INITIAL ALLOCATION OF QUOTA TO PROCESSORS IN THE PACIFIC COAST GROUNDFISH FISHERY

Some Comments and Considerations

Prepared by:
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The Pacific Fishery Management Council is currently contemplating, and will soon take final action upon, a proposal to limited access to the Pacific Coast groundfish fishery using (at least for the onshore non-whiting trawl sector) an ITQ (transferable quota) system. Under consideration is a system whereby an initial allocation of quota (representing a fraction of the annual allowable harvest in the fisheries) would be awarded to those who hold (limited entry) licenses allowing them to participate in the fishery. The amount of quota to be allocated to the current license holders would be premised upon the history of harvests associated with each such license. This is a fairly “standard” feature of the initial allocation of quota in such programs, and does not by itself engender a great deal of concern.

However, the Council has indicated its intent (by selection of a “Preliminary Preferred Alternative”) to take another step. After determining how much quota each of the license holders would receive, the Council would then reduce the quota to be held by harvesters by 20% and reallocate that amount to a small number of processors (who would already receive quota without the adjustment, premised on the licenses they currently hold). This raises a number of policy and legal questions.

I have been asked to comment on the scheme. In doing so, I have reviewed the Council’s DEIS for the program, as well as a recent paper by Dr. Jim Wilen, an economist with the Department of Agriculture and Resources Economics at the University of California, Davis, prepared for the Fishermen’s Marketing Association and the Fishing Vessel Owners’ Association.

Dr. Wilen’s arguments in opposition to the proposed extra allocation to processors are quite compelling. He effectively rebuts the arguments that such an allocation policy would address the issue of “stranded capital,” that it would lead to a level playing field in negotiations with harvesters in price formation, and that it would simply be more “fair” to the processors.

Additionally, and just as importantly, I would suggest that the Council has no legitimate basis upon which to make the proposed allocation.
National Standards

Under the “National Standards” set out in Section 304 of the Magnuson-Stevens Fishery Conservation and Management Act (MSA), a Council may only design a program if it uses the “best scientific information available” (Standard 2), and may only allocate fishing privileges if such allocation is “(A) fair and equitable... (B) reasonably calculated to promote conservation...; and (C) carried out in such a manner that no particular individual, corporation, or other entity acquires an excessive share of such privileges” (Standard 4). [emphasis supplied] Finally, National Standard #8 provides that, “to the extent practicable,” a program should “minimize adverse economic impacts on ... communities” (the National Standards are appended).

Data

There are insufficient data in the EIS to determine the actual outcome of the proposed alternative. Even if landings data attributed to each license are adequate for analysis purposes, there is no break-out of licenses (and the fishing history associated with them) held by processors and subsidiaries of processors. In other words, no one really knows whether the proposed initial distribution will result in an excessive share being allocated to the processing companies, individually or collectively. When the additional quota (above the amount derived from license histories) is taken from harvesters and allocated to processors, the result could well be that all processors receive quota at the level of the cap; i.e., protected from excessive shares by the program requirement that divestiture of QS will be required if any entity receives more than the (yet-to-be-determined) caps on quota holdings. This is a laudable feature, but if there is no “individually and collectively” test, and if there are no data to implement it, overlapping ownership of license-holding processing entities could result in actual control of the quota lodged in the hands of a very few processing companies.

This problem can be cured. Managers can calculate how much quota any particular entity holds, or controls. Once the Council determines what an “excessive share” of quota would be, and caps on quota holding are set at a certain level or percentage, ownership data could be scrutinized to insure that overlapping ownership mechanisms are not used to foil the cap calculations. Similar information should be received and analyzed by the Council before it sets out initial allocation rules, thus insuring that the final program design fits within the requirements of the National Standards.

This “individual and collective” feature is not an untested. Consider the regulations for the halibut/sablefish IFQ, and the BSAI crab programs in Alaska. The regulations for those programs provide:

[For the halibut/sablefish IFQ program, at 50 CFR 679.42(g)(8)]: A corporation, partnership, or other entity, except for a publicly held corporation, that receives an initial allocation of QS assigned to category B, C, or D must provide annual updates to the Regional Administrator identifying all current shareholders or partners and affirming the entity’s continuing existence as a corporation or partnership.
The reporting form can be found at: www.alaskafisheries.noaa.gov/ram/Ownchan.pdf
[For the BSAI crab program, at 50 CFR 680.42(a)(6): Non-individual persons holding QS will be required to provide, on an annual basis, a list of persons with an ownership interest in the non-individual QS holder. This list of owners shall be provided to the individual level and will include the percentage of ownership held by each individual. This annual submission of information must be submitted as part of the complete annual application for crab IFQ/IPQ permit. The reporting form can be found at: www.alaskafisheries.noaa.gov/sustainablefisheries/crab/rat/ram/ifqipqannualapp.pdf

Quota-holding entities that are not individuals (natural persons) complete the forms annually, and are required to attest to the accuracy and completeness of the information provided (failure to honesty complete the form is perjury). The agency enters the submitted data and uses the information to test for "collective" holdings in excess of the limits established by the regulations. The data are also reviewed when such an entity applies to receive additional quota by transfer.

Fairness

In most quota programs, initial allocation is accomplished by providing each eligible person (in this case, license holder) with an amount of quota that reflects a close proximity to the holder's recent history in the fishery. As a result, when the fishing under the program begins, and participation in the fishery is thus limited, each participant is effectively "grandfathered in" to the fishery at approximately the same level that s/he enjoyed prior to the limitation being imposed. This is fair, as it allows each participant to continue in the fishery and to exit the fishery on his or her own terms.

However, subtracting 20% of a license holder's quota at the outset of the program and redistributing it to a small class (and, further, "taxing" the fisherman's annual harvest value at 3% to meet the MSA cost recovery requirement) will have the immediate effect of driving some fishery participants out of the fishery. Such was not the intent of the MSA and it should not be the outcome of a Council program, particularly when such outcomes have not been fully analyzed and, therefore, fully understood.

Excessive Shares

Further, in the absence of the ownership data discussed above, it is surely premature for the Council to blindly force a reallocation of quota away from harvesters (who are readily identifiable, in most cases, as individual owner-operators or family-owned businesses) to a small group of businesses that may or may not be legally tied together through corporate structures. As noted this is not "fair and equitable," nor does it guard against a complex of corporate entities receiving an excessive share of the harvest privileges.

This problem can be cured by establishing an "individually and collectively" rule (discussed above) that would assure initial identification of ownership structures and would be used to avoid over-allocation and subsequent over-consolidation of quota into too few hands. Such a system should be a permanent part of the program, included in the regulations, and the ownership data should be updated annually.

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Community Impacts

Once allocated quota, there is nothing in the program as proposed that would protect communities from processors who decide to move their operations, close plants, etc. In the BSAI crab program, there are a plethora of community protection measures, including regional landing requirements, constraints on processors attempting to move their operations, community right of first refusal to purchase quota, etc. No such measures are proposed for the Pacific fishery. Such operational decisions should not be encouraged by the way the quota is initially distributed.

Although it is true that harvesters may transfer (sell) their quota, and may move from their home communities, thus shifting the residence of those who hold it, most harvesters have deep roots in their communities and are less mobile than their fishing operations. By only allocating harvesting quota to harvesters (license holders), community stability will no doubt be enhanced.

The Control Issue

Allocating quota to processors (in excess of the quota represented on licenses they currently hold) will not only be unfair to fishermen and communities, it will also raise the distinct possibility of a handful of processors controlling a large component of the industry. And even if sufficient steps are taken to insure that the “individual and collective” holdings are kept below the caps, there is still a possibility that business arrangements could lead to effective control over significant elements of the industry.

This control is not only the disproportionate bargaining power the processors will gain by their “oligopsonistic” control of the price negotiation process, it also extends to the formation of vertically integrated business structures in which two or more firms associate with each other and control harvesting, processing, marketing, and (in some situations) retailing of the public’s fishery resources.

Such behavior, if allowed, is inconsistent with American business practices, fair play, the best interests of consumers, and the public. Taken to extremes, it could run afoul of the law and subject the industry to the disruption and uncertainties resulting from anti-trust investigations and prosecutions. At all events, concentrating industry control in a very few corporate hands is surely not in the public interest, nor is it consistent with fisheries management policies and authorities.

Other than insuring full disclosure of ownership structures by corporate recipients of the harvest privilege (as discussed above) there are not a large number of options for managers to insure that such control does not evolve over time. But an effort has been

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1 In transferable license limitation programs and quota programs in Alaska, there has been a general trend of permits and quota to "migrate" from small and isolated rural villages to larger, more centralized, communities over time. In less isolated, more stable West Coast communities, this phenomenon is not expected to occur, at least to the same degree.
made. In the BSAI crab program, the Council provided firm guidelines to determine which entity was "affiliated" (not just owned) by others. For instance, the crab regulations provide (at 50 CFR 680.2) that an "affiliation" of entities exists when:

... a relationship between two or more entities in which one directly or indirectly owns or controls a 10 percent or greater interest in, or otherwise controls, another, or a third entity directly or indirectly owns or controls a 10 percent or greater interest in, or otherwise controls, both. For the purpose of this definition, the following terms are further defined:

1. Entity. An entity may be an individual, corporation, association, partnership, joint-stock company, trust, or any other type of legal entity, any receiver, trustee in bankruptcy or similar official or liquidating agent, or any organized group of persons whether incorporated or not, that holds direct or indirect interest in:

   (i) Quota share (QS), processor quota share (PQS), individual fishing quota (IFQ), or individual processing quota (IPQ); or
   (ii) For purposes of the economic data report (EDR), a vessel or processing plant operating in CR fisheries.

2. Indirect interest. An indirect interest is one that passes through one or more intermediate entities. An entity's percentage of indirect interest in a second entity is equal to the entity's percentage of direct interest in an intermediate entity multiplied by the intermediate entity's direct or indirect interest in the second entity.

3. Controls a 10 percent or greater interest. An entity controls a 10 percent or greater interest in a second entity if the first entity:

   (i) Controls a 10 percent ownership share of the second entity, or
   (ii) Controls 10 percent or more of the voting stock of the second entity.

4. Otherwise controls.

   (i) A PQS or IPQ holder otherwise controls QS or IFQ, or a QS or IPQ holder, if it has:

      A. The right to direct, or does direct, the business of the entity which holds the QS or IFQ;
      B. The right in the ordinary course of business to limit the actions of or replace, or does limit or replace, the chief executive officer, a majority of the board of directors, any general partner or any person serving in a management capacity of the entity which holds the QS or IFQ;
      C. The right to direct, or does direct, the transfer of QS or IFQ;
      D. The right to restrict, or does restrict, the day-to-day business activities and management policies of the entity holding the QS or IFQ through loan covenants;
      E. The right to derive, or does derive, either directly, or through a minority shareholder or partner, and in favor of a PQS or IPQ holder, a significantly disproportionate amount of the economic benefit from the holding of QS or IPQ;
      F. The right to control, or does control, the management of, or to be a controlling factor in, the entity holding QS or IFQ;
      G. The right to cause, or does cause, the sale of QS or IFQ;
      H. Absorbs all of the costs and normal business risks associated with ownership and operation of the entity holding QS or IFQ; and
      I. Has the ability through any other means whatsoever to control the entity that holds QS or IFQ.

   (ii) Other factors that may be indicia of control include, but are not limited to the following:

      A. If a PQS or IPQ holder or employee takes the leading role in establishing an entity that will hold QS or IFQ;
      B. If a PQS or IPQ holder has the right to preclude the holder of QS or IFQ from engaging in other business activities;
      C. If a PQS or IPQ holder and QS or IFQ holder use the same law firm, accounting firm, etc.;
      D. If a PQS or IPQ holder and QS or IFQ holder share the same office space, phones, administrative support, etc.;
      E. If a PQS or IPQ holder absorbs considerable costs and normal business risks associated with ownership and operation of the QS or IFQ holdings;
(F) If a PQS or IPQ holder provides the start up capital for the QS or IFQ holder on less than an arm's length basis;
(G) If a PQS or IPQ holder has the general right to inspect the books and records of the QS or IFQ holder; and
(H) If the PQS or IPQ holder and QS or IFQ holder use the same insurance agent, law firm, accounting firm, or broker of any PQS or IPQ holder with whom the QS or IFQ holder has entered into a mortgage, long-term or exclusive sales or marketing agreement, unsecured loan agreement, or management agreement.

The affiliation language quoted above results from the issuance of processing quota in the BSAI fisheries, and the Council's attempt to guard against de facto vertical integration within the industry. Although the groundfish fishery under consideration by the Pacific Council does not contain a processing quota option (only an excessive allocation of harvesting quota to processors), the problems of vertical integration and excessive control may well still exist.

One of the tools to analyze those effects, used in the BSAI crab fisheries includes extensive reporting of otherwise private economic data by quota holders, subject to continuing analysis and Council review. The economic data reporting requirement resulted from processors agreeing to such revealing and intrusive data collection in exchange for the unique privilege or receiving processing quota. The authority for the reporting requirement is derived from the statutory mandate to implement the program, a mandate that was specific to the rationalization program for the BSAI crab fisheries.

Although such reporting may be beneficial in the fisheries under discussion, the Council and NOAA Fisheries lack legal authority to require it; specific legislative authority would be required. Currently, the MSA prohibits the collection of financial and business information. In Section 402, the Act provides as follows:

(a) COUNCIL REQUESTS.--If a Council determines that additional information (other than information that would disclose proprietary or confidential commercial or financial information regarding fishing operations or fish processing operations) would be beneficial for developing, implementing, or revising a fishery management plan or for determining whether a fishery is in need of management, the Council may request that the Secretary implement an information collection program for the fishery which would provide the types of information (other than information that would disclose proprietary or confidential commercial or financial information regarding fishing operations or fish processing operations) specified by the Council. The Secretary shall undertake such an information collection program if he determines that the need is justified, and shall promulgate regulations to implement the program within 60 days after such determination is made. If the Secretary determines that the need for an information collection program is not justified, the Secretary shall inform the Council of the reasons for such determination in writing. The determinations of the Secretary under this subsection regarding a Council request shall be made within a reasonable period of time after receipt of that request. [emphasis supplied]

Accordingly, unless the Council requests and receives specific legislative authority to collect the otherwise prohibited financial and business information, perhaps the best way to insure that excessive controls are not exerted by a handful of quota holders in the fishery is to insure that the rules provide for a fair and rational distribution of the shares,
and not devise a "super-allocation" for processors in the initial distribution element of the program.

Why Stop With Processors?

In any program designed to drain excess harvesting capacity from a fishery, the operating assumption is that the fishery is "overcapitalized" (defined by some as "too many boats chasing too few fish"). The economics of the fishery are thus skewed by spending too much money "up front" to harvest the fish in the race for fish environment, resulting in inefficiencies, safety issues, product quality declines, waste, etc.

As a result of the economic inefficiencies and their attendant problems, transferable quota programs are designed to allow harvesters to "rationalize" the economics of the fishery. This is accomplished by allowing fishermen to trade (buy and sell) shares, normally under certain rules specific to the fishery. Thus, the "excess capital" is, over time, removed from the fishery and the savings are shared with participants.

It should be noted, however, that others benefit from the race for fish. Vessel builders and ship yards, insurers, fuel suppliers, part-time crew members, processors, etc. all benefit, to some extent, from the money being spent on the race. And all of those "sectors" of the industry will be disadvantaged, at least to some extent, by ending the race.

But not all of them can be compensated, and certainly not with a special allocation of shares. Under these circumstances, it seems fundamentally unfair to only address the potential distress of processors.²

One approach that has been considered, and deserves more thought and analysis, is the possibility of allowing anyone who suffers a loss that can be directly attributed to the reallocation of capital resulting from the program to formalize a claim that documents the nature and extent of the loss. With such information in hand, those with claims could present them to an independent Council-appointed group to evaluate. When all losses have been totaled, Congress could allocate a "loan" to the industry to compensate for the losses, with such a loan to be repaid over time by a small ex-vessel tax on the landings. This is conceptually very similar to the current vessel/permit buyback provisions of the MSA, and would help all segments of the industry, not just the segment with the most political power.

² Processors benefit from the race to fish by decreeing when they wish to see product arrive at the docks, thus limiting their business expenses to shorter periods of time; further, because fishermen have only a narrow window of time in which to fish, processors are advantaged at the bargaining table. Rationalizing a fishery simply returns the relationship between processors and harvesters to the "status quo ante" (i.e., the relationship that existed before the overcapitalization that causes the race.)
Disproportionate Bargaining Power

As noted above (and in the Wilen report), one of the arguments for allocating extra harvesting shares to processors is to insure that the bargaining table for price formation is relatively level. A concern expressed is that holding IFQs, and the ability to fish them at any time during a lengthened season, will give harvesters disproportionate bargaining power. But (as noted by Dr. Wilen) such an assertion is unfounded. There are so very few processors that a bigger problem may well be processor collusion in setting prices, in violation of anti-trust laws.

Either way, one solution that has been proposed to the unequal bargaining power problem (if such exists) is an arbitration system similar to that used to form prices in the BSAI crab fisheries. Although that system appears to work, it does only because a federal regulation, premised on a specific federal law, requires the parties to bargain in good faith; further, it provides for binding arbitration in situations where good faith bargaining sessions lead to impasse.

Although the Alaska arbitration system may work in the crab fisheries, it can not be exported and mandated by the Pacific Council for the groundfish fishery without specific legislation to authorize it. I have not conducted any formal research on the matter, but officials with both NOAA Fisheries (NMFS) and staff to the North Pacific Council agree with that assessment.

So What to Do?

As noted, there do not appear to be any truly meritorious arguments for allocating additional shares to processors. However, in a process that is fundamentally political, the Council may find it necessary, or desirable, to make such an allocation. That can be done, but doing so should not be done on the current record. There are alternative ways to accomplish the task.

Get Good Data

Obtaining better ownership information is imperative before making an allocation that could well result in a violation of National Standard 4’s prohibition on any entity holding an “excessive share” of the quota. The Council, and NOAA Fisheries, should collaborate on rule-making to require any non-individually held entity (corporation, partnership, etc.) to fully disclose its entire ownership structure to NOAA Fisheries and the Council. Only with those data in hand can the Council make an informed and rational judgment about the advisability of allocating additional quota to processors.

Consider a “Trailing Amendment”

While the basic program recommendation (without the extra processor allocation) goes forward to rule-making and implementation, the Council can conduct the data-gathering and analysis exercise and consider whether to proceed with its preliminary
recommendation to allocate additional quota to processors. If, having conducted the analysis, the Council decides to proceed with the recommendation, it can pass an amendment to the program to accomplish the goal.

Although such an amendment would no doubt be disruptive to the implementation process, and cause anxiety among fishery participants, it could be done. Even if the initial allocation had proceeded (unlikely, in consideration of the time and tasks required to implement this very complex program), a "post-implementation" adjustment in the allocation could be accomplished. There are two ways in which this could happen:

1. Simply decree the shift in share allocation and simply reduce shares held by all non-processors and re-allocate those shares to qualified processors in one step; or, in a more orderly fashion,

2. Accomplish the transfer of quota over time, with a small percentage reduction in non-processor shares (over a period of years) and reallocation. Though this would be less fraught for the harvesters, it would also inject an element of uncertainty into the intended market advantages of the program and would make business planning more difficult.

Trailing amendments have been used extensively in Alaska’s limited access efforts. The Council, wishing the basic program to go forward, has put off formal adoption of one or more elements until more data were available and the public had a chance to fully understand, and comment on, the proposal. Examples of such amendments include the "block" system for the halibut/sablefish IFQ program (and subsequent adjustments to the basic program), some features of the groundfish and crab License Limitation Program, the adjustment of the fishery definitions in the BSAI crab fisheries, etc.

In other words, in what is clearly a dynamic process, the Council can make adjustments to the program when its information has improved and the requirements of the program demand it. Although that is not always tidy, it is preferable to starting the program with a glaringly unfair misallocation problem.

Conclusion

In this short paper, I have tried to offer helpful comments on the proposal to allocate additional shares to processors in the West Coast groundfish fishery. The findings and conclusions are my own, and I take responsibility (and blame, if need be) for any errors of misconceptions.

Persons with questions or comments may contact me at the address provided in the appendix (overleaf):

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Juneau, Alaska
October 2008
Appended:

1. Information (bio) on Phil Smith

2. National Standards from the Magnuson-Stevens Fishery Conservation and Management Act
About Phil Smith

Phil Smith retired from NOAA Fisheries in late 2006. In his 13 years with that agency, he organized and staffed the Restricted Access Management (RAM) Division, the Alaska Regional organization unit that implemented all of the Alaska Region’s limited access programs (including the halibut and sablefish IFQ system, the groundfish and crab license limitation program, the American Fisheries Act, and the Bering Sea/Aleutian Islands crab rationalization program). Phil’s job was to take a Council-passed limited entry system, assist with the regulatory development, engage the interested public with informational visits and other communications, oversee the application and issuance procedures, provide access to the administrative appeals system, and maintain the programs over time.

Prior to NOAA Fisheries, for eight years (1983 – 1991), Phil served as a Commissioner on the State of Alaska’s Commercial Fisheries Entry Commission. While on the Commission, he worked with two colleagues to devise regulations to implement the Alaska Limited Entry statute, governing almost all State-water fisheries.

In addition to his hands-on work experience, he has also done considerable writing and research on limited access systems world-wide, and has presented papers and served on panels at fishery conferences, not only in the U.S. but at international events in Australia, Canada, South Africa, and Chile. Most recently, he was an invited expert at a two-day symposium for Council members from around the U.S., sponsored by Duke and Stanford Universities, and organized by the Environment Defense Fund (the “Fisheries Leadership and Sustainability Forum”).

Phil was raised in rural Alaska (primarily Cordova) and has extensive early experience as a commercial fisherman and cannery worker. He’s a veteran, and also has ten years experience working with rural Alaskan communities in addressing their social and economic concerns. He is currently consulting on a limited basis. Recent clients have included the Environmental Defense Fund (writing and research on limited access programs), the Alaska Marine Conservation Council (program development), and the Chenega Corporation (fisheries strategic planning and community involvement in the halibut and sablefish fisheries).

Phil and his wife Deborah live in Juneau, Alaska; their two grown children live in Amsterdam and Anchorage, so keeping up with family obligations is a major effort!

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National Standards from Section 304 of the
Magnuson-Stevens Fishery Conservation and Management Act

1) Conservation and management measures shall prevent overfishing while achieving, on a continuing basis, the optimum yield from each fishery for the United States fishing industry.

(2) Conservation and management measures shall be based upon the best scientific information available.
(3) To the extent practicable, an individual stock of fish shall be managed as a unit throughout its range, and interrelated stocks of fish shall be managed as a unit or in close coordination.

(4) Conservation and management measures shall not discriminate between residents of different States. If it becomes necessary to allocate or assign fishing privileges among various United States fishermen, such allocation shall be (A) fair and equitable to all such fishermen; (B) reasonably calculated to promote conservation; and (C) carried out in such manner that no particular individual, corporation, or other entity acquires an excessive share of such privileges.

(5) Conservation and management measures shall, where practicable, consider efficiency in the utilization of fishery resources; except that no such measure shall have economic allocation as its sole purpose.

(6) Conservation and management measures shall take into account and allow for variations among, and contingencies in, fisheries, fishery resources, and catches.

(7) Conservation and management measures shall, where practicable, minimize costs and avoid unnecessary duplication.

(8) Conservation and management measures shall, consistent with the conservation requirements of this Act (including the prevention of overfishing and rebuilding of overfished stocks), take into account the importance of fishery resources to fishing communities in order to (A) provide for the sustained participation of such communities, and (B) to the extent practicable, minimize adverse economic impacts on such communities.

(9) Conservation and management measures shall, to the extent practicable, (A) minimize bycatch and (B) to the extent bycatch cannot be avoided, minimize the mortality of such bycatch.

(10) Conservation and management measures shall, to the extent practicable, promote the safety of human life at sea.