

BRIEFING FOR THE MINISTER OF POLICE			
<b>Priority</b>	<input type="checkbox"/> Urgent <input checked="" type="checkbox"/> Time-Sensitive <input type="checkbox"/> Routine		
<b>Subject</b>	<b>Compensation for dealers – provisional advice for discussion</b>		
<b>Date</b>	15 May 2019	<b>Ref</b>	BR/19/48

## Executive Summary

This paper provides initial advice on a compensation scheme for licensed dealers to support the prohibition of semi-automatic firearms under the Arms Act 1983.

The key policy decision required to establish compensation for dealers is the pricing approach. Proposed options include:

- Stock at value defined by KPMG OR
- Stock at import or wholesale price, plus 10% or 20% OR
- Stock at import or wholesale price, including or excluding freight.

## Recommendations

It is recommended that Minister of Police:

- note** the purpose of the buy-back is to get as many prohibited semi-automatics out of private ownership as possible
- note** that settings for dealer compensation may impact on the overall success of the buy-back
- agree** in principle that the pricing approach for compensation is Yes/No
  - Stock at import or wholesale price, excluding freight OR
  - Stock at import or wholesale price, including freight OR
  - Stock at import or wholesale price, plus 10% OR
  - Stock at import or wholesale price, plus 20% OR
  - Stock at values defined by KPMG list
- note** that compensation payments are estimated to be between \$2.6 million and \$9.0 million and this can be funded through the funding being allocated to the buy-back
- agree** that this paper is shared with the Minister of Finance for early discussion

## BRIEFING FOR THE MINISTER OF POLICE

- f) **note** that following Ministerial direction, Police will draft a paper for establishment of dealer buy-back regulations, for discussion by Ministers with Power to Act and inclusion in a paper for LEG seeking approval for Regulations.

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Mike Clement  
Deputy Commissioner, National Operations

<b>First contact</b>	s 9(2)(a)	
<b>Second contact</b>	Mike Clement, Deputy Commissioner, National Operations	s 9(2)(a)

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## **Compensation for dealers – provisional advice for early discussion**

### **Purpose**

1. This paper provides initial advice on the approach for a compensation scheme for licensed dealers for stock held following amendments to the Arms Act 1983, prohibiting certain types of semi-automatic firearms, parts and magazines.

### **Background**

2. Ministers with Power to Act agreed to settings for a buy-back initiative for newly prohibited firearms on 4 April 2019 [BR/19/34] and on 8 April 2019 [BR/19/36]. One of the decisions made was that the compensation provision will specify that compensation need not account for economic, consequential, business loss. We have interpreted that to mean that future profit or lost future business opportunity cannot be compensated for, but compensating for retail price for stock is an option.
3. Ministers are yet to make decisions on the pricing approach for the buy-back scheme for firearms owners. Decisions regarding compensation for licensed dealers should be timed alongside decisions for the broader buy-back scheme to ensure the two schemes work logically together

### **Dealers are important players for the buy-back scheme to be successful**

4. In the planning for the buy-back scheme, it has become increasingly apparent that retail dealers will play a crucial role in the success of the scheme. We provided advice to you [BR/19/49] about developing a network of dealers to act as collection points. We expect this to improve firearms surrender rates, as it will give more convenient locations and times for handing in, and because dealers are able to draw on their community connections to encourage surrender. This approach also reduces the safety risk of concentration at collection points.
5. The first policy decision is whether to compensate dealers. We recommend that government does compensate dealers, and that it should be approached with the same underpinning purposes as the individual buy-back. That is, to get as many prohibited semi-automatics out of private ownership as possible.
6. Not compensating dealers, or providing a level of compensation perceived as unreasonably low, would carry risks, including:
  - Dealers not willing to assist in the individual buy-back process (receiving surrendered firearms and associated administration)
  - Dealers not willing to partner alongside Police in the on-going administration of the Arms Act and losing any goodwill in relation to the broader firearm reform programme
  - Loss of confidence in government by the firearms community
  - Lengthy and costly civil litigation.

7. This paper is focused on the sub-set of licensed dealers who are retailers, wholesalers and importers. Others hold a dealer license because they generate income for example hiring firearms for theatrical or film production purposes. When we give further detailed advice about dealer compensation we will recommend whether all dealers should be included in dealer compensation, or whether some would align better with the general buy-back scheme.
8. We understand from engagement with the firearms community that there may be some small dealers who are at risk of going out of business as a result of the prohibition of certain types of firearms.

#### **Decisions are required on the scope of the compensation**

9. Compensation for stock on hand is consistent with the decision of Ministers not to compensate for economic, consequential, business loss. This includes prohibited items detained at the border or that have been handed over by Customs to Police due to the legislation amendment.
10. Dealers making a compensation claim would be required to: prove their losses through producing records (this also ensures that items were not purchased by a dealer after the Order in Council of 21 March); and demonstrate that reasonable steps were taken in order to mitigate any losses, in particular that import orders not yet shipped were cancelled. Compensation could take account of costs incurred in mitigating losses.

#### **Setting an approach to price**

11. The key policy decision required to establish dealers' compensation in the buy-back is the approach to establishing the level of compensation.
12. Police has drawn on the following criteria and approaches when considering compensation for dealers
  - Operational simplicity
  - Fairness and effectiveness in meeting business costs
  - Impact on willingness of dealers to engage as positive partners in the buy-back scheme and broader firearm reforms
  - Risk of litigation
13. Proposed pricing options, for new stock include:
  - stock at import or wholesale price excluding freight
  - stock at import or wholesale price including freight
  - stock at import or wholesale price plus a percentage
  - stock at value defined by the KPMG price schedule

14. Table One in the Appendix outlines these options, and identifies the implications for the success of the buy-back scheme.
15. If compensating for freight was agreed, this would be on a pro-rata basis. This may be difficult to estimate for many claims, given prohibited items being compensated for may only be an element of a freighted import consignment that has been freighted. There is a large variance between air freight and shipping costs. Our analysis of some recent import consignments shows that shipping has virtually no cost (a few cents per kilogramme) whereas air freight has an average of \$20 per kilogramme, which equates to approximately \$60 for one firearm. We think that the administration of compensating for freight costs would be large, for a relatively small benefit payable to dealers. Our initial analysis suggests that freight could average out to be around 1% of the value of prohibited items held by dealers. For some dealers domestic freight costs should also be allowed for.
16. In at least one Australian buy-back, dealers were paid a wholesale price plus 10 percent for items which they surrendered. The wholesale price in Australia was an average wholesale price determined by firearms experts in consultation with firearm dealers. Importers were paid the customs value plus 20 per cent for surrendered items. The customs value was determined by what was declared to the Australian Customs service at the time of importation. We propose that the import price is based on the declared Customs value, if this is less than what was invoiced.
17. Compensating with an additional percentage would enable Ministers to acknowledge the costs to businesses that relate directly to the stock held, but are beyond the actual price paid in the supply chain. This would account for administrative and other costs such as insurance and storage. Ministers could set this percentage at a rate that could mitigate the risk of lower participation of dealers in the buy-back scheme.
18. s 6(c)
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

#### **Cost of options for compensating for prohibited firearms, parts and magazines**

19. Table One shows the cost estimations that apply for each option. In order to estimate the costs we have taken an approach of using information provided to Police from large dealers, importers and some manufacturers, of their stock of prohibited items on hand. For most of these dealers this is an estimation of their stock value, therefore we have some wide ranges. Further, we have made estimations to account for the small-scale dealers that we did not obtain information from.

20. A relatively small number of dealers do the majority of the importing. Some are importer-wholesalers who supply to retail dealers and do their own on-line sales. Others, including the largest retailer, import direct for sale. We understand that wholesalers apply around 45% mark up, and retail dealers apply around another 30%. Therefore if compensation is based on the price paid, the level of compensation for the same item will depend on where in the supply chain the item is held in stock.

**Further advice will be given**

21. Following your feedback on this paper we will provide advice in the next paper to Ministers with Power to Act on other settings for compensation for dealers, including

- Second-hand stock
- Costs incurred in returning stock to suppliers
- Modifications to shotguns
- Manufacturers of firearms parts
- Process considerations – assessment, approval and payment of claims
- Timing for the dealer compensation

**Financial implications**

22. There is limited information on the likely scale of compensation to dealers. This advice is based on the compensation being for those dealers who sell firearms (including manufacturers). We understand these may be around a quarter of the 493 licensed dealers in New Zealand. We do not have any information on what proportion of stock, if any, is likely to be able to be returned to suppliers.

23. This work has been undertaken without extensive engagement and limited consultation with affected parties relating to stock currently held. This limits the 'auditing' of the range of costs inherent in the system, leading to the need to undertake high level estimations. Significant variation in different business costs based on scale and nature of business would also make generating average costs problematic.

24. We have estimated a range of \$2.6 million to \$9.0 million for compensation for newly banned firearms, parts and magazines held by dealers. This range reflects the lower and upper limits across all the options outlined in Table One. A

s 9(2)(b)(ii)

25. The financial implications of administering the buy-back and amnesty for dealers are not yet known. Police is working to develop an estimate of these costs.

**Ministers' comments and signature**

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Hon Stuart Nash  
Minister of Police

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**Appendix:** Table One Pricing options for dealer compensation

Pricing option	Features	Implications for success of buy-back scheme
No compensation	<ul style="list-style-type: none"> <li>Does not meet fair and reasonable expectation that buy-back is based on</li> <li>Would likely lead to loss of confidence in government by firearms community</li> <li>Would likely lead to civil litigation</li> <li>No administration costs</li> </ul> <p>Compensation cost is nil</p>	<ul style="list-style-type: none"> <li>Dealers would likely be unwilling to participate as collection agents in the buy-back</li> <li>Dealers not participating as collection agents would               <ul style="list-style-type: none"> <li>risk the scheme not succeeding in removing most prohibited items from the community, due to significantly reduced availability of collection points, creating barriers for firearms owners to surrender prohibited items within the buy-back period</li> <li>Costly and complex logistical burden on Police, creating risks associated with potential delays to destroy items and make payments</li> </ul> </li> <li>Dealers, as influential players in the firearms community, would likely undermine the trust and confidence in the scheme</li> </ul>
Stock at import or wholesale price excluding freight	<ul style="list-style-type: none"> <li>Close to, but less than, actual losses relating to stock on hand</li> <li>Administratively straight-forward</li> <li>No component for any business costs</li> <li>Straight-forward administration</li> <li>No delays likely for making payments</li> </ul> <p>Estimated cost \$2.6 million to \$6.3 million</p>	<ul style="list-style-type: none"> <li>Compensating for price paid (with or without freight) may remove dealers' willingness to participate as collection agents in the buy-back</li> <li>Compensating with an additional percentage, perceived as too low by dealers, may remove their willingness to participate as collection agents in the buy-back</li> <li>Dealers not participating as collection agents would               <ul style="list-style-type: none"> <li>risk the scheme not succeeding in removing most prohibited items from the community, due to significantly reduced availability of collection points, creating</li> </ul> </li> </ul>
Stock at import or wholesale price including freight	<ul style="list-style-type: none"> <li>Reflects actual losses of stock on hand</li> <li>Freight component small in most cases</li> <li>Freight component likely to be difficult to determine in most cases</li> </ul>	



	<ul style="list-style-type: none"> <li>• High degree of fairness given the widely varying freight costs (air vs sea)</li> <li>• No component for other business costs</li> <li>• Complex administration could cause delays to payments being made</li> </ul> <p>Estimated cost \$2.6 million to \$6.5 million</p>	<p>barriers for firearms owners to surrender prohibited items within the buy-back period</p> <ul style="list-style-type: none"> <li>• Costly and complex logistical burden on Police creating risks associated with potential delays to destroy items and make payments</li> </ul>
Stock at wholesale or import price with additional percentage	<ul style="list-style-type: none"> <li>• Includes some recognition of freight and/or business costs</li> <li>• Administratively straight-forward</li> <li>• May compensate more or less than actual losses, depending on variable overheads such as freight</li> <li>• Approach taken in pistol buy-back in Australia 2004 (10% applied to wholesale price; 20% applied to customs value)</li> <li>• Straight-forward administration</li> <li>• No delays likely for making payments</li> </ul> <p>Estimated cost \$2.9 million to \$6.9 million (+10%)</p> <p>Estimated cost \$3.1 million to \$7.5 million (+20%)</p>	<p>NB:</p> <ul style="list-style-type: none"> <li>• A higher 'additional percentage' would likely alleviate dealer discontent, bringing the benefits of dealer participation of collection agents, as itemised in first option (value defined by KPMG list)</li> </ul>
Stock at value defined by KPMG list	<ul style="list-style-type: none"> <li>• Compensates significantly beyond costs incurred</li> <li>• Wholesale importers reap larger reward than the price they would have sold for</li> <li>• Likely to be preferred by claimants</li> <li>• Straight-forward administration</li> <li>• No delays likely for making payments</li> </ul> <p>Estimated cost \$3.7 million to \$9.0 million</p>	<ul style="list-style-type: none"> <li>• Would create more goodwill leading to dealers participating as collection agents in the buy-back</li> <li>• Would greatly enhance the accessibility of collection points (locations and available days/times)</li> <li>• Dealers, as influential players in the firearms community, would likely help build trust and confidence in the scheme</li> <li>• Would lead to greater numbers of prohibited items being surrendered</li> </ul>