

Executive Summary

In August of 2005, fishing in the Bering Sea and Aleutian Island crab fisheries began under a new share-based management program (the "program"). The program is unique in several ways, including the allocation of processing shares corresponding to a portion of the harvest share pool. These processor shares were allocated to processors based on their respective processing histories. To protect community interests, holders of most processor shares were required to enter agreements granting community designated entities a right of first refusal on certain transfers of those shares. Since implementation, community representatives and fishery participants have suggested that some aspects of the rights of first refusal may inhibit their effectiveness in protecting community interests. This amendment package considers actions intended to address the following five concerns:

- 1) the relatively short period of time allowed for exercising and performing under the right;
- 2) the lapse of the right after three consecutive years of use of the individual processing quota (IPQ) outside the community or if a community entity elects not to exercise the right on a transaction to which it applies;
- 3) the requirement that the right apply to all assets involved in a transaction, which could include assets outside the community;
- 4) the limited protection to community interests by the right of first refusal; and
- 5) the need for better notices to communities entities and NOAA Fisheries to track use and transfer of shares subject to the right.

The Council has also included in this amendment package a sixth action intended to redress the concerns of a specific right holder, Aleutia Corporation, who asserts that a transaction subject to the right occurred without that entity being provided the opportunity to exercise the right. The action proposes to allocate to that entity an amount of processor quota shares approximately equal to the amount transferred in the transaction that triggered the right.

Purpose and Need Statement

The Council has adopted two purpose and need statements for this amendment package. The first purpose and need statement provides:

The Bering Sea/Aleutian Islands crab rationalization program recognizes the unique relationship between specific crab-dependent communities and their shore-based processors, and has addressed that codependence by establishing community "right of first refusal" agreements as a significant feature of the program. These right of first refusal agreements apply to the Processor Quota Shares initially issued within each community, and are entered into and held by Eligible Crab Community Organizations on behalf of each respective community.

To date, there have been several significant Processor Quota Share transactions, resulting in Eligible Crab Community Organizations now owning holding substantial portions of the PQS in each rationalized fishery. However, the ability of the right of first refusal to lapse may diminish the intent to protect community interests. Also, limiting the time period to exercise the right may conflict with the ability to exercise and perform under the right of first refusal. In addition, some communities, when exercising the right of first refusal may have no interest in purchasing assets located in another community and feel the right of first refusal contract should exclude any such requirement. Lastly, under the current structure, right holders and NOAA Fisheries have limited information concerning the transfer and use of PQS and IPQ subject to the right.

Additional notices from PQS holders to right holders and NOAA Fisheries concerning the use of IPQ and transfer of PQS and IPQ would allow community entities to more effectively protect their interests through the rights of first refusal.¹

The second purpose and need statement provides:

At least one PQS transfer is believed to have occurred without the right holder (Aleutia Corporation) being informed of the transaction, denying that right holder of the ability to exercise its right of first refusal to acquire PQS as intended by the program. This lack of notice allowed the transfer of PQS to a party other than the right holder and the movement of the processing to another community. Providing that right holder with a direct allocation of PQS could mitigate the negative impacts arising from that transaction. In addition, providing for notice of the location of use of IPQ and transfers of PQS to right holders could prevent similar circumstances from arising in the future and make the right more effective in protecting communities' historical interests in processing and ensure that community entities are better able to assert their interests as provided for by the right.

Alternatives

The Council has identified six actions for this amendment package. Under Action 1, the time available for a community entity to exercise a right of first refusal would be extended from 60 days to 90 days, and the time for a community entity to perform under the contract would be extended from 120 days to 150 days.² Action 2 could be used to address two provisions. First, the action could be used to continue rights of first refusal regardless of whether IPQ are used outside of the community from which those shares originated. Under the current rule, the right expires if IPQ are used outside that community for three consecutive years. The action could also be used to change the community that benefits from the right, in the event a community entity fails to exercise the right on a transfer to which the right applies. Under this alternative, the new PQS holder would be permitted to identify the community that would benefit from the right, by selecting one of the community entities qualified to hold a right of first refusal. Action 3 could be used to apply a community entity's right to either the subject PQS only or to the subject PQS and assets located in the community intended to benefit from the right of first refusal. The current rule applies the right to any assets included in the transaction with the subject PQS, which may include any assets outside of the community. Under Action 4, a PQS holder could only use IPQ yielded by PQS in the community that benefits from the right of first refusal, unless the community benefiting from the right consents to the use of the IPQ outside that community. Currently, IPQ may be used by the PQS holder in any location (subject to any applicable regional landing requirement). Action 5 would create new notice requirements intended to ensure that the right holder and NOAA Fisheries have adequate information to track use of IPQ and transfers of IPQ and PQS as needed to protect their interests under the right. Under Action 6, Aleutia Corporation would receive an allocation of newly-issued PQS in an amount such that the allocation equals 0.55 percent of the PQS pool.

Effects of Action 1 – Increase the time for exercise and performance of the right of first refusal

In considering whether to exercise a right of first refusal, a community must examine the merits of the transaction and arrange its performance. These factors suggest that extending the period to exercise a right and perform under the contract could be beneficial to entities making that decision. The extension is likely to be particularly beneficial for communities that adopted provisions for public notice and meetings

¹ Note that the bolded section of the purpose and need statement is a staff addition request by the Council.

² Unless specified otherwise, all references to days in this document refer to calendar days.

to decide whether to exercise the right. Even this extended time period, however, is likely to pose a challenge, for large transactions that include a variety of assets other than the subject PQS. Although lengthening the time for exercise and performance under the right may benefit community entities, lengthening those time periods could complicate transactions for parties affected by the right. Under the terms of the right, a PQS holder and buyer can prevent a community entity from intervening in the transaction, if the buyer agrees to grant a right of first refusal to the community entity and to use a portion of the IPQ yielded by the PQS in the community for a period of years. Although these concessions may affect the value of the assets transferred (including the PQS), the parties to the transaction can effectively limit the ability of the community entity to exercise the right. This ability may reduce the difficulty posed by the time period extensions to PQS holders. As a result, the proposed time period extensions are likely to have only minor effects on PQS holders, the parties with which they might transact, and community entities.

Effects of Action 2 – Removing the provision under which the right lapses after use of the IPQ outside the community for three years and establishing a new right, if the original right holder elects not to exercise the right

This action could revise two provisions. The first part would remove a provision under which rights lapse if the IPQ are used outside the community for three consecutive years. So, once the right is triggered by a transfer, the right would supersede the interests of other parties, including communities where the yielded IPQ had been processed in the intervening years. The exercise of a right in this circumstance could upset the dependence on the processing activity that developed in the community that attracted the processing. At the extreme, this dependence could be established through several years of processing activity. Extending the right without the lapse for use outside the community would reflect an interest in protecting the community from which the PQS originated, at the potential expense of other communities that might have developed a subsequent dependence on process of those shares.

The second part of this action would modify a provision under which rights lapse if the right is triggered by a transfer and the community entity fails to exercise the right. Under the first action alternative, the right would be extended for the same entity, regardless of the failure of that entity to exercise the right when it was triggered. Since the right is only triggered by transfer in which the recipient intends to use the shares outside the community, this change could result in an entity intervening in a transaction for PQS in which another community has developed a dependency. In addition, an entity could have multiple opportunities to exercise a right. Providing multiple opportunities could be viewed by some as unnecessary, since the community would have allowed transfers to transpire without intervening. On the other hand, the extension could benefit entities that allow transfers only because of their inability to exercise their rights. These future opportunities to exercise the right may be important, if the circumstances and financing of the community entity change or the second transaction is on more appealing terms, which could occur if fewer PQS are included in the transaction or prices change. Those entities may later develop the capacity to exercise rights. The second action alternative would allow the new PQS holder to designate a new right holder (after a transfer to which the right applies, but on which the right is not exercised). Allowing the PQS holder to designate the new right holder is intended to streamline administration (as dependence based criteria could be administratively cumbersome). Since use of the shares would be at the discretion of the PQS holder, that holder should be best situated for identifying the community that would be dependent on the shares in the future. Although it is not certain what criteria the PQS holder would use to select a community, selecting the community in which the PQS holder intends to use the shares might avoid complications that could arise from the application of the right to future transfers.

The action is intended primarily to benefit communities and their representative entities; however, PQS holders are also affected by these extensions of the right. To the extent that rights of first refusal diminish the value of PQS, that diminution would be perpetuated by extending the right. Despite the existence of the right, it remains likely that for most transactions PQS holders and buyers will avoid triggering the right by agreeing to use the IPQ in the right holding community to the extent required for avoiding triggering the right. In the long run, meeting this minimal requirement may be more difficult, particularly if processing activity is discontinued in some communities. To the extent that the right is intended to protect community interests, that protection may be lacking under the status quo, in part, because of its current lack of permanence. Yet, several other aspects of the right limit the effectiveness of the provision in protecting community interests. By its nature, the right only applies to transfers. Absent a transfer, shares may move freely among communities under other processing arrangements (including those internal to a company, as well as custom processing arrangements). This limitation on the right leaves a community entity unable to prevent the movement of processing from its community, as long as the PQS holder chooses not to transfer the shares. In addition, communities that become reliant on these allowed movements of processing activity are unprotected by the right in its current form.

Effects of Action 3 – Apply the right of first refusal to only subject processor shares or subject processor shares and assets in the community of the entity holding the right

Under the status quo, rights of first refusal apply to all assets included in a transaction that includes processor shares subject to the right of first refusal. Under the first action alternative, right of first refusal contracts would be required to provide that the right shall apply to only the PQS. In the event assets other than PQS are included in the proposed sale, the price of the PQS shall be determined by an appraisal process.

PQS holders are likely to respond to the application of the right to only PQS in a few predictable ways. First, the PQS holder may attempt to negotiate an agreement with the community entity to allow the sale to proceed without the entity exercising the right. To secure an agreement, the PQS holder may need to provide something of value to the entity, which could be financial remuneration or a portion of the PQS. A community entity may have little leverage in this negotiation, if the PQS holder knows that the entity is without the wherewithal to exercise the right, but the community could receive some compensation for the security it provides in exchange for its agreement to allow the sale. CDQ groups that represent communities are likely to be better positioned to exercise the right than other community entities, but this could change over time if the other entities develop portfolios of fishing privileges and other interests. Alternatively, the person receiving the PQS could avoid the right being triggered by agreeing to use the requisite amount of IPQ in the community for the required period and extending the right to the entity in a second contract. This approach would maintain the community entity's interest in the PQS under the terms of the right with the new holder. A third way to avoid community entity intervention in a transaction is for the PQS holder, prior to the transfer, to use the IPQ outside of the community for three consecutive years causing the right to lapse.³ To use this approach, the PQS holder would only need to move the IPQ from the community ahead of the transaction to ensure the right lapsed; however, this approach provides the PQS holder with the greatest flexibility at the time of the PQS sale. Lastly, a PQS holder that is undertaking a transaction might also subdivide the transaction. One transaction could be for the PQS; the other transaction would be for any other assets. By subdividing the transaction in this manner, the PQS holder and the buyer may attempt to ensure that the price of PQS and the price of other assets in the transaction are set at an acceptable level, should the right holder intervene in the transaction. At the extreme, assets not subject to the right could be offered at a nominal price, with the PQS carrying

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the bulk of the value of the transaction. Although a right holder may contest the contract price for the PQS, the use of that process could be costly. Clearly, a variety of contractual arrangements might be made to increase the potential for the PQS holder to receive reasonable value for assets (including the PQS), particularly in cases where the value of the assets is highly dependent on the accompanying PQS. Given the costliness of any administrative process associated with determining a price for assets subject to the right and the potential for PQS holders to avoid triggering the right, it is questionable whether the action alternatives would provide substantially greater protection of community interests than the existing right.

Under the second action alternative, the right of first refusal would apply to processor shares and any assets based in the community benefiting from the right that are included in the transaction with the processor shares. In the event that this alternative is adopted, the Council must define a standard for determining items that are subject to the right (i.e., assets that are "community-based"). Many assets are mobile and can be moved among communities. For example, a company that sells its PQS with its floating platform may be confronted by a community (or processor) claim that the floating platform is (or is not) a community based asset. If the Council wishes to proceed with this alternative, a standard would need to be defined for determining the assets based in a community to which the right would apply. The current motion suggests that an arbitrator or appraiser could be used to make this determination, but a specific process and timeline are not specified. Those aspects of the alternative require additional attention.

Assuming that assets to which the right will apply are well-defined, the process for establishing a price for those assets (independent of other assets included in the transaction but excluded from the right) must be considered. As suggested in the motion, a jointly selected appraiser (or team of appraisers would be used). The time for selection and performance of appraisers and its effect on the timeline for exercising a right and performing under the contract should be considered.

Notwithstanding the specific development of this action, PQS holders are likely to respond to the application of the right to only PQS (and possibly community based assets) in a few predictable ways (as under the preceding alternative). First, the PQS holder may attempt to negotiate an agreement with the community entity to allow the sale to proceed without the entity exercising the right, providing some value to the community entity to receive its consent. Alternatively, the person receiving the PQS could avoid the right being triggered by agreeing to use the requisite amount of IPQ in the community for the required period and extending the right to the entity in a second contract. The PQS holder, prior to the transfer, could use the IPQ outside of the community for three consecutive years causing the right to lapse.⁴ Lastly, a PQS holder could subdivide the transaction. Although the motion suggests a process that would allow a right holder to contest the price, the use of that process could be costly (specifically more costly than under the preceding alternative, since the community based assets must also be identified). Clearly, a variety of contractual arrangements might be made to ensure that the PQS holder receives reasonable value for assets (including the PQS), particularly in cases where the value of the assets is highly dependent on the accompanying PQS. Given the costliness of any administrative process associated with determining a price for assets subject to the right and the potential for PQS holders to avoid triggering the right, it is questionable whether the action alternatives would provide substantially greater protection of community interests than the existing right.

⁴ This choice may be unavailable, if the Council elects to extend the right in perpetuity.

Effects of Action 4 – Require consent of the community benefiting (or formerly benefiting) from the right to use IPQ outside of the community

Under the status quo, a PQS holder may use the IPQ yielded by its PQS in any location that it chooses (provided it complies with regional landing requirements). This flexibility allows PQS holders to derive the maximum value from their PQS, choosing where and how to process IPQ, with limited geographic constraints. Thus, PQS holders have the option to move processing between communities to other plants that they own or through leasing or custom processing arrangements with other plant owners. This flexibility also allows a PQS holder to both derive greater value from their IPQ and to address contingencies that could arise in season, such as plants being disabled or inaccessible.

While this flexibility to use PQS in any location (within a permitted region) benefits its holders, it also creates some uncertainties for communities that have developed dependency on processing of crab for economic activity and tax revenues. The use of IPQ outside of the community from which those IPQ historically originated (particularly on a large scale) may deprive a community of benefits. Transfer of the use of small amounts of IPQ outside of a community would likely only reduce tax revenues of the community (as the economic activity arising from marginal amounts of IPQ is likely to be minimal). The movement of larger amounts of IPQ from a community will likely have a broader effect on a community. Not only are tax revenues affected, but also economic activity in the community that is generated by activity at the plant, vessels making deliveries and their crews, and processing employees. This activity often sustains support businesses that are a critical part of the economies of most communities with processing.

The action alternative would require IPQ processing to occur in the community that benefits from the right of first refusal unless that right holding entity consents moving IPQ processing. While the action would strengthen the position of these entities considerably, the action would affect the ability of processors (and possibly harvesters) to achieve efficiencies and derive benefits from the fisheries. Processing consolidation to realize production efficiencies could only take place if agreed to by an entity. End of season consolidation of small amounts of remaining IFQ (and IPQ) in a single trip could require the consent of several communities. In addition, any attempt to respond to an emergency or redirect a landing that might be prevented by an unforeseen circumstance would only be possible with community consent. Even if these consents are reasonable granted, delays could arise, if communities are unable to respond to requests quickly. In deciding this action, these operational concerns should be balanced against community interests that some may believe are not adequately protected under the current program measures.

Effects of Action 5 – Require notices to the community entity and NOAA Fisheries concerning the use and transfer of shares subject to the right

Currently, right holders have little information on the use of IPQ that are subject to the right. In addition, NOAA Fisheries may not be aware of a right holder's contention that a right has lapsed from use of IPQ outside of the community that benefits from the right and may not know whether PQS holders have provided a right holder with either the ability to exercise the right or a new agreement extending the right. The fifth action would provide additional notices to NOAA Fisheries and right holders, as well as require PQS holders to certify that right holders have received an opportunity to exercise the right or a new agreement extending the right at the time of a transfer. These notices and certifications will impose a very slight burden on PQS holders, but will ensure that the public, fishery managers, and right holders have better information concerning the status of rights of first refusal and their effects.

Effects of Action 6 – Issuance of newly created POS to Aleutia Corporation

The sixth action would allocate 0.55 percent of the PQS in the Bristol Bay red king crab to Aleutia Corporation to address its claim that it was denied the opportunity to exercise a right of first refusal on a transfer of PQS. Under the status quo, Aleutia may receive a future right of first refusal, as the current holder has offered to extend the right to settle Aleutia's grievance. Even holding that right, Aleutia is unlikely to have an opportunity to exercise the right, as the current holder is a Community Development Quota group affiliate that is unlikely to transfer the shares in the foreseeable future. The action alternative would provide Aleutia with the benefit of the share allocation, at no cost to Aleutia. Aleutia is likely to contract custom processing of landings in the Aleutians East Borough to contribute economic activity to the borough. The allocation will dilute PQS holdings of all other processors slightly (as the effect is distributed among all PQS holders in proportion to their holdings). The action will also result in a minor redistribution of processing geographically to the location of processing chosen by Aleutia (most likely King Cove) at the expense of other communities. Since the amount of crab at issue is very small, the redistribution is unlikely to affect the amount of economic activity or municipal revenues in any other location to a noticeable degree.