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Hunt Blog Newsletter

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CATTLE PRODUCERS NEED A STRONG REPRESENTATIVE BODY TO COUNTERACT SUPERMARKET AND PROCESSOR POWER

PART 2

CONCLUSIONS AND SOLUTIONS

Foreword

This is Part 2 of the Hunt Blog newsletter on the urgent need to establish a sustainably funded, truly representative and effective grass fed cattle body in Australia

Last week in Part 1 Hunt Blog explored:

- recent parliamentary enquiries into grass fed cattle organisational structures and concentration of processor power;
- recent government attempts to curb the deleterious effects of increasing supermarket and processor power on the rural sector by strengthening the power of the ACCC;
- reports by the Australian Farm Institute and the National Farmers Federation about the ineffectiveness of Australian rural advocacy groups in comparison to successful overseas models;
- the unsustainable plight of the cash-strapped State Farmer Organisation (SFO) based Cattle Council of Australia (CCA);
- the relative financial and representative weakness of CCA in comparison to successful overseas service fee and levy funded rural advocacy bodies and other Australian levy funded advocacy and policy development organisations; and
- the different outcomes achieved by America and Australia representative bodies with respect to the quantum of industry taxes and government costs and producers' share of the retail dollar.

This week Hunt Blog:

- explores possible funding models for cash strapped SFO representative bodies such as the CCA;
- examines key recommendations of the Grass Fed Cattle Levy Funded Structures and Systems Senate Inquiry that may help strengthen grass fed cattle organisational representation;

- draws some conclusions that seem to flow inexorably from these examinations and the material set out in Part 1; and then
- proffers some solutions for consideration by the red meat industry and government.

The Need for a Well-Funded, Truly Representative Grass Fed Cattle Advocacy Body

As was explained in detail in last week's Hunt Blog entry on 20 April 2016 ("*Cattle Producers Need a Strong Representative Body to Counteract Supermarket and Processor Power Part 1*"), a number of factors including the declining influence of SFOs in the last 25 years and the shift in responsibility for agricultural policy from the states to the federal government have created a need for a powerful and more effective lobby group for the Australian grass fed cattle industry.

A host of successful representative advocacy bodies in Australia and overseas all fund part of their operations from a mixture of levy funds, membership fees, and derive income from services supplied to their members. It is common ground in Australia that organisations can use levy funds for policy development and there are a number of examples of levy funded bodies that either by charter or in practice utilise statutory levies to fund advocacy as well.

A well-funded, unified advocacy group would allow the grass fed cattle industry to effectively lobby the federal government to implement the policy changes needed for the long term success of the Australian grass fed cattle producers.

Levy Funded Advocacy

Arguments against the use of levy funds by representative bodies for advocacy have to be understood in the context that:

- Australian political parties are allowed to overcome the financial effect of falling membership and fund their political campaigns from Consolidated Revenue;
- the current red meat Peak Councils can utilise interest earned from levy reserve funds and levy "service fees" for policy development and advocacy; and
- other Australian and overseas rural representative bodies can receive and utilise levy funds to fund policy development, advocacy, and service delivery.

It follows that there is no fundamental logical impediment to the proposed new grass fed cattle representative body also receiving and utilising cattle transaction levy funds for policy development, advocacy, and service delivery.

The only logical restrictions that need to be placed on levy expenditure for rural representative advocacy is to preclude the use of levy funds to fund political parties and political candidates and perhaps to prohibit the use of levies to fund litigation against the Government. Prohibitions that can be, and usually are, inserted in all levy Statutory Funding Agreements (SFAs).

In any event, any qualms about a representative body using levy funds for advocacy or lobbying can be resolved by the representative body quarantining income received from interest received from the RMAC reserves and income earned from the provision of membership services for advocacy and lobbying with all levy funding being spent on policy development and R&D.

Financial Chinese Walls and the Example of the National Cattlemen's Beef Association (USA)

As outlined in Hunt Blog's Part 1 of this newsletter, the National Cattlemen's Beef Association (NCBA) in the United States is a consumer-focused, producer-directed marketing organisation and trade association that is regarded as being highly representative of cattle producers and feeders.

The NCBA aims "to advance the economic, political, and social interests of the U.S. cattle business and to be an advocate for the cattle industry's policy positions and economic interests." The NCBA lobbies Congress to achieve its aims, and funds full-time lobbyists in Washington, D.C.

The funds from the Checkoff levy (a \$1 transaction levy on cattle in America), is split between the Federation of State Beef Councils (the 'Federation'), the State Beef Councils, and the Cattlemen's Beef Board ('CBB'). These

organisations have what may be described as a “symbiotic” relationship with the NCBA and its State affiliates, especially given their memberships come from the NCBA and its State affiliates, and that the Federation is itself a division of the NCBA.

The Federation is the division of NCBA that oversees beef and beef production promotion, research, information, and related activities funded by the beef Checkoff levy, up to 50 cents on the dollar of which are permitted to be retained by individual State Beef Councils and contributed to the Federation.

In order to keep the Checkoff levy funds from being used for the more political actions of the NCBA, structurally there is what amounts to a financial “Chinese Wall” inside the NCBA whereby the Checkoff levy funds are in a separate bank account that is controlled by the Federation Directors and Executive Committee inside the NCBA to ensure that the Checkoff levy funds are not used for the lobbying activities of the NCBA.

Such a financial “Chinese Wall” could easily be constructed in an Australian grass fed cattle representative body.

Key Recommendations of the Senate Inquiry into Grass Fed Cattle Levy Funded Structures and Systems

Four of the Seven Recommendations of the Senate Inquiry into Grass Fed Cattle Levy Funded Structures and Systems relate directly to the creation of a strong grass fed cattle representative body.

Recommendation 1 – *calls for the formation of a new grass fed cattle Peak Council (‘Newco’) that truly represents every Cattle Transaction Levy Payer in Australia with the authority to receive and dispense all the Cattle Transaction Levies*

The Federal Government has thus far supported the Senate Inquiry’s Recommendation for the formation of a new grass fed cattle representative body but:

- has not yet endorsed implementation of that part of the Senate Committee’s Recommendation that would allow the new body to receive and disperse all of the grass fed cattle transaction levies; although
- Agriculture Minister Barnaby Joyce has left the door open to at least part of the cattle transaction levy being allocated to the new grass fed cattle representative body if at least 60% of cattle transaction levy payers vote in favour of that proposal.

The Cattle Council of Australia (CCA), the Australian Beef Association (ABA), the Australian Meat Producers Group (AMPG) and the Concerned Cattle Producers (CCP) representative bodies all come together earlier this year in an historic consensus to agree on a new corporate representative structure for the grass fed cattle industry Peak Council, a Newco corporate structure that will represent every grass fed cattle transaction levy payer in Australia and whose seven man producer board will be elected from representatives from 15 regions across Australia.

An Implementation Committee has been formed and is attempting to raise seed funding to establish the Newco representative body by developing new funding arrangements and lobbying the Federal Government to implement a workable funding model for the new grass fed cattle representative body.

Recommendation 2 – *calls for the establishment of a cost-effective, automated cattle transaction levy system to identify levy payers against levies paid, provide for more immediate settlement of levy fees paid and the allocation of voting entitlements, subject to regular independent auditing and verification*

In response to Recommendation 2 of the Senate Inquiry, the *Review of MLA process for registering and determining voting entitlements* was undertaken by MLA to investigate the most effective way to identify levy payers and calculate voting entitlements.

The review handed down its Final Report in September 2015. This report considered a number of methods of registering and determining voting entitlements and identified three possible legitimate options:

- NLIS / NVD leverage: involves a change to forms and information collection procedures so agents collect additional data to identify levy payer - removes producer self-declarations (report: option 1)
- Legislative pathway: requires a change in legislation with agents providing data to Dept. Agriculture – Levies Revenue Service (report: option 2)

- Legislative pathway: requires a change in legislation with agents providing data via Dept. Agriculture – Levies Revenue Service directly on to MLA’s nominated commercial data services and registry commercial provider (report: option 2a - hybrid).

The full Final Report can be accessed on www.huntblog.com.au.

Recommendation 3 – *recommends that the Primary Industries (Excise) Levies Act 1999 be amended to ensure that levies paid by processors are recognised as processor (or slaughter) levies and not as producer (or cattle transaction) levies.*

The *Cattle Transaction Levy Act 1997* imposes a deemed transaction levy on all cattle purchased by a processor and held for a period of more than 60 days after the day of purchase and before the day of slaughter.

Consequently, processors pay this deemed transaction levy on all their background cattle and 70-day, 90-day, and 120-day grain fed feedlot cattle.

As the Senate Inquiry Committee points out, when the current levy system was implemented in 1998 the current extent of feedlot and backgrounding vertical integration by processors could not have been foreseen.

Consequently, eleven of the top seventeen levy payers to MLA in 2010-11 owned an abattoir and Swifts, the world’s biggest meat processor, is the biggest MLA levy payer with the highest voting entitlement at MLA AGMs. If cattle producers want to ensure that the new grass fed cattle producer corporation is wholly owned by grass fed cattle producers, it will also be necessary to implement Recommendation 3 in order to ensure that all grass fed cattle transaction levies paid by processors on cattle that they have owned for more than 60 days prior to slaughter are paid to the Australian Meat Processor Corporation (AMPC).

Thus far, the Government’s position with respect to Recommendation 3 has been that any proposal to change a levy should come directly from the payers of that levy. Hunt Blog’s reading of the tea leaves suggests that many significant processors, perhaps the majority, do not believe that they are receiving value for the levies that they pay to MLA and would prefer all their levies to be paid to the AMPC so that processors can have complete control over how their levies are invested.

Recommendation 7 – *recommends that the Department of Agriculture, in consultation with the cattle industry, conduct an analysis of the benefits, costs and consequences of introducing legislation akin to the American Packers and Stockyards Act 1921 and Livestock Mandatory Price Reporting Act 1999.*

Cattle Price Information

Australia’s current market information cattle price indices are derived from saleyard prices but currently less than 30% of cattle slaughtered in Australia each year are sold through saleyards. Indeed, the largest meat processors are buying over 80% of their cattle through direct consignment from producers with most large lines of cattle and some of the best quality young cattle being sold directly to abattoirs.

Currently, published price indicia’s such as the Eastern Young Cattle Indicator (EYCI) are however based on saleyard prices. Consequently, unlike their American counterparts who have access to twice daily mandatory price information reporting under the Livestock Mandatory Price Reporting Act, Australian cattle producers lack the necessary price information which is a fundamental requirement of a free market economy.

As well-known American beef cattle commentator and journalist Steve Kay said in an article in Beef Central on 14 April 2016, “*All Markets, whatever goods they trade, must be as open and transparent as possible to function successfully.*”

Boxed Beef and Carcass Wholesale Prices and Retail Beef Prices

The pros and cons of the introduction of an Australian reporting equivalent of the US Livestock Mandatory Price Reporting Act for abattoir back door wholesale and retail prices are however more equivocal.

Australia exports almost 70% and only consume about 30% of its beef production compared to the 11% exported and 89% consumed by the American beef industry, Consequently the farm gate share of the domestic retail price is

far more relevant in the US than in Australia where the relevant issue is the farm gate share of export and domestic retail prices.

In a range of submissions to the Grass Fed Cattle Levy Funded Systems and Structures Senate Inquiry and the Processor Power Senate Inquiry, Australian cattle producers have broadly expressed concern that they receive a disproportionately small margin of the end retail dollar for a beast partly as a result of the lack of information regarding prices paid and received along the beef supply chain.

Most of the evidence which was presented to the Senate Committee highlighted the lack of transparency in relation to cattle pricing and the need for a level market playing field. In light of factors including the diversity of product coming out of the farm gate, increasing focus on export markets, consolidation of the processing sector and the extent to which there is genuine competition at stockyards, producers are unable to clearly follow the path of the supply chain.

The view was put to the both the grass fed and the processor power Senate Inquiries that a legislative mechanism to require disclosure of the abattoir back door wholesale beef prices as well as wholesale to retail prices could improve competitiveness in the livestock market.

Some supporters of price transparency argued that a system which establishes the true price of the cattle market by requiring transparency in market reporting along the whole price chain, underpinned by the prospect of investigation into anti-competitive behaviour, has the potential to improve industry profitability. The counter argument is that there should not be a mandatory requirement for abattoirs to report on prices received by them for the processed beast because Australia exports 70% of its production mandatory disclosure and publication of average prices paid for export beef would put each abattoir at a commercial disadvantage when negotiating sale with a multitude of overseas buyers from various countries and would therefore be counterproductive to the achievement of the best export price.

Agriculture Minister Barnaby Joyce acknowledged the importance of supply chain price transparency in his opinion piece which was published in Beef Central on 15 July 2015, following the publication of the Senate Committee's findings.

In 2014 MLA commissioned the consultancy firm AGINFO to investigate the issue of price transparency in the beef supply chain. AGINFO published a shortlist of options for achieving greater price transparency in August 2015, which fall into three broad categories:

- mandatory price reporting;
- voluntary price reporting; and
- enhancement of existing market intelligence services.

Hunt Blog's Conclusions on the Need for Grass Fed Cattle Organisational Reforms

There must be a solution. CCA have indicated that the erosion of their funds mean they have between one year and eighteen months before they no longer have the funds to operate. Therefore, a solution for the representation of grass fed cattle producers is necessary.

It goes without saying that:

- a geographically fragmented cattle producing industry comprising somewhere around 100,000 relatively small individual producers located at disparate parts of a large continent need a strong representative body if they are to counteract the economic might and strength of a concentrated processing sector where the three top processes slaughter over 50% of the cattle and a concentrated Australian supermarket sector where the two largest supermarkets retail 57% of the beef consumed in Australia;
- true representation of an industry sector or can only be achieved if:
 1. all the participants in that sector are entitled to be members of the body that represents them and are entitled to influence the policies of that body by electing its board and having the right to vote on significant policy matters; and
 2. the representative body for that sector is sufficiently resourced to carry out its representative functions;
- the efficient operation of a free market is dependent upon the participants in that free market having adequate knowledge of the prices being paid in that market.

It follows that the success of any moves to ameliorate the effect on the Australian red meat industry of increasing concentration of power in the supermarket and processor sectors over the last two decades will ultimately depend upon the establishment of sustainably funded, truly representative producer bodies.

The veracity of this conclusion is borne out by the following matters discussed in detail in Part 1 of this newsletter last week:

- the relative success and influence of well-resourced, levy and service fee funded overseas rural representative bodies facing similar concentrations of supermarket and processing power in their countries;
- the higher percentage of the retail dollar being obtained by overseas cattle producers, and particularly American cattle producers, compared to the percentage of the retail dollar obtained by the Australian cattle producers while facing similar concentrations of supermarket power on a regional basis and similar, if not greater, concentrations of processor power; and
- the higher government influenced costs and charges paid by Australian cattle producers compared to their overseas counterparts.

It is also self-evident that the services offered by any statutory levy funded service provider such as the MLA should, to the extent possible, be fully contestable. The current effective MLA service monopoly must as a matter of practice and free market theory lead to inefficiencies, and potential service cost blow out when compared with a truly competitive, free-market system.

Hunt Blog's Solutions to the Challenge of Establishing an Effective Grass Fed Cattle Representative Body

The Federal Government should implement at least Recommendations 1, 2, 3, and 7 of the Grass Fed Cattle Levy Funded Structures and Systems Senate Inquiry Report, in full or in part, in order to establish a strong cattle producer representative body (Newco) to countervail the increasing concentration of Australian supermarket and processor power.

The establishment of the proposed grass fed cattle representative Newco with a board elected by all Australian grass fed transaction levy payers from a pool of elected representatives from 15 regions across the whole of Australia which has the support of all grass fed cattle producer representative bodies and the Federal Government will be a truly representative Peak Council for the grass fed cattle producer industry.

The challenge, however, of providing seed capital to establish Newco and finding a sustainable income stream to fund its activities still remains. A number of alternatives come to mind, including a mix of levy funding and income from the provision of services to Newco's levy paying members along the lines of the successful rural representative overseas models discussed above and in Part 1 of this Hunt Blog newsletter.

If the Federal Government were to implement Recommendation 1 in full, so that all grass fed cattle transaction levies went to Newco, then, the red meat industry Memorandum of Understanding (MOU) could require Newco to contribute a portion of the levies received by it to fund core MLA activities and functions in the same way that AMPC and Livecorp are currently required to contribute to core and joint MLA functions. MLA's continuing existence and the retention of MLA's key personnel would therefore be assured.

The sheep industry could adopt a similar structure to that adopted by the grass fed cattle industry and perhaps combine with Australian Wool Innovations (AWI) as some very prominent members of the sheep meat and wool industry have suggested to form a very powerful sheep and wool industry representative body. MLA could also provide contestable non-core services to Newco and all the other red meat industry sectors.

Alternatively, if only that part of the levy that was necessary for Newco to conduct policy development and carry out its charter under the existing red meat organisational structure were provided to Newco, as CCA have suggested, then the balance of the grass fed cattle transaction levy paid to MLA should be held in a distinct MLA trust account on behalf of grass fed cattle levy payers with a requirement that it could only be spent with the prior written approval of Newco.

The Federal Government therefore needs to work constructively with the Implementation Committee for the proposed Newco:

- to provide or help to facilitate the provision of necessary seed funding to establish Newco;

- to facilitate the provision of an ongoing sustainable stream of funding for Newco which could and should include a mix of service fee income and grass fed cattle transaction levies; whilst
- ensuring that the MOU delivers sufficient core funding to MLA to enable it to retain its key personnel and fully utilise its store of intellectual property in the interests of the red meat industry as a whole; but
- otherwise, requiring all non-core or beef specific activities to be supplied by MLA or another service provider on a contestable basis.

The Federal Government should:

- facilitate a plebiscite, in accord with the Levy Principles and Guidelines, through Newco after it is established to determine whether grass fed cattle producers supported the Grass Fed Cattle Levy Funded Structures and Systems Senate Inquiry Report Recommendation 3 that all levies, currently paid by processors to MLA should be paid instead to AMPC in order to ensure that MLA was a truly producer corporation;
- consult with the processors through the AMPC or facilitate a plebiscite, in accord with the Levy Principles and Guidelines, of all AMPC levy payers to ascertain whether or not the majority of processors support Recommendation 3 of the Grass Fed Cattle Levy Funded Structures and Systems Senate Inquiry Report; and
- introduce and enact legislation to implement Recommendation 3, if a majority of *either* the producers or the processors were found to support Recommendation 3.

Finally, the Federal Government should introduce and enact the Australian equivalent of the US Livestock Mandatory Reporting legislation with respect cattle prices paid to producers by abattoirs to ensure market transparency and provide the necessary market price information to Australia's cattle producers to compete in an open and free-market.

Please visit www.huntblog.com.au to review Part 1 of this newsletter and for further information and commentary on Australian cattle reform issues.