

D2 Crab Binding Arbitration Discussion Paper

December 2024



This discussion paper is intended to provide additional information on issues with the binding arbitration provisions of the CR Program under low TACs that the Council identified at its June 2024 meeting after receiving the Crab Rationalization Program Review.



Background: Four Issues the Council Identified in June

1. Timing of joining an arbitration organization. Regulations require annual membership by May 1 before any crab catch limits are set (including no TACs).
2. Requirements of the binding arbitration system
 - Only Class A quota holders can initiate binding arbitration (contract terms).
 - The arbitrator must only select a remedy proposed by one side.
 - Ability for parties to receive the arbitrator's written report and rationale
3. Evaluate whether current regulations allow an IPQ/IFQ holder to withdraw their application for quota any time prior to the quota being issued.
4. Consider an alternate structure under low TAC levels in which binding arbitration would not apply (provide stability and protection).



Background: Discussion at the October Meeting

- The low and unexpected snow crab TAC generated discussion of how the fishery would be prosecuted.
 - Processor withdrawal of IPQ applications
 - How North shares would be treated in terms of where they would be landed if there was no floater or plant operating in the North and compensation if landed the South Region
 - Addressing issues not anticipated when the program was developed.



Presentation Overview

- Provides an overview of the current regulations, focusing on the issues identified by the Council in June.
- Based on discussions at the June and October Council meetings the last section considers alternatives to the current binding arbitration structure. These structures are not analyzed in detail, based on direction from the Council when requesting this paper
- Congress granted the Council authority to request modifications to the CR Program.



Binding Arbitration Program

- The binding arbitration system was designed to resolve disputes between harvesters and processors in a way that is faster and less expensive than litigation.
- Addresses concerns about market power to help ensure fair and equitable resolutions for unaffiliated Class A IFQ and IPQ holders.
- The system includes Arbitration Organizations, Market Analyst, Formula Arbitrator, and Contract Arbitrators, with specific duties outlined in 50 CFR 680.20.
- Baseball arbitration style is used, where the arbitrator must choose between the proposals of the IFQ and IPQ holders without negotiation.
- Four annual data collections are required: Annual Arbitration Organization Report, Market Report, Non-binding Price Formula Report, and Cost Allocation Agreement.
- Arbitration costs are shared equally between harvesters and processors, with recent annual costs averaging around \$110k.
- Only Arbitration IFQ holders can initiate binding arbitration to establish contract terms, while both IFQ and IPQ holders can initiate arbitration for performance disputes.



Impacts of not Allowing Processors to Initiate Arbitration

- Unilateral arbitration is typically implemented when the party allowed to initiate arbitration is assumed to have a higher risk if they have an adverse outcome. In the CR Program, the overall issues of market power and risk borne by the participants are complex, and the allocation of IPQ and the current arbitration structure were initially included to balance those issues.
- Based on the structure selected, the previous Council recommending the regulations assumed that the harvest sector had a higher risk if they had an adverse arbitration outcome.
- Arbitration IFQ holders are most likely to initiate the arbitration process when they anticipate prevailing in the arbiter's ruling.
- Regulations at 50 CFR 680.20(h)(3)(v) states that there will be only one Binding Arbitration Proceeding for an IPQ holder, but multiple Arbitration IFQ holders may participate in this proceeding. The limit of one arbitration per IPQ holder means that if the IPQ holder initiated arbitration, the IFQ holder may not.
- Could increase the number of arbitrations and the cost associated with arbitration.



Impacts of not Allowing Processors to Initiate Arbitration

- Processors could force arbitration by offering a low price that Arbitration IFQ holders would be unwilling to accept, forcing harvesters into arbitration. Employing such tactics might further erode trust between the two sectors during economic times when cooperation is important. This may negatively impact cooperation in the longer term.
- It creates uncertainty about the ex-vessel price processor will pay after share-matching relative to the two sides agreeing during the negotiation period.
- The increased uncertainty could impact whether processors apply for IPQ or request that their application be withdrawn, especially when margins are small in other fisheries and they cannot, or will not, be used to subsidize crab fisheries.
- Share matching requires processors to process any matched IFQ that is delivered to them under the terms of the agreement (either both parties agreeing or a contract established by an arbitrator). Harvesters are not required to deliver all the share-matched crab to the processor. The processor has no recourse unless there is a performance contract.



Impacts of not Allowing Processors to Initiate Arbitration

- Past discussions have also noted that processors may be less willing to take market risks associated with developing new products if the production costs do not change the profit margin.
- If more PQS/IPQ holders with processing capacity do not submit their IPQ allocations, or withdraw them after submission, it may negatively impact IPQ holders without processing capacity.
 - Must find custom processors for a higher percentage of the available crab but may have fewer options if the first wholesale price is low and custom processing fees are high.
 - Under low TACs, the cost of processing a crab unit is higher than in higher TAC years due to economies of scale.
- This may negatively impact IPQ holders without processing capacity if increased custom processing fees are not accounted for when ex-vessel prices are established.



Binding Arbitration Written Report

- The Council requested that this discussion paper review the possibility for the parties to the arbitration to receive a written report from the arbitrator outlining the rationale for the decision and a publicly available report providing the decision and key considerations that influenced the decision.
- A paper drafted for Congress by the Department of Justice Antitrust Division noted that requesting the release of information utilized in arbitrations, even by the arbitrator, should be carefully considered and if requested, ensure the information requested would not trigger antitrust concerns.
- The types of information requested should not include price and production information and should not "have the effect of dampening competition" to prevent being illegal under the Sherman Act
- Harvesters participating in an FCMA cooperative could share information within their cooperative, but they would risk antitrust liability if they shared information outside the cooperative.



Binding Arbitration Written Report

- The Department of Justice Antitrust Division and the current regulations limit the types of information that the arbitrator could release through a public written report. Information that likely could be released includes the prevailing side of the arbitration, the methodology (formula) used to make the determination (e.g., the historical percentage division of first wholesale price based on a set of years), and any other general considerations utilized by the arbitrator to make the determination so long as it did not disclose any information that can “have the effect of dampening competition” or release confidential information.
- The exact type and scope of information that could dampen competition may need to be determined on a case-by-case basis to avoid antitrust violations.
- Some stakeholders felt that requiring a written arbitration decision could ultimately save costs. More information would be available for people hired to support the arbitration process, specifically the Contract Arbitrator and Formula Arbitrator. The reports could be used as background information to help them better understand the process.
- A written report could also explain why other stakeholders have not prevailed. Using that information may change future arbitration approaches.



Binding Arbitration Program Timing

- Determination of annual membership in the Arbitration Organization must be established by May 1. Arbitration Organizations jointly choose a formula arbitrator and a pool of contract arbitrators. This is before the fishing year, before any crab TACs are set (including no TACs), requiring participants to incur costs to hire a share-matching agent, contracted arbitrators, and a market analyst and non-binding price formula arbitrator before knowing whether binding arbitration will be needed.
- Crab IFQ and IPQ applications for the upcoming crab fishing year are due June 15. For the application to be considered complete, all fees required by NMFS must be paid, and EDRs must be submitted.
- At least 50 days (30 days for AI golden king crab) before the season opening a non-binding price formula is produced
- TAC is announced (less than 2 weeks before the fishing season opens)
- 7 days before the season opening a market report is produced
- NMFS issues IFQ/ IPQ (clock starts on share matching) (about a week before season opening)
- For 5 days after IFQ/IPQ issuance, share-matching is based on mutual agreement by the IPQ and IFQ holders
- After 5 days, harvesters unilaterally share-match with available IPQ holders
- For 15 days after IFQ/IPQ issuance, Arbitration IFQ holders may either initiate binding arbitration OR choose the “lengthy season approach”.



Withdrawing IPQ/IFQ Application

- The Council requested additional information regarding whether current regulations allow for withdrawing IPQ or IFQ applications and the terms of such withdrawals.
- Regulations require a complete IPQ or IFQ application to be postmarked or received by NMFS by June 15 for the upcoming crab fishing year.
- NMFS has allowed IPQ application withdrawals before issuing IFQ/IPQ, but regulations do not clearly define the conditions for approval. IPQ withdrawal requests are evaluated on a case-by-case basis
- Previous application withdrawals were submitted well in advance of annual IPQ issuance.
- Emergency regulatory action could be requested if no IPQ holders are capable or willing to process crab.
- To clarify how these potential withdrawals should be treated, NMFS staff recommended that the Council consider regulatory changes to proactively address potential scenarios of low or no IPQ applicants, ensuring stability in the processing sector.



Other Methods to Resolve Disputes

- Mediation, negotiation, and collaborative law are described.
- These methods are often used before binding arbitration by harvesters and processors.
- None of these approaches result in a binding contract that must be adhered to by both parties.
- They are unlikely to resolve contract disagreements beyond what is already being realized by the two parties.



Not Producing Required Reports During Low TAC Years

- Regulations allow Arbitration Organizations representing more than 50% of the PQS holders and 50% of the unaffiliated QS holders not to develop a market report or a non-binding formula when the fishery is not expected to open.
- The agreement must include a provision for producing the market report and a non-binding formula if a fishery's opening is announced later.
- Cost savings could be considered minor in most years, but the provision could benefit participants by avoiding those costs when economic conditions are poor.
- A representative of the harvest sector noted that the cost of these reports might outweigh the benefits harvesters derive from their production since they are often not used by the sector.
- If this view is widely held, the Council could consider eliminating the regulations requiring these reports.



No Arbitration During Low TAC Years

- Civil contract agreement not to arbitrate
- Persons eligible to join an Arbitration Organization could agree before the season that they would not use binding arbitration that fishing year. This approach may be most helpful in years when both harvesters and processors assume there will not be a fishery or the TAC will be very low.
- The general concept is like the current regulations allowing reports not to be produced if agreed to by more than 50% of the PQS and 50% of the Arbitration IFQ holders.



No Arbitration During Low TAC Years

- Discussions at the October Council meeting mentioned implementing regulations that would remove the option of initiating binding arbitration for a fishery to establish contract terms during years when a TAC is low.
- The general concept would be to create more certainty regarding whether Arbitration IFQ holders would initiate binding arbitration during a year and the impact that may have on the PQS holder's decision to apply for IPQ.
- Table 2 shows the TACs after CDQ deductions for three species since the CR Program was implemented. The lowest 25% of TACs over that period were:
 - Snow crab 18.8 million lbs.
 - Bristol Bay red king crab 3.2 million lbs.
 - AI Golden king crab 5.1 million lbs.



Changing CR Program Structure

- The intent of this section is to describe various options for changing the CR Program that have been mentioned by the Council or in public testimony.
- The Council noted in June that these concepts are intended to foster additional discussion and if further consideration is warranted could be addressed through a committee that has not been defined and/or through additional analysis.



Changing CR Program Structure

- Baseball-style arbitration was initially selected as an efficient arbitration system that incentivizes members of Arbitration Organizations to submit reasonable offers.
- The current arbitration structure was implemented to help ensure predictability and fairness for the parties involved.
- The non-binding price formula and the contract arbitrator's decision must be based on the historical distribution of first wholesale revenues using arm's length first wholesale prices and ex-vessel prices.
- The price should preserve the historical division of gross revenues in the fishery while considering several factors.
- Without the written reports from the arbitrators, it is difficult to ascertain what other factors were considered when making the decision.
- Both sectors have noted that their costs have increased substantially in recent years. Verifying costs was noted as a concern if the price formula was changed to consider costs.



Changing CR Program Structure

- Granting the arbitrators greater discretion to select a specific outcome could make the selection of arbitrators more contentious and place more pressure on the arbitrator to select outcomes. It may also make providing written reports on why the outcome was selected even more important than under the current system.
- The authority to select an intermediate position could result in the requested outcomes by the two parties being more divergent.
- Baseball arbitration was selected, in part, because it was thought to be less costly than other forms of arbitration.



Implement a Price Determination Panel

- This concept was raised in public testimony during the June meeting and based on the Canadian Model.
- There are several differences in the regulations for the two Countries associated with anti-trust that would make this structure difficult to implement.
- Since the paper was released for public review, the price determination panel structure authorized under the Fishing Industry Collective Bargaining Act has been removed from regulations for the Newfoundland and Labrador snow crab fishery.



Allocate Processors QS instead of PQS

- This method has been used in the Pacific whiting fishery and PCTC program.
- The allocation is intended to address market power issues resulting from implementing those catch share programs.
- Reallocating shares would be controversial.
- The regulatory process to implement this change could take several years.



Establish a Cooperative System like CGOA Rockfish

- This structure would allocate cooperative quota to cooperatives, based on QS assigned to the cooperative by harvester members
- A processor would be associated with each cooperative.
- The cooperatives would utilize civil contracts to establish delivery terms and enforce compliance of the contract terms.
- The CGOA Rockfish Program requires delivery in Kodiak. A similar structure could be developed to address Northern share deliveries. Southern share delivery locations could be determined by each cooperative and their affiliated processor.



Thank you!

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