery there is an objective to limit the concentration of shares (quota). In that fishery there is a limit on the holding of quota from which a single entity can benefit of 3.6%. The SARC recognises that such constraints can be circumvented through the use of different company structures. After further consideration however, the SARC has concluded the use of maximum share holdings should be subject to discussion at a share class level, following implementation of share linkages and that such measures could legitimately be retained if the government and industry agree. Further, in relation to foreign ownership rules, while the risk is likely to be small given the overall value of NSW fisheries (~\$70-80 million) compared with other fisheries/primary industries around Australia and that considerable resources (e.g. forensic accountants) would be needed to fully administer them, the SARC believes those provisions should be retained for the time being.

6 Creation of new share classes (allocated in any other way than upon existing shares)

The issue of new share classes has been discussed by the SARC in previous Chair's Summaries (Section 5.9 Chair's Summary 5th meeting September 2013, Section 7.6,

Chair's Summary 7th meeting January 2014 and Section 12.10 Chair's Summary 12th meeting June 2014).

As previously advised, the SARC believes that new share classes should be used where:

- a. a small number of shareholdings in the existing share class account for the bulk of current catches potentially placing an unacceptable and unintended financial burden on these fishing businesses which would be required to purchase a large amount of shares to continue their fishing operation thus having significant impacts on their economic viability;
- b. no other suitable linkage options and associated measures are available or feasible for the existing share class (e.g. staged implementation or delaying the commencement of the ITCAL) to minimise the financial burden on those operators;
- c. the benefits of moving to a new share class clearly outweigh the costs; and
- d. the proposed new share class must have the strongest form of share linkage feasible (i.e. a catch quota or if that is not feasible, a very tight effort quota).

As noted previously, the SARC believes that the creation of new share classes should only occur in exceptional circumstance and where the above conditions are met. The information now available to the SARC suggests that these conditions are likely to be met in a limited number of cases. As a result the SARC has considered the process for implementing a new share class.

As the SARC has warned previously, the creation of a new share class (where allocation is based on anything other than current shares) will generally require a new allocation process and experience in other fisheries suggests that where such allocation includes a component of catch history, the allocation process can take many years. The SARC has been advised that decisions on the basis for the allocation need to be made using a thorough process including consultation with the affected fishers. Such processes do not come within the scope of the SARC's work and will need to be initiated separately and subsequently to the SARC's recommendations on share linkages. That is, while the SARC may recommend the creation of a new share class it cannot provide certainty about the basis of the allocation of those new shares (i.e. whether quota would be allocated on the basis of, for example 80% catch history/20% shareholding or 50% catch history/50% shareholdings). The SARC acknowledges that this does create some uncertainty for the fishers involved and will affect their ability to participate effectively in the exit grant program.

The SARC advises that in making any recommendation for the creation of a new share class (incorporating factors other than existing shares) the SARC will also recommend that such linkages occur over a much longer time frame than the implementation of share linkage options that link shares to existing entitlements.

7 Targeted Consultation

The SARC hopes to have recommendations on linkages and related matters completed by mid year. The SARC will undertake additional targeted consultations with industry before finalising its recommendations. The points below provide an indication of the proposed format and sequence of this consultation:

- i) Draft recommendations, including rationale, mailed to fishers and placed on the Department website
- ii) Opportunity for fishers/others to comment on draft recommendations via correspondence to the SARC and/or feedback to managers/liaison officer
- iii) Written and verbal feedback synthesized by SARC for consideration at meetings of industry working groups
- iv) Working group meetings (chaired by SARC) at three locations
- v) Meeting with main established industry groups (PFA and the Coalition)
- vi) Meeting with representatives from the recreational fishing and conservation sectors
- vii) Meeting with the Fishing Co-operatives Association

Following this sequence and after due consideration of feedback, the SARC will finalise its recommendations and provide them to the Minister.

In the meantime, the opportunity remains open for fishers to write to the SARC. Comments and correspondence can be sent to the SARC through the Industry Liaison Manager:

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