Golden king crab arbitration workgroup meeting
PSPA Conference Room, Fishermen's Terminal, Seattle, Washington
North Pacific Fishery Management Council
May 22nd and 23rd, 2012

Participants – Duncan Fields, Joe Sullivan, Dick Tremaine, David Capri, Mark Fina, Greg White, Linda Kozak, Dick Powell, Jill Capri, Andrew Richards, Brett Reasor, Mark JoHahnson, Larry Cotter, Steve Minor, Jake Jacobsen

The committee briefly discussed the plan for the meeting. The group identified a potential goal as the development of one or more negotiated price setting structures that could be agreed by individual parties, as an alternative to arbitration. Arbitration would remain a backstop, in the event a negotiated price could not be reached.

The group discussed several different topics throughout the meeting. These discussions were interspersed throughout the discussion of the previous meetings minutes and different proposals presented by each side. First, the minutes from the previous meeting were reviewed. Following that discussion, a proposal by processors was presented for establishing a price differential for Western fishery landings (including adjustments for deliveries in the West region) (attached). This was followed by a proposal of harvesters in response to the processor's proposal from the previous meeting (attached). The harvester proposal included a proposed system for establishing a fixed price for deliveries (attached). The discussion of the harvester proposal was followed by a general discussion that touched on several topics and developed a plan for the next meeting. The remainder of these minutes summarizes the discussion by topic and concludes with a brief outline of the plan for the next meeting. This format may better illuminate areas of agreement and disagreement for future discussions.

Lengthy season agreements
Participants generally agreed on the approach to limiting lengthy season arbitration initiation based on the timing of deliveries and sales (as proposed at the previous meeting). Both sides agreed that the lengthy season agreements could include a deadline for the initiation of arbitration that would be based on delivery and product sale thresholds.

Delivery timing
Participants also agreed conceptually to arrangements that define mutually acceptable delivery periods. Harvesters suggested that the specific arrangements may need to be defined annually, as a part of share commitments and price negotiations. Under this approach, price adjustments (if any) for delivery timing would be arrived at through direct negotiations with each processor based on that processor's preferences.

Harvesters presented information concerning the timing of deliveries before and after implementation of the rationalization program, which show that, with the exception of the years immediately preceding program implementation, delivery periods were as long or longer prior to rationalization (see attachment). Based on this information, harvesters question the extent to which processors have been harmed by delivery periods under the rationalization program. Processors believe that delivery timing under the rationalization program should be prioritized based on market timing and that delivery periods prior to implementation of the program may not be relevant to those market timing considerations.

Leasing and custom processing

Participants disagreed on whether leasing is relevant to the arbitration system. Harvesters believe that lease agreements are not relevant to discussions of the arbitration system. Processors believe that the leasing obligations of IFQ holders limit their ability to negotiate price settlements. Harvesters believe that the arbitration system should protect the financial health and stability of harvesting and processing sectors (i.e., the harvesters that harvest crab, as a sector, and the processors that process crab, as a sector) but not necessarily IFQ holders that do not harvester their allocations or IPQ holders that do not process their allocations. Harvesters believe custom processing and marketing arrangements are comparable to leases.

Use of multiyear agreements

The group discussed the potential to use multiyear agreements, as an alternative to annual negotiations and the potential for arbitration. Some participants suggested that multiyear agreements are needed to ensure stability. Harvesters expressed concern that multiyear agreements could be considered to establish an affiliation with an IPQ holder that would prevent harvesters from using the arbitration system.

Western fishery deliveries

Processors presented an example of possible adjustments from Eastern and Western fishery deliveries (see attachment). The proposal includes:

1) Product mix adjustments (quality – ratio of #1 and #2) – the group discussed whether this adjustment could be avoided by simply focusing on the first wholesale price of deliveries of Western fishery crab – the group generally agreed that using the first wholesale prices of deliveries from Western fishery landings would address this differential
2) Recovery rate adjustment
3) Cost differences for West region deliveries – which could include holding costs, processing costs, and transportation costs

In discussion the proposal, processors suggested that the proposal is only illustrative of possible adjustment and it was agreed that price adjustments would need to be documented to administer any contract. Harvesters suggested that additional operating costs and losses in the harvest sector are relevant, as well as additional higher tax rates on deliveries in the West region. As an example, harvesters cited the stranding of in excess of $1 million worth of quota during the 2006-2007 season because no processing capacity was available to accept deliveries of West region IFQ in that year. The participants agreed that higher processing costs should be shared costs, rather than borne by one side. Processors agreed to provide specific shared cost proposals in the future.

Fixed price agreement proposal

The harvesters presented a fixed price agreement proposal that could apply an agreed price index on the date or month of delivery to a pricing formula (effectively a applying a prediction of the first wholesale price to a division of revenues). This agreement would avoid any need for reviews of processor prices and instead would rely on a public index for determining an estimated first wholesale price. The formula for price prediction included in the proposal was based on the formula contained in the first year's pricing formula. The group also discussed the potential to use more than one index or consider an average of an index over a period of time to reduce risks in a trending market. In any case, establishing a predicted price based on an index (or indices) at the time of delivery would result in the processor receiving the full benefit (and bearing the full cost) of its performance in the first wholesale market relative to the predicted price. The result is that the processor has an incentive for holding and marketing crab to attain the highest net return (as its marginal gains (or losses) are not shared with harvesters). Some participants suggested that red king crab prices may not be appropriate for use as an index and that a source for the index, other than the Urner Barry reports, may be appropriate. Participants generally agreed that this approach to pricing could effectively address the lack of incentive for processors to achieve the greatest net return from their sales that arises under the current pricing system.

The current arbitration system

While processors believe that both the shared margin agreement and fixed price agreement may have merit, they believe that the arbitration system needs adjustments to provide an appropriate backstop for the development those agreements. Processors contend that the exhibits shown at the last Council meeting demonstrate their issue with the current formula percentage. They believe that moving from the current percentages is necessary to address their issue.

Harvesters do not agree that the arbitration system needs an adjustment to provide an appropriate backstop. Harvesters also argue that the arbitration system is not as effective as it should be since it does not create a strong incentive for processors to pursue higher prices in sales. They believe that failure to aggressively market golden king crab has hurt markets generally and other processors. Harvesters argue that some processors market crab to long term, reliable customers at lower prices, rather than to marketsw that may have the greatest return for crab sales. Harvesters believe that better processor marketing efforts would alleviate revenue shortfalls.

Both sides believe that additional supporting information is needed to support any calculations for making adjustments in the formula.

In response to processors' concern that the backstop of arbitration needs adjustment, harvesters suggested that a single flat percentage may not adequately address their problem. If first wholesale prices are low, even at relatively low percentages, a processor may not receive sufficient revenue to cover operating costs. An alternative may be to have the harvesters' historical percentage of first wholesale revenue adjusted downward at low first wholesale prices. This would allow processors a margin at low prices (as they would pay a low percentage of first wholesale revenues). As prices increased a larger share would be paid to harvesters to make up for the relatively low percentage paid in the low price market. Both sides agreed to further explore this approach at the next meeting.

Harvesters suggested that any agreement of this group could be delivered to the formula arbitrator as comments on the formula that operates as a backstop. If accepted by the formula arbitrator, this process could be used to effectively change the backstop, as the formula is generally accepted to serve that purpose currently.

Shared margin agreements

Harvesters have expressed a concern that adding specificity to the shared margin arrangements through this group could pose an antitrust issue. Processors agreed to develop a memo concerning this issue.

Other issues

Processors suggested that they should be able to trigger arbitration and recover overpayments relative to those derived by applying the formula defining revenue division. Harvesters do not accept this proposition.

It was suggested that the pricing be developed to accommodate new entrants; however, after discussion, the group agreed that the program should not be developed to accommodate costs of entry.

It was also suggested that any consideration of overall conditions would need to incorporate both the Western and Eastern fisheries. Both fisheries (and processing in the West region) are relevant to understanding the situation.

The group discussed the application of the formula to value added products. Harvesters clarified that the formula is should be applied to traditional product form (i.e., cluster) prices only (allowing processors to gain any additional revenues from value added production), provided that the value added production does not affect harvester costs. If a harvesters costs were affected (for example, by requiring smaller deliveries), harvesters would need to negotiate the distribution of those added costs (or added revenues from the value added production).

It was noted that custom processing is an added cost and that IPQ holders who have crab custom processed by others may not be able to make money in low price years, if custom processing costs are high. It was suggested that the formula with a fluctuating percentage (low percentage in low price years) would help address this issue, but may not address the issue in all cases.

In addition, it was suggested that the focus in developing accommodations in the formula should be on differences that have arisen since the program was implemented, as those are most relevant to the adjustments.

<u>Next meeting</u>

The goal for the next meeting is to add details to all of the following proposals.

1) Cost adjustments to the percentage of historical division of revenues (processor's Option 1 from the April meeting) – what is the evidence of adjustment need – in response, harvesters have suggested that a formula could be developed under which the percentage of first wholesale price paid to harvesters fluctuates with the first wholesale price – a lower percentage would apply in times when first wholesale prices are low, the percentage would increase with increases in the first wholesale price (Greg White agreed to distribute a proposal for this formula for consideration)
2) Sharing of margins – further definition of the agreement is needed including:
    a. What costs should be considered
    b. What marketing involvement would a harvester have
    c. What cost control involvement would a harvester have

    (Joe Sullivan agreed to distribute a proposal on these elements)
3) Fixed price arrangements –
    a. Review the formula numbers – what is an appropriate formula
    b. What indices are appropriate
    c. What time period for indices are appropriate (day of delivery, month of delivery, monthly average, seasonal average)

    (Processor representatives agreed to review the proposal as written – Dick Tremaine agreed to look at different formulations of the arrangement)
4) West fishery adjustments
    a. What adjustments are made for East region deliveries
    b. What additional adjustments are made for West region deliveries

    (Mark JoHahnson and Bret Reasor agreed to provide additional details on the different factors that would define adjustments and the amounts of proposed adjustments)

5) Framework discussion – what is required for verification of any information used in applying these concepts – all participants agreed to be prepared for discussion of factors that would need to be verified and the means of verification at the next meeting
6) Delivery date price adjustments –processors brought a specific proposal at the last meeting, which harvesters believe is not needed – processors agreed to respond to the harvesters position, with a specific proposal, if needed

The next meeting will begin at 1 pm on June 28th. Participants should expect the meeting to extend into the 29th. The meeting will be held in the Council office conference room in Anchorage (Room 205, Old Federal Building, 605 West 4th Avenue, Anchorage).

Attachments available upon request from the Council office.