Photo credit: Mark Fina

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BSAI Crab Arbitration Discussion Paper

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Presentation to the AP

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Introduction

- Proposed through public testimony – impact of the Alaska min wage change on costs associated with processing labor
- Analyze changing operational costs of crab IFQ and IPQ holders
- Impacts of maintaining the historical distribution of first wholesale revenue
- Review current criteria used by the non-binding price formula arbitrator
- **Should operational cost changes to the sectors be considered in setting the non-binding price formula?**

Terminology

- **First wholesale price:** first price received by the producer (i.e., the processor)
- **Ex vessel price:** the full price paid to the harvester
- **Gross revenue:** the value of harvesting or processing crab without any costs deducted (i.e., the first wholesale or ex-vessel price multiplied by the quantity of product)
- **Profit** (net revenue, economic rent, etc): the value of harvesting or processing production less costs of production.
- **Fixed costs:** Costs that are independent on the level of output.
- **Variable costs:** Costs that are dependent on the level of output.

Prior to crab rationalization….

- Harvesters often collectively negotiated ex vessel price using AMA
- Harvesters used collective strategies to motivate price
  - Delaying fishing
  - Rewarding processors with additional deliveries
- Prices remained relatively stable in the short seasons.
- Both sectors negotiated based on their experience the previous year.
- For example, processor margins tended to be more narrow and sensitive to change in price. They demonstrated an aversion to risk; sought stability in their business plans by adjusting the % of wholesale price they paid to harvesters

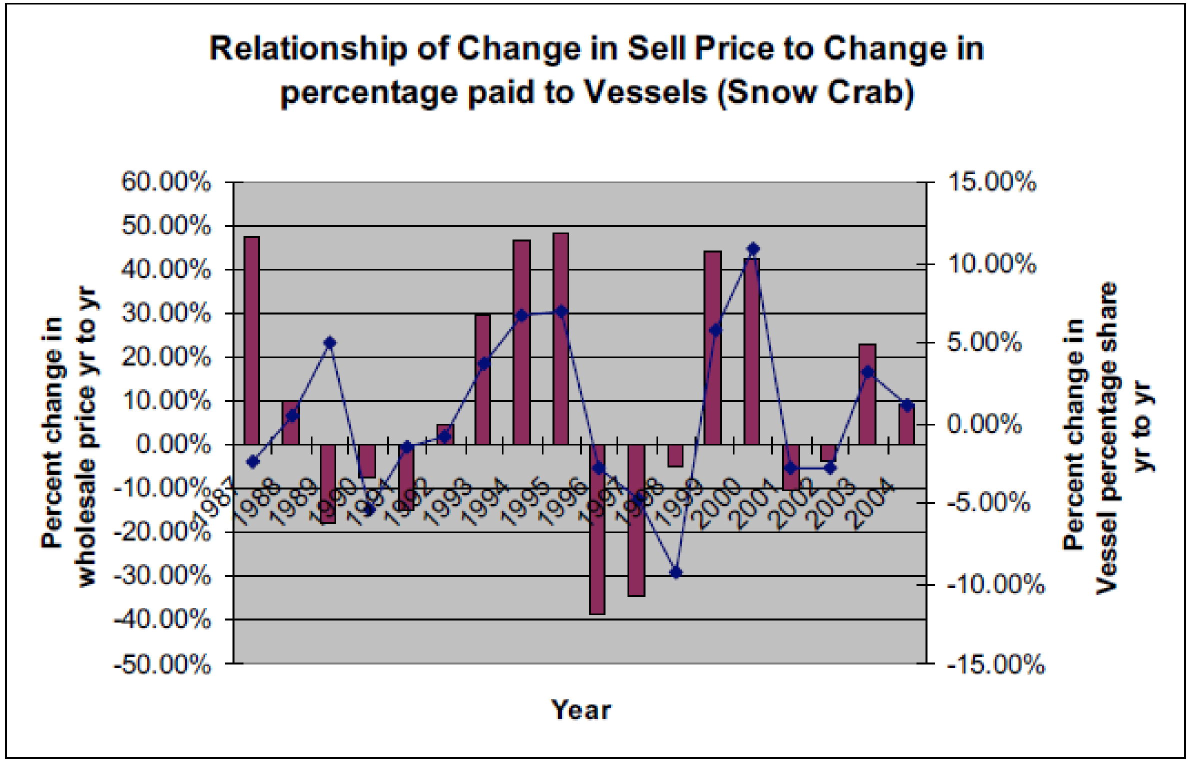
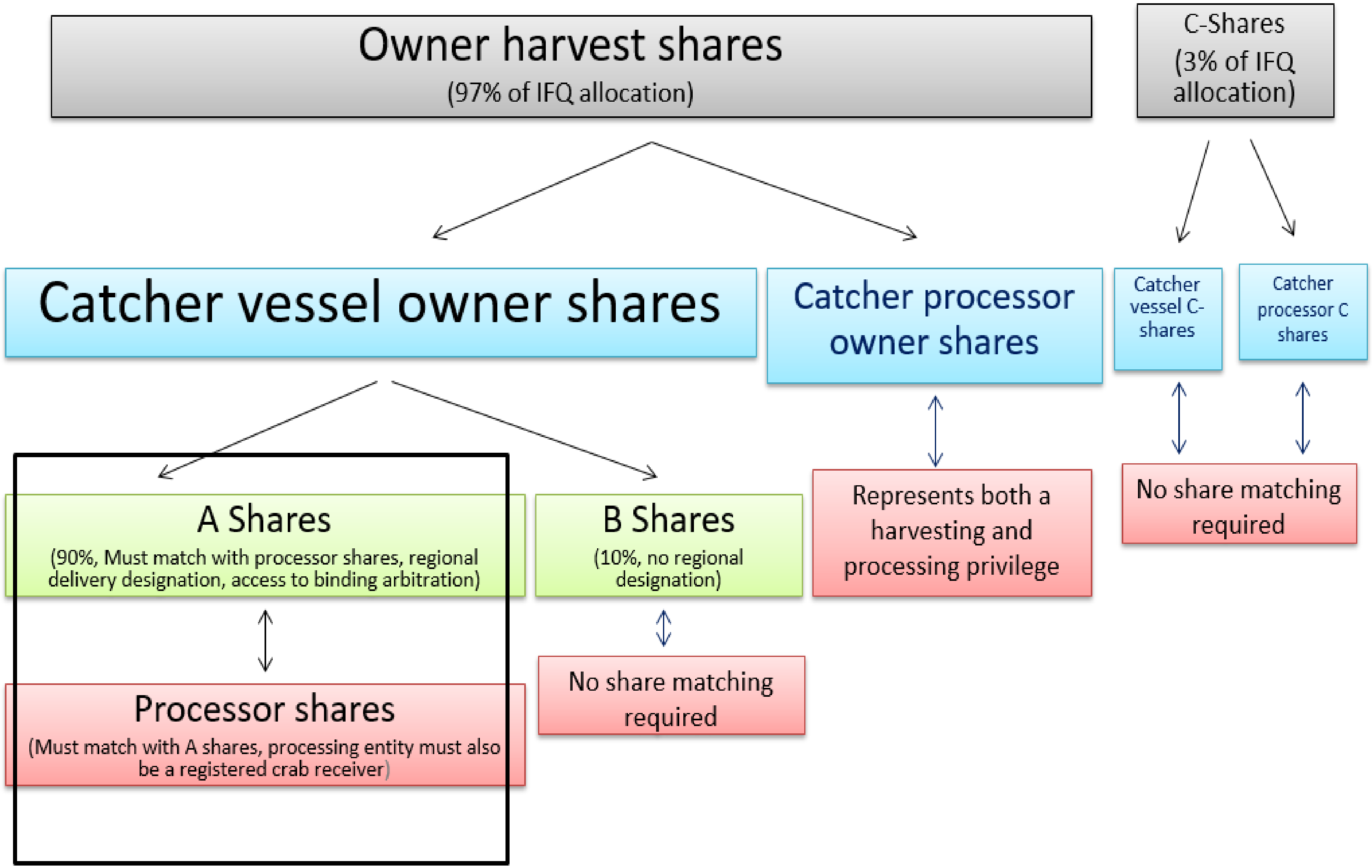


Figure 4: The relationship of change in sell price to change in percentage paid to harvesters, in snow crab.

Source: AFD&G COAR database & Seafood Datasearch

Crab Fishery TAC - 10% for CDQ & Adak = IFQ allocation



The Arbitration System

- Nature of price negotiations would change after crab rationalization; shift in leverage
  - Issuance of harvester QS = Longer seasons, could choose to shop around
  - Issuance of processor QS = 'guaranteed' market share, harvesters cannot use collective inducements
- System for price negotiations that complies with anti-trust law
- Arbitration is the resolution of a dispute by a party selected under law (or by the parties) to resolve the dispute.
- Arbitration System in crab rationalization is more than just for settling disputes; annual process

Timeline of the Arbitration System

- AO's jointly choose formula arbitrator and a pool of contract arbitrators
- At least 50 days (30 days for GKC) prior to season opening non-binding price formula is produced
- TAC is announced (about 12 days prior to season opening)
- 7 days prior to season opening a market report is produced
- NMFS issues IFQ/ IPQ (clock starts on share matching) (about a week prior to season opening)
- For 5 days after IFQ/IPQ issuance, share-matching based on mutual agreement
- After 5 days, harvesters unilaterally share-match with available IPQ holders
- For 15 days after IFQ/IPQ issuance, time period to either initiate binding arbitration
- OR choose "lengthy season approach" prior to season opening
- Season opens
- Processors and harvester negotiate price (in 2 phases) using the non-binding price formula, market report, and other information
- If needed harvesters initiate binding arbitration to settle a dispute on price or terms of delivery (usually lengthy season approach, i.e. after crab has been harvested)

Non-binding Price Formula

- Specifies ex vessel price as portion of the first wholesale
- Has a regulatory standard to follow
- It is NON-BINDING, but it has been treated as if it is
- Initially required much effort, discussion, compromise to determine methods, data used, etc.
- Has become very stable
- Formal process for communicating with the formula arbitrator and making a change to the formula

Binding Arbitration

- If an IFQ holder is committed to an IPQ holder and they are not able to resolve price or terms of delivery, IFQ holder can initiate binding arbitration
- Members of the same FCMA coop that are also committed to that IPQ holder can join the binding arbitration event
- Use a "last best offer" model – 2 choices
- Arbitrators have a regulatory standard to follow

Formula Arbitration Standards (page 6 & 7)

(ii) The Non-Binding Price Formula shall:
(A) Be based on the historical distribution of first wholesale revenues between fishermen and processors in the aggregate based on arm's length first wholesale prices and ex-vessel prices, taking into consideration the size of the harvest in each year; and
(B) Establish a price that preserves the historical division of revenues in the fishery while considering the following:

- (1) Current ex-vessel prices, including ex-vessel prices received for crab harvested under Class A, Class B, and CVC IFQ permits;
- (2) Consumer and wholesale product prices for the processing sector and the participants in arbitrations (recognizing the impact of sales to affiliates on wholesale pricing);
- (3) Innovations and developments of the harvesting and processing sectors and the participants in arbitrations (including new product forms);
- (4) Efficiency and productivity of the harvesting and processing sectors (recognizing the limitations on efficiency and productivity arising out of the management program structure);
- (5) Quality (including quality standards of markets served by the fishery and recognizing the influence of harvest strategies on the quality of landings);
- (6) The interest of maintaining financially healthy and stable harvesting and processing sectors;
- (7) Safety and expenditures for ensuring adequate safety;
- (8) Timing and location of deliveries; and
- (9) The cost of harvesting and processing less than the full IFQ or IPQ allocation (underages) to avoid penalties for overharvesting IFQ and a mechanism for reasonably accounting for deadloss.

(C) Include identification of various relevant factors such as product form, delivery time, and delivery location.
(D) Consider the "highest arbitrated price" for the fishery from the previous crab fishing season, where the "highest arbitrated price" means the highest arbitrated price for arbitrations of IPQ and Arbitration IFQ which represent a minimum of at least 7 percent of the IPQ resulting from the PQS in that fishery. For purposes of this process, the Formula Arbitrator may aggregate up to three arbitration findings to collectively equal a minimum of 7 percent of the IPQ. When arbitration findings are aggregated with 2 or more entities, the lesser of the arbitrated prices of the arbitrated entities included to attain the 7 percent minimum be considered for the highest arbitrated price.

Binding Arbitration Standards (page 7 & 8)

(i) The Contract Arbitrator's decision shall:

(A) Be based on the historical distribution of first wholesale revenues between fishermen and processors in the aggregate based on arm's length first wholesale prices and ex-vessel prices, taking into consideration the size of the harvest in each year; and

(B) Establish a price that preserves the historical division of revenues in the fishery while considering the following:

(1) Current ex-vessel prices, including ex-vessel prices received for crab harvested under Class A IFQ, Class B IFQ, and CVC IFQ permits;

(2) Consumer and wholesale product prices for the processing sector and the participants in the arbitration (recognizing the impact of sales to affiliates on wholesale pricing);

(3) Innovations and developments of the harvesting and processing sectors and the participants in the arbitration (including new product forms);

(4) Efficiency and productivity of the harvesting and processing sectors (recognizing the limitations on efficiency and productivity arising out of the management program structure);

(5) Quality (including quality standards of markets served by the fishery and recognizing the influence of harvest strategies on the quality of landings);

(6) The interest of maintaining financially healthy and stable harvesting and processing sectors;

(7) Safety and expenditures for ensuring adequate safety;

(8) Timing and location of deliveries; and

(9) The cost of harvesting and processing less than the full IFQ or IPQ allocation (underages) to avoid penalties for overharvesting IFQ and a mechanism for reasonably accounting for deadloss.

(C) Consider the Non-Binding Price Formula established in the fishery by the Formula Arbitrator.

Interpretation of Standards and Consideration of Operational Costs

- Confusion arose in early interpretation of application of standard
- First non-binding price formula reports both discussed the importance of including certain variable costs in the formula
- Gross revenue sharing vs. profit sharing
- Impact of significant and long-terms shifts in variable costs
- Cited standards #4 and #6 for justification for this inclusion in their discussion.

Interpretation of Standards and Consideration of Operational Costs

- HOWEVER, primary task for arbitrators was intended to be establishing a price that preserves the historical division of revenues
- Council rejected a standard that would have divided the "historical division of economic rents"
- An equitable division of rent was thought to have the potential to deter innovation by ensuring rents for inefficient participants.
- It could create an incentive for participants to artificially inflate their cost of business in order to secure a higher percentage of first wholesale price.
- Practical challenges associated with identifying and calculating variable costs + risk of creating perverse incentives for inefficiency, prompted current interpretation of standard which has NOT included consideration of costs

Alaska Minimum Wage

Table 2 Alaska minimum wage standards over time

Effective Date	Minimum Wage
04/01/1991 - 09/30/1996	$4.75
10/01/1996 - 08/31/1997	$5.25
9/1/1997	$5.65
1/1/2003	$7.15
7/24/2009	$7.25
1/1/2010	$7.75
Beginning 02/24/2015	$8.75
Effective 01/01/2015	
1/1/2016	$9.75
1/1/2017	$9.80

Source: Alaska Division of Labor Standards and Safety, http://labor.alaska.gov/lss/whact.htm

- Discussion instigated due to one type of operational cost
- In Nov 2014, the Alaskans voted to raise the state min wage $1 in 2015, $1 in 2016 and subsequently with inflation (or Fed min wage)
- Increased cost wholly absorbed by the processing sector
- Processors say this cost is unlike others in that it is significant, long-term, imposed by AK statute, only increasing, and unavoidable.
- Have some EDR data to demonstrate overall change in plant-level median wages

If min wage is considered in the arbitration system, SOMEONE will need to determine.....

- Regulatory rationale for why min wage is appropriate for consideration,
- Scope of other appropriate costs, and
- How to adjust formula for this and other possible costs,
- While being mindful of proper incentives for efficiency in each sector.

Council Action

1. Do nothing – status quo interpretation

2. Make it clear that based on the Council's interpretation of the standards operational costs already *CAN* be considered under the current language of #4 or #6 – if the sector can make a strong enough case for it.

3. Make it clear that the arbitrators *SHOULD* consider min wage as an operational cost and that this has been demonstrated consistent with the current standards.

4. The Council could move an FMP/ regulatory amendment package to make it explicit that min wage impacts can be included in the price formula and contract arbitration process.

Attachment 1:
Formula arbitrator's comments

- Requested this issue be brought to the Council because of the precedent in interpretation of standard; the issue was understandably divided
- Viewpoint is that the formula arbitrator should be able to consider a legislatively mandated increase in min wage under current standards (#4 and #6)
- Rises to the level of threat to financial health
- Could address the problem with an adjustment to price formula
- Would collect the cost information from processor AO or EDR data if appropriate
- Would employ the formal process already in place to communicate with the harvester and processor AOs to revise the formula appropriately
- Seeking Council clarification on the issue
- *Note that the formula arbitrator submitted additional comments on operational costs he believes should be considered by the contract arbitrators*