UNITED STATES DEPARTMENT OF COMMERCE
National Oceanic and Atmospheric Administration
Office of General Counsel
P.O. Box 21109
Juneau, Alaska 99802-1109

May 25, 2004

Chris Oliver
Executive Director
North Pacific Fishery Management Council
605 West 4th Street, Suite 306
Anchorage, Alaska 99501-2252

Dear Chris,

In April, NOAA contracted with Arnold & Porter, LLP, to obtain expert legal services in the areas of antitrust and arbitration law. I am enclosing the final legal opinion we received from Arnold & Porter analyzing whether the arbitration system of the Crab Rationalization Program as legislated by section 801(j)(1) of the Consolidated Appropriations Act of 2004, Pub. L. No. 108-199, could be implemented consistent with the antitrust laws. The opinion recommends several changes to the arbitration system to ensure compliance with the antitrust laws.

I also am enclosing a markup of the arbitration system provisions of the Council's Motion showing what changes need to be approved by the Council to bring the system into compliance with the antitrust laws.

Please distribute the enclosed to Council members for their review prior to the June meeting.

Sincerely,

Lisa L. Lindeman
Alaska Regional Counsel

Enclosures

cc: Jane Chalmers
Jim Balsiger

Binding Arbitration System (from February 2003 motion) SUGGESTED AMENDMENTS TO MAKE ARBITRATION SYSTEM CONSISTENT WITH ANTITRUST LAWS – BASED ON ANTITRUST COUNSEL LEGAL OPINION May 25, 2004

The Council adopts the following elements for a system of binding arbitration to resolve failed price negotiations.

1. The Standard for Arbitration

The primary role of the arbitrator shall be to establish a price that preserves the historical division of revenues in the fisheries while considering relevant factors including the following:

a. Current ex vessel prices (including prices for Class A, Class B, and Class C shares recognizing the different nature of the different share classes)
b. 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)
c. Innovations and developments of the different sectors and the participants in the arbitration (including new product forms)
d. Efficiency and productivity of the different sectors (recognizing the limitations on efficiency and productivity arising out of the management program structure)
e. Quality (including quality standards of markets served by the fishery and recognizing the influence of harvest strategies on the quality of landings)
f. The interest of maintaining financially healthy and stable harvesting and processing sectors
g. Safety
h. Timing and location of deliveries
i. Reasonable underages to avoid penalties for overharvesting quota and reasonable deadloss

10. Market Report

An independent market analyst selected by the mutual agreement of the sectors will present to both sectors and all designated arbitrators an analysis of the market for products of that fishery.

11. Selection of the Arbitrator(s) and Market Analyst

The market analyst and arbitrator(s) will be selected by mutual agreement of the PQS holders and the QS holders. PQS holders collectively must agree and QS holders collectively must agree. Processors may participate collectively in the selection process. The details of the selection will be decided at a later time.

12. Shares subject to binding arbitration

This binding arbitration system shall address price disputes between holders of delivery restricted IFQ (including Class A IFQ and Class C IFQ when subject to delivery restrictions) and holders of IPQ. Binding arbitration does not apply to the negotiation of price for deliveries under the class B IFQ and Class C IFQ when not subject to delivery restrictions. C share holders, however, may elect to participate in the arbitration process prior to delivery restrictions taking effect.

13. Shares of processor affiliates

Participation of processor affiliates in binding arbitration as IFQ holders will be determined by any applicable rules governing anti-trust. Any parties eligible for collective bargaining under the Fishermen's **Cooperative** Marketing Act of 1934 **(FCMA)** will be eligible to participate **collectively as a member of that FCMA co-op** in binding arbitration. No antitrust exemption should be made to enable processor affiliated IFQ holders to participate in arbitration.

14. Payment of the arbitration and market analysis

The payment for the market analysis and the arbitrators will be shared by the two sectors. Cost shall be shared by all participants in all fisheries.

For shared costs, the payment of those costs shall be advanced by IPQ holders. The IPQ holders will collect the IFQ holders' portion of the shared costs by adding a pro rated surcharge to all deliveries of Class A crab.

15. Quality dispute resolution

In cases where the fisherman and the processor cannot come to agreement on quality and thus price for crab, two mechanisms are suggested for resolving the price dispute-after the processor has processed the crab (to avoid waste from dumping the load at sea): (1) In cases where fishermen and processors have agreed to a formula based price, the two parties would take their normal shares of the price, after the disputed load is sold. (2) This type of dispute would most likely apply in cases where fishermen desire to stay with fixed dockside prices and there is disagreement on quality and therefore price. These cases could be referred to an independent quality specialist firm. The two parties in dispute would decide which firm to hire.

16. Data used in arbitration

Under any arbitration structure, the arbitrator must have access to comprehensive product information from the fishery (including first wholesale prices and any information necessary to verify those prices).

~~Processors may participate in common discussions concerning historical prices in the fisheries~~. **(Reasons: Insufficient limitation. Poses serious antitrust risks. Delete. See pages 30-31 of the legal opinion.)**

Subject to limitations of antitrust laws and the need for proprietary confidentiality, all parties to an arbitration ~~proceeding~~ shall have access **only** to ~~all~~ information provided to the arbitrator(s) **or panel for that arbitration directly by the parties to** ~~in~~ that **arbitration.** ~~proceeding.~~ **Access to information by a harvester participating in an arbitration will be limited to information submitted by itself and the processor. All participants to an arbitration shall sign a confidentiality agreement stating they will not disclose any information received from the arbitrator.**

(Reasons: The current provision presents serious antitrust concerns. The provision implies that all parties involved in an arbitration could have access to competitively sensitive information submitted to an arbitrator by every harvester and processor during all prior arbitration sessions. Since parties will be providing arbitrators with pricing and cost information, this could give parties in subsequent arbitrations access to their competitors' current cost structure and pricing information. Also, risk of antitrust liability if cooperative or members of a cooperative share sensitive competitive information or attempt to collaborate with non-member harvesters on any issues related to price or costs. See legal opinion, pages 26-30).

Data collected in the data collection program may be used to verify the accuracy of data provided to the arbitrator(s) in an arbitration proceeding. Any data verification will be undertaken only if the confidentiality protections of the data collection program will not be compromised.

17. Enforcement of the Arbitration Decision

The decision of the arbitrator will be enforced by civil damages

18. Oversight and administration of the Binding Arbitration system.

Oversight and administration of the binding arbitration should be conducted in a manner similar to the AFA cooperative administration and oversight. System reporting requirements and administrative rules should be developed in conjunction with the Council and NOAA Fisheries after selection of the preferred program.

The structure for the system of Binding Arbitration system shall be as described below:

LAST BEST OFFER BINDING ARBITRATION

GENERAL

The Last Best Offer Model provides a mechanism to resolve failed price and delivery negotiations efficiently in a short period before the opening of the season. The Model includes the following specific characteristics:

1. Processor-by-processor. Processors will participate individually and not collectively, except in the choice of the market analyst and the arbitrator/arbitration panel.
2. Processor-affiliated shares. Participation of processor-affiliated shares will be limited by the current rules governing antitrust matters.
3. Arbitration standard. The standard for the arbitrator is the historic division of revenues between harvesters and processors in the aggregate (across the entire sectors), based on arm's-length first wholesale prices and ex-vessel prices (Option 4 under "Standard for Arbitration" in the staff analysis). The arbitrator shall consider several factors including those specified in the staff analysis, such as current ex vessel prices for both A, B and C Shares, innovations, efficiency, safety, delivery location and timing, etc.
4. Opt-in. An IFQ holder may opt in to any contract resulting from a completed arbitration for an IPQ holder with available IPQ by giving notice to the IPQ holder of the intent to opt in, specifying the amount of IFQ shares involved, and acceptance of all terms of the contract. Once exercised, an Opt-in is binding on both the IPQ holder and the IFQ holder.
5. Performance Disputes. Performance and enforcement disputes (e.g. quality, delivery time, etc.) initially will be settled through normal commercial contract dispute remedies. If those procedures are unsuccessful, the dispute will be submitted for arbitration before the arbitrator(s). If those procedures are unsuccessful and in cases where time is of the essence, the dispute will be submitted for arbitration before the arbitrator(s). The costs of arbitration shall be paid from the fees collected, although the arbitrator(s) will have the right to assign fees to any party for frivolous or strategic complaints.
   Lengthy Season Approach. For a lengthy season, an IPQ holder and an IFQ holder (or group of IFQ holders) may agree to revise the entire time schedule below and could agree to arbitration(s) during the season. That approach may also be arbitrated pre-season if the holders cannot agree.

PROCESS

1. Negotiations and Voluntary Share Matching.

At any time prior to the season opening date, any IFQ holders may negotiate with any IPQ holder on price and delivery terms for that season (price/price formula; time of delivery; place of delivery, etc.). If agreement is reached, a binding contract will result for those IFQ and IPQ shares. IPQ holders will always act individually and never collectively, except in the choice of the market analyst (which may occur at any time pre-season) and the arbitrator/arbitration panel for which all IFQ and IPQ holders will consult and agree.

2. Required Share-Matching and Arbitration.

Beginning at the 25-day pre-season point, IFQ holders may match up IFQ shares not already subject to contracts with any IPQ shares not under contract, either ~~as collective groups of IFQ holders~~ **collectively as part of an FCMA cooperative** or as individual IFQ holders (the offered IFQ Shares must be a substantial amount of the IFQ Holder(s)' uncontracted shares). The IPQ holder must accept all proposed matches up to its non-contracted IPQ share amount. All IFQ holders "matched" with an IPQ holder will jointly choose an arbitrator with that IPQ holder. The matched share holders are committed to the arbitration once the arbitrator is chosen (if the parties wish, the arbitrator may initially act as a mediator to reach an agreement quickly). Arbitration must begin no later than 15 days before the season opening date.

3. Data.

The Arbitrator will gather relevant data independently and from the parties to determine the historical distribution of first wholesale crab product revenues (at FOB point of production in Alaska) between harvesters and processors in the aggregate (across the entire sectors). For a vertically integrated IPQ holder (and in other situations in which a back-calculation is needed), the arbitrator will work with that IPQ holder and the IFQ

holders to determine a method for back-calculating an accurate first wholesale price for that processor. The Arbitrator will receive a pre-season market report from the market analyst, and may gather additional data on the market and on completed arbitrations. The Arbitrator will also receive and consider all data submitted by the IFQ holders and the IPQ holder. The Arbitrator will not have subpoena power.

4. Arbitration Decisions.

Arbitration will be based on a "last best offer" system, with the Arbitrator choosing one of the last best offers made by the parties. The Arbitrator will work with the IPQ and IFQ holders to determine the matters that must be included in the offer (e.g. price, delivery time & place, etc.) and will set the date on which "last best offers" must be submitted. The last best offers may also include a price over a specified time period, a method for smoothing prices over a season, and an advance price paid at the time of delivery.

If several groups or individual IFQ Holders have "matched" with that IPQ Holder, each of them may make a last best offer. Prior to submission of the last-best offers, the Arbitrator may meet with parties, schedule joint meetings, or take any actions aimed at reaching agreement. The Arbitrator will notify the IPQ holder and the IFQ holders of the Arbitration Decision no later than 10 days before the season opening date. The Arbitration Decision may be on a formula or ex-vessel price basis. The Arbitration Decision will result in a contract for the IPQ holder and the IFQ holders who participated in arbitration with that IPQ holder.

5. Post-Arbitration Opt-In.

Any IFQ holder with shares not under contract may opt in to any contract resulting from an Arbitration Decision for an IPQ holder with IPQ that is not under contract, on all of the same contract conditions (price, time of delivery, etc.). If there is a dispute regarding whether the "opt in" offer is consistent with the contract, that dispute may be decided by the arbitrator who will decide only whether the Opt-in is consistent with the contract.

~~6. Formula and Prices.~~

~~Throughout the year, the market analyst will survey the crab product market and publish periodically a composite price. That price will be a single price per species, based on the weighted average of the arm's length transactions in products from that species.~~

(Reason: Periodic price announcements present a serious antitrust risk. There appears to be no procompetitive purpose for the periodic publication of prices in the crab product market or any need for such publication occasioned by the crab rationalization program. To the extent this information is necessary for the arbitrations, the arbitrator will have it. The reporting of periodic price information could provide a way of matching up prices with individual market participants. The more frequent the periodic price updates, the smaller will be the number of harvesters and processors and [distributors or customers] generating the composite price being reported. This will make aggregation less effective and if market participants know or can learn which particular processors and harvesters completed their negotiations or arbitrations in a given survey period, then it may be hard to ensure price anonymity. The announcement of recent prices and the lack of anonymity could make it easier for processors to arrive at agreements to set prices and for processors to enforce the agreements.)

7. Non-Binding Price Arbitration (from the April 2003 motion)

There will be a single annual fleet-wide arbitration to establish a non-binding formula under which a fraction of the weighted average first wholesale prices for the crab products from each fishery may be used to set an ex-vessel price. The formula is to be based on the historical distribution of first wholesale revenues between fishermen and processors, taking into consideration the size of the harvest in each year. The formula shall also include identification of various factors such as product form, delivery time and delivery location. The non-binding arbitration shall be based upon the Standard for Arbitration set out in the February 2003 Council motion, Item 1 including a. through i. As a part of this process, the arbitrator will review all of the arbitration decisions for the previous season and select the highest arbitrated prices for a minimum of at least 7% of the market share of the PQS. This provision allows for the aggregation of up to 3 arbitration findings that

collectively equal a minimum of 7 percent of the PQS, to be considered for the highest price for purposes of this provision. If arbitration findings are aggregated with two or more entities, then the lesser of the arbitrated prices of the aggregated entities included to attain the 7 percent minimum market share of PQS shall be considered for purposes of developing the benchmark price. The arbitrator in the non-binding arbitration shall not be an arbitrator in the last best offer binding arbitration(s). This formula shall inform price negotiations between the parties, as well as the Last Best Offer arbitration in the event of failed price negotiations.

8. Public Disclosure of Arbitration Results

The result of each arbitration will be announced as it occurs to the processors and harvesters in that arbitration and non-vertically integrated harvesters that have not committed to a processor.

(Add this in per opinion at pages 32-35.)

ARNOLD & PORTER LLP

PRIVILEGED AND CONFIDENTIAL
ATTORNEY WORK PRODUCT

Memorandum

To: NOAA General Counsel

From: Debbie Feinstein, Donna Patterson, Jon Nathan (Arnold & Porter LLP), and Andrew Dick (CRA)

Date: May 18, 2004

Re: NOAA Proposed Crab Arbitration Program

We have been asked by the National Oceanic and Atmospheric Administration ("NOAA") to analyze whether an arbitration system legislated as part of the Bering Sea and Aleutian Islands ("BSAI") Crab Rationalization Program can be implemented consistent with the antitrust laws.[1] We were further asked to make specific recommendations for changes to the arbitration system to ensure compliance with those laws.[2]

[1] Our understanding of the legislation derives from a review of the "Draft Council Motion for BSAI Crab Rationalization as updated through April 5, 2003," the Letter from the North Pacific Fishery Management Council to Congress of 8/5/02 and Appendix 1 - Regulatory Impact Review (November 2003) as well as discussions with Lisa Lindeman, Alaska Regional Counsel, NOAA, and Mark Fina, Senior Economist, North Pacific Fishery Management Council.

[2] The statute requires that the Secretary approve by January 1, 2005 and thereafter implement by regulation the Voluntary Three-Pie Cooperative Program for Crab Fisheries ("the Program") approved by the North Pacific Fishery Management Council ("the Council") between June 2002 and April 2003, and all trailing amendments reported to Congress on May 6, 2003. Consolidated Appropriations Act of 2004, Pub. L. No. 108-199, § 801(j)(1). This does not preclude the Secretary of Commerce from approving the Program by January 1, 2005, and implementing any subsequent amendments approved by the Council. *Id.* at § 801(j)(3). The statute also expressly states that federal antitrust laws will still apply to the program. *Id.* at § 801(j)(6).

We conclude that the proposed arbitration program can be implemented with relatively few changes. Our primary concern focuses on the information exchange between processors and harvesters possible under the planned arbitration procedures. Specifically, we recommend:

- Limiting the access of harvesters and processors in an arbitration to the data and information submitted by the specific participants in an arbitration rather than allowing the participants full access to all information available to the arbitrators.
- Eliminating the provision allowing processors to discuss pricing with each other.
- Providing access to the results of other arbitration sessions only to arbitrators and non-affiliated harvesters that have not committed shares to a processor.

I. EXECUTIVE SUMMARY

We recognize that the arbitration system is a necessary component of a rationalization program that includes both harvester and processor quotas. We conclude that the proposed arbitration program can be implemented with relatively few changes. Our primary concern focuses on information exchanges that could occur under the planned arbitration procedures that differ from those permitted in an unregulated competitive market.

First, we conclude that the non-binding arbitration program does not pose a high antitrust risk as long as certain restrictions are followed. Neither the promulgation of a non-binding pricing formula nor the market report provides participants with significantly more information than could be obtained by the parties individually (or collectively in the

case of a harvesters' cooperative) in a non-rationalized market. So long as the parties do not collectively agree to use the pricing formula in any particular way, the announcement of a pricing formula itself poses few risks. While the market report could pose some antitrust risk depending on its content, this risk can be diminished if information contained in the report is restricted to historical information, is assembled by a third party, and provides aggregated information.

Second, we recommend that harvesters and processors have access only to the data and information submitted to the arbitrator in the arbitration in which they participate, rather than allowing them full access to all of the information available to the arbitrators (including data from completed arbitrations). Harvesters in a legitimate Fisherman's Cooperative Marketing Act ("FCMA") co-op[3] would remain free to share information with each other but the arbitrator would not be the one to disseminate such information.[4] We believe it is important for the arbitrators to be able to access information from prior arbitration sessions in order to ensure that the arbitrator has access to information that could otherwise be available to parties in the open market. It also assists the arbitrator in confirming that the information presented by the parties is accurate. However, providing every party to an arbitration "with access to all information provided to the arbitrator(s) in that proceeding"[5] could provide participants with access to competitively sensitive information from competitors.

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[3] To avail itself of the antitrust exemption applicable to FCMA co-ops, a defendant must establish that it is qualified to act collectively and that all entities with which it entered an agreement are also entitled to an antitrust exemption. *See* discussion at V.B.2.C. *infra.*

[4] Except where noted, we do not believe that different antitrust issues are raised in the case of harvesters who are members of an FCMA co-op as compared to those who are not.

[5] Draft Council Motion, at 12.

Because this information could include competitors' current cost structure and pricing information, this sort of information exchange raises serious antitrust concerns. The exchange of current pricing information could facilitate coordination among competitors. This concern is especially high for the processors given their relatively small number. Moreover, we see no procompetitive or legitimate reason why the parties to an arbitration would need access to this information. It is common in arbitrations for parties to be given access to information submitted by the parties themselves and we support allowing this exchange to occur as long as the parties sign a confidentiality agreement. However, concern with the potential anticompetitive risks of providing parties access to all information provided to arbitrators underlies our recommendation that this exchange cannot be permitted.

Third, we recommend removing the provision in the Draft Council Motion permitting processors "to participate in common discussions concerning historical prices in the fisheries."[6] The anticompetitive risks associated with encouraging competitors to discuss pricing information, even if historical, are too great. There is a high probability that competitors will move beyond a "historical" conversation. Moreover, the availability of pricing information facilitates collusion, especially when the processors will be identified with the prices they charge. The small number of processors contributes to this concern. Although this provision was included to facilitate the development of information about the historic division of revenues in the industry, we believe this information can be generated in another manner that does not raise serious antitrust concerns (such as by provision of this information to the market analyst).

[6] Draft Council Motion, at 12.

Finally, we recommend that the results of the completed arbitration sessions not be publicly announced and instead be provided only to arbitrators and to harvesters that have not committed to a processor and may opt-in to a previous harvester-processor contract. While we recognize that the "opt-in" provision cannot work unless the arbitration findings are available to holders of uncommitted Class A IFQs, there is no reason for the processors to have access to this information. While harvesters who are members of a cooperative could freely exchange the information among members, allowing processors (including vertically-integrated harvesters) and harvesters who are not co-op members to share the results of other arbitration sessions would run the risk of violating the antitrust laws as an exchange of current pricing information. Additionally, access to this information could influence a harvester's or processor's final offer to the arbitrator in later proceedings or facilitate pricing coordination for other seafood or in future crab seasons. Moreover, vertically-integrated harvesters present similar concerns and should be denied access to this information out of a concern that they could share it with their affiliated processors.

II. BACKGROUND

In 2001, Congress directed "[t]he North Pacific Fishery Management Council[7]...[to] examine the fisheries under its jurisdiction, particularly the Gulf of Alaska groundfish and Bering Sea crab fisheries, to determine whether rationalization is needed. In particular, the Council shall analyze individual fishing quotas, processors quotas,

[7] The Council is one of eight regional fishery management councils established by Congress under the auspices of NOAA pursuant to 16 U.S.C. § 1852. It has authority over the fisheries in the Arctic Ocean, Bering Sea and Pacific Ocean seaward from Alaska. § 1852(a)(1)(G).

cooperatives, and quotas held by communities." Consolidated Appropriations Act of 2001, Pub. L. No. 106-554. Rationalization programs are currently in place in other fisheries and generally allocate tradable shares to harvesters in the fishery. These programs are designed to ensure the sustainability of the fishery stock as well as the overall industry.

The proposed rationalization program would replace the existing system where the Council, NOAA Fisheries and the State of Alaska annually establish the harvest limits. Currently, once the season opens, harvesters can fish until the harvest limit in the fishery is reached, at which point the season closes. This system results in a frenzied "race-for-fish" lasting as little as 72 hours, raising conservation and bycatch concerns. This results in economic instability for harvesters, processors and coastal communities and low occupational safety for workers. It also contributed to overcapitalization by both harvesters and processors: harvesters overcapitalized to catch as much crab as quickly as possible and processors added capacity to process the arriving crab before spoilage.

Under the proposed rationalization program, the total allowable catch ("TAC") would be divided among harvesters, communities and captains and crew. Letter from the Council to Congress of 8/5/02, at 2. After an initial 10% of the TAC is allocated to Community Development Quotas[8] the remaining TAC is initially allocated as follows: 3% to vessel captain and crew shares,[9] and 97% as individual shares. *Id.* at 1-2. These distributions are made through the allocation of long-term shares (referred to as quota

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[8] Community Development Quotas provide harvest allocation to groups representing rural western Alaska communities to facilitate fishing activity and economic development in those areas. Letter from the Council to Congress of 8/5/02, at 1, n.1.

[9] These quotas are allocated to a captain based upon historical fishing activity. They are transferable by purchase and sale among active captains and crew. The individuals who hold the shares are required to be onboard the vessel that fishes the shares. Consolidated Appropriations Act of 2004, Pub. L. No. 108-199 tit. VIII, § 801.1.8.1.

shares ("QS")) that entitle the holder to an annual allocation of harvestable pounds referred to as individual fishing quotas ("IFQs"). Ninety percent of the individual harvester IFQ would be designated as Class A shares requiring that the crabs be processed by a processor holding unused processor quotas. *Id.* at 2, 6. The remaining 10% of the individual harvester IFQ would be labeled Class B shares and could be processed by any processor.[10] *Id.* The initial allocation of QS is based on historical fishing activities. *Id.* at 6. Individual harvester QS and IFQs would be fully transferable for the first five years of the program,[11] but no harvester would be permitted to hold more than 1%-10% of the TAC within each fishery with the maximum varying by fishery. *Id.* at 9. Harvester quotas have been implemented in several other fisheries with considerable success in promoting sustainable fisheries. *See, e.g.*, General Accounting Office, Individual Fishing Quotas (GAO-04-277, February 2004).

The rationalization program would also create specific processor allocations, called processor quota shares ("PQS") and individual processor quotas ("IPQs"). Letter from Council to Congress of 8/5/02, at 12. PQS, initially allocated based on historical processor activity, represent a revocable, long-term interest to receive a portion of the annual processing allocation in the fishery. IPQs are the annual allocations that entitle the holder to purchase and process a specific poundage of crab harvested with Class A IFQ. *Id.* Processors who processed crabs in 1998 or 1999 and those who had processed

[10] The captain and crew shares will be referred to as C shares. For the first three years of the rationalization program, the C shares will be treated as Class B shares and will not be part of the arbitration program. After three years, these shares will convert such that C QS will yield annual allocations of Class A and Class B shares in the same manner as individual harvester QS. At that time, the annual IPQ allocation will increase by the corresponding amount. Consolidated Appropriations Act of 2004, Pub. L. No. 108-199 tit. VIII, § 801.1.8.1.

opilio crab in all years between 1988-1997 and invested over $1 million in processing equipment would be eligible for PQS based proportionally on their processing history. *Id.* The IPQs would be freely transferable among eligible processors, although none would be permitted to hold over 30% of the IPQs in a particular fishery. *Id.* at 15. No U.S. fishery has implemented IPQs. *See* North Pacific Fishery Management Council, Bering Sea Crab Rationalization Program Alternatives: Public Review Draft (May 2002).

Finally, the proposal includes a two-part arbitration program with a non-binding and binding component. The proposed program would begin with the harvesters and processors jointly appointing a market analyst and an arbitrator or arbitration panel prior to the harvesting season. Draft Council Motion for BSAI Crab Rationalization as updated through April 5, 2003, at 11 (hereinafter "Draft Council Motion"). The market analyst/arbitrator would develop a market report and announce a non-binding benchmark price to help guide price negotiations and inform any arbitration sessions.[12] Appendix 1 – Regulatory Impact Review (November 2003), at 396. The market report will comprehensively describe the market for crab and its products. *Id.* By doing so, it should reduce posturing by the parties and provide the arbitrator and industry with background on market conditions. *Id.* The pricing formula would be based on historical pricing information, cost and pricing information supplied by the parties and an assessment of the current market for crab and crab products. Draft Council Motion, at 11.

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[11] After the first five years, in order to encourage cooperative membership, the transferability of the IFQs would be limited to members of a harvesters' cooperative. Letter from the Council to Congress of 8/5/02, at 9.

[12] The proposal is unclear whether the market analyst and arbitrator that generates the non-binding pricing formula are the same individual.

After announcement of this price "guide," processors and harvesters are free to negotiate contracts with each other. Harvesters who are FCMA co-op members can negotiate collectively with individual processors, but processors cannot negotiate collectively. Letter from the Council to Congress of 8/5/02, at 17. For a fixed time period prior to the season holders of Class A IFQ and holders of uncommitted IPQ will be free to commit deliveries with or without a price agreement. After that time, Class A IFQ holders will be permitted unilaterally to commit deliveries to any holder of uncommitted IPQs. Draft Council Motion, at 13. If any Class A IFQ holder is unable to reach a price agreement with a processor to which it commits deliveries, the IFQ holder or group of holders can initiate a binding arbitration procedure with that processor. *Id.*

The arbitrators' "primary role shall be to establish a price that preserves the historical division of revenues in the fisheries while considering other relevant factors." *Id.* The chosen arbitration method is a "last best offer" model with the arbitrator required to choose from among the last best offers made by the parties. Appendix 1 - Regulatory Impact Review (November 2003), at 2. If several individual IFQ holders have matched with an IPQ holder, each may participate in the arbitration by making an offer; the arbitrator would select between the best offer made by each harvester and the processor's offer. *Id.* This could result in a processor having different contracts with each harvester. *Id.* The arbitration sessions would occur during the pre-season before the harvesting gets underway. Draft Council Motion, at 13 and Letter from the Council to Congress of 8/5/02, at 17. If a harvester chose not to reach its own agreement with a processor or participate in an arbitration, it could opt in to the price and terms developed in others' arbitrations with a processor that has unfilled IPQ. Draft Council Motion, at 13.

In January 2004, Congress mandated that NOAA approve by January 1, 2005, a crab rationalization program based on the program outlined above. Consolidated Appropriations Act of 2004, Pub. L. No. 108-199. Prior to this legislation, NOAA's General Counsel sent a letter to the Department of Justice Antitrust Division ("DOJ") in January 2003, requesting DOJ's assistance in identifying any antitrust issues associated with the planned arbitration system. In August 2003, DOJ responded to NOAA's request, expressing concerns regarding certain aspects of the proposed program, including the arbitration system and the IPQ program. Dep't of Justice, Business Review Letter from R. Hewitt Pate, Assistant Attorney General, to James R. Walpole, General Counsel, NOAA, of 8/27/03.

Specifically, DOJ urged NOAA to oppose the implementation of IPQs. DOJ believes that IPQs eliminate beneficial competition among processors, discourage the efficient use of resources and stymie product innovation because the processor has little incentive to improve quality or invest in new technology if he cannot be rewarded with additional market share. *Id.* DOJ also recommended that NOAA reject both aspects of the proposed arbitration procedure. It viewed arbitration as a poor substitute for pricing typically determined by market forces. *Id.* Moreover, DOJ cautioned that the announcement of the benchmark price as well as the information exchange between harvesters and processors contemplated as part of the arbitration could facilitate collusive behavior. *Id.* This letter was followed by Deputy Assistant Attorney General Bruce McDonald's testimony before the Senate Committee on Commerce, Science, and Transportation in which he restated DOJ's position taken in the letter. *The Economic Impact of Seafood Processor Quotas: Hearing Before the Senate Comm. on Commerce,*

Science, and Transportation, 108th Cong. (2004) (statement of J. Bruce McDonald, Deputy Assistant Attorney General, Antitrust Division, Dep't of Justice).

In response, NOAA has asked us to consider the antitrust issues raised by the proposed arbitration procedure and craft recommendations to minimize the risks that antitrust law violations would occur as a result of the arbitration system. There is no statutory exemption from the antitrust laws provided in the legislation. In fact, the legislation explicitly states that specific aspects of the arbitration program are "subject to the limitations of antitrust laws" and that activities will be "limited by the current rules governing antitrust matters." Draft Council Motion, at 12, 13. However, even absent such explicit statements, the federal antitrust laws would still apply to the arbitration program. "Repeals of the antitrust laws by implication from a statute are strongly disfavored and have only been found in cases of plain repugnancy between antitrust and regulatory provisions." *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 350-51 (1960); *Latin America/Pacific Coast Steamship Conference v. Federal Mar. Comm'n*, 465 F.2d 542, 546-48 (D.C. Cir.)("there is a presumption that antitrust principles apply unless a contrary intent appears expressly or by necessary implication."), *cert. denied*, 93 S. Ct. 269 (1972). Accordingly, since the legislation does not explicitly waive antitrust liability, there is no reason to conclude that the antitrust laws would not apply.[13] Thus, processors or harvesters who commit antitrust violations could be subject to various penalties. These include criminal fines and possible jail time for explicit price fixing

[13] For example, the fact that the legislation does not explicitly state that the antitrust laws apply to the processor discussions regarding historical pricing does not imply an antitrust exemption for those discussions. Such discussions among processors do not necessarily violate the antitrust laws absent an exchange of current pricing or other sensitive information. However, they do raise a significant risk of violation because competitors are being brought together to discuss pricing information. For these reasons, we recommend not allowing the processors to converse collectively.

arrangements, as well as civil suits by federal or state antitrust agencies. Additionally, crab consumers, harvesters or other parties directly harmed by the anticompetitive action could bring private antitrust suits seeking treble-damage awards.

Our analysis begins with a discussion of how the market created by the proposed rationalization plan differs from an unregulated, competitive market. Next, we turn to the effects of the quota system and why it necessitates the use of an arbitration system. Within that context, we consider the antitrust implications of the proposed arbitration provision in order to identify any antitrust problems that would prevent implementation of the arbitration program consistent with the antitrust laws. Finally, we recommend solutions to any identified antitrust concerns to minimize the antitrust risks associated with the arbitration system while preserving as closely as possible the original structure of the Council-approved arbitration system.

III. COMPETITIVE ENVIRONMENT

The Council's proposed crab rationalization program for Alaska crab fisheries diverges from the functioning of a perfectly competitive market in two significant respects. First, under the Council's proposal, QS and PQS are initially assigned based on "historical interests," and in conjunction with the TACs, will determine the quantity of crabs caught and processed in a fishery. In a perfectly competitive market, in contrast, harvesters' costs of fishing would determine the supply of crabs caught in each fishery, while the demand for processed crabmeat by the consuming public would determine processors' demand for crabs. Second, in contrast to the Council's proposed binding price arbitration, prices in a perfectly competitive market would equilibrate the quantity of crabs supplied by harvesters with the quantity demanded by processors. In markets

with IFQs, IPQs and price arbitration, the quantities demanded and supplied will be pre-determined, and the arbitration price's only function will be to distribute the value of the quota between harvesters and processors to "preserve[] the historical division of revenues." Draft Council Motion, at 11.

In a perfectly competitive market, the prices that individual harvesters received for their crabs would tend to diverge only if (i) crabs differ in quality (including such dimensions as delivery date or location) or (ii) harvesters and processors have limited information about market conditions, including about the price and quality of crabs. Harvesters that catch higher quality crabs will be rewarded with higher prices, but on a quality-adjusted basis, prices in a perfectly competitive market will still tend to equalize across harvesters. Competition will ensure this outcome.[14] In a perfectly competitive market, buyers and sellers become well-informed about prevailing market conditions through a myriad of channels including, most significantly, feedback about competing offers during their own negotiations. In a perfectly competitive market where each buyer and seller is sufficiently small to prevent any given market participant from influencing the prevailing price, the fact that market participants are well informed about prices does not raise antitrust concerns (assuming information is obtained through appropriate means, rather than through improper communications among competitors). To the contrary, access to reliable and timely information is critical to the smooth and efficient functioning of perfectly competitive markets.

[14] To see this, suppose that a particular processor offered to pay only an average price for a catch of above-average quality crabs. When other processors learn of this potential bargain, they will compete with each other to outbid the first processor, and they will bid up the price until it exactly reflects the catch's higher quality. An unstated but important assumption driving this process is that harvesters and processors have access to timely and reliable information about the prices and qualities of crabs that are being bought and sold in their fishery.

In the current, "pre-rationalization" market there is minimal variation across harvesters or processors in the prices for crabs themselves. Only a few factors, such as location, delivery date and the level of services offered, contribute to the price deviation that does occur. Today, in the larger fisheries, prices are determined through a series of discussions between harvesters and processors. The process begins when representatives of the harvesters' cooperative, the Alaska Marketing Association ("AMA"), meet with each of the major crab processors to discuss the market for crab products. Appendix 1 - Regulatory Impact Review (March 2004), at 113. Based on information derived from these conversations and general market research, the AMA determines an expected price for crab, which it then communicates to processors. *Id.* An AMA representative then negotiates a price with an individual processor, the members vote on the price, and if accepted, the rest of the harvesters and processors usually follow that price. *Id.* In the smaller fisheries, prices are negotiated in a less formal and less coordinated manner.

IV. THE EFFECTS OF THE IFQ AND IPQ SYSTEM

The effect the IFQ and IPQ programs play in altering the competitive nature of the market must be considered when analyzing the arbitration system. As discussed above, the Council recommended the allocation of IFQs to prevent the frenzied "race to fish" and its attendant problems that have arisen in recent years. By creating a system of IFQs, the Council hoped to lengthen the harvesting season and better manage resource use.

However, crab processors were concerned that their bargaining position vis-à-vis harvesters would be unfairly diminished as a result of the extended harvesting season and the allocation of IFQs. Rather than a rushed period where all crab required processing at

the same time to prevent spoilage, the extended season would result in excess processing capacity and scheduling complications for processors because of the labor-intensive nature of crab processing. Processors feared that this would shift economic rents from processors to harvesters. In response to this concern, processors requested the implementation of IPQs. The IPQs allocate buying rights for the crab among a handful of processors, in a manner such that each IPQ holder is guaranteed to receive a certain percentage of the overall market.

A. Supply and Demand in Balance

The use of IFQs in conjunction with IPQs ensures equilibrium between supply and demand quantities for 90% of the market (or for that part of the market for which IPQs are allocated). Whereas prices in a competitive market would be determined by the process of supply and demand adjusting into balance, under the proposed system there will be no market forces driving prices to equilibrium for 90% of the market. Under the proposed system, the processors will be discouraged from competing to fill their capacity by offering a higher price to harvesters because processors know they will obtain the full amount of their IPQ as long as they offer any price greater than the harvester's cost of fishing for the crabs. Likewise, harvesters will be discouraged from competing by asking a lower price from processors because they know they will obtain the full value of their IFQ as long as they ask any price less than the processor's total profit from processing crabs. With neither processors nor harvesters having any incentive to compete on price, the parties may never converge on a "market price." The imposition of quotas on both sides of the market essentially turns negotiations into a contest to see which side concedes on price earliest. Absent the possibility of arbitration, price negotiations potentially could continue indefinitely, and this delay could prove costly as both

harvesters and processors kept their capacity or work crews idle while awaiting a conclusion to the negotiations.[15]

B. Last Person Standing Problem

The negative result of the equilibrium between harvester and processor shares will be felt most acutely by the last harvester and processor to contract. The last parties will have only a single market for their product or service. Accordingly, they will have little ability to negotiate a fair deal. For example, the final harvester to contract would have little choice but to accept a price for its crab equal to its expenses incurred in harvesting the crab. Similarly, the final processor with remaining capacity will face the same pricing pressure since its only option is either to idle its equipment or just cover its out-of-pocket cost.

C. Arbitration as a Remedy for Problems Resulting from IPQs

To address the complications arising from the implementation of the proposed IFQ/IPQ system, the Council recommended the use of an arbitration procedure. The arbitrator would settle disputes between the parties unable to reach an agreement through negotiation. This procedure would alleviate many of the concerns resulting from the parity between supply and demand: if a processor or harvester offered an unreasonable price, the arbitrator would choose a more appropriate one. A desirable feature of instituting a last best offer system is that it removes the potential incentive for parties to quote an unreasonable final offer price because the arbitrator is likely to reject that price in favor of the other party's offer rather than rewarding this behavior by splitting the difference between the two parties' offer prices.

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[15] This situation would be less problematic for vertically-integrated harvesters and processors because the close ties between the affiliates could prevent this on-going negotiation.

V. ARBITRATION PROCEDURE

As seen above, given the adoption of both IFQs and IPQs, there appears to be no alternative but to have recourse to arbitration (or price regulation). The proposed arbitration system consists of two different stages. It begins with a non-binding arbitration that has two components: 1) the production of a non-binding "market report" that describes market conditions and prices; and 2) the non-binding price formula. The second stage is a binding arbitration that results if the IFQ and IPQ holders are unable to reach a negotiated agreement on price. NOAA has asked us to consider the antitrust implications of the arbitration system as currently legislated by the Consolidated Appropriations Act of 2004, which requires the Secretary of Commerce to approve and hereafter implement by regulation the Voluntary Three-Pie Cooperative Program for crab fisheries of the Bering Sea and Aleutian Islands approved by the North Pacific Fishery Management Council between June 2002 and April 2003, and all trailing amendments, including those reported to Congress on May 6, 2003.

A. Market Analyst/Non-binding Arbitration

We begin with the premise that the use of IFQs and IPQs requires the use of an arbitration procedure. As proposed, the non-binding arbitration process would begin during the pre-season with the PQS and QS holders jointly selecting an independent market analyst/arbitrator.[16] Letter from the Council to Congress of 5/6/03. The Motion is unclear as to whether the analyst and arbitrator in the non-binding component of the program are or can be the same individual.[17] The non-binding arbitrator would review

[16] We do not believe any antitrust risks are raised by the joint selection of an arbitrator. The discussion must be restricted to the choice of the arbitrator and the parties must not discuss pricing or other sensitive information.

[17] From an antitrust standpoint, we are neutral as to whether the analyst also serves as the non-binding arbitrator.

submitted harvester and processor data along with market conditions and announce a pre-season formula for setting a non-binding ex-vessel price.[18] *Id.* The Council proposed the preseason announcement of a pricing formula "to provide a benchmark price that will be a starting point for negotiations and minimize the number of price disputes as negotiations progress." *Id.* This benchmark formula would also aid the arbitrators in determining which offer to select during future arbitration sessions.

By announcing a benchmark pricing formula, the proposed non-binding arbitration could raise some antitrust concern. First, the public announcement of any pricing information could tend to stabilize prices artificially or be the means to coordinate a collusive pricing scheme. *See United States v. Container Corp. of America*, 393 U.S. 333, 337 (1966) ("The exchange of price information tends toward price uniformity . . . Stabilizing prices as well as raising them is within the ban of § 1."). Here, while price uniformity alone is not necessarily anticompetitive,[19] the concern would be that the announcement of the benchmark price would encourage collusion because it provides a uniform price that could be easily adopted by the competing parties. Price uniformity alone is not an antitrust violation,[20] in the absence of coordination. Agreeing to price uniformity is. Second, the price announcement could lead to antitrust violations if the processors agreed among themselves to use the benchmark price as the starting or "focal"

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[18] Because the arbitrator will announce an aggregate formula, rather than disclosing specific information submitted to the analyst, we are not concerned with provision of information to the analyst.

[19] "Price uniformity is normal in a market with few sellers and homogeneous products." *E.I. Du Pont Nemours & Co. v. Federal Trade Comm'n*, 729 F.2d 128, 139 (2d Cir. 1984).

[20] Evidence of price uniformity can, however, serve as strong evidence of collusion and lead to antitrust lawsuits on those grounds. *See King & King Enters. v. Champlin Petroleum Co.*, 657 F.2d 1147, 1154 (10th Cir. 1981)(holding that evidence of price uniformity among competitors strongly supports a claim of collusion).

point for negotiations. *See In re Industrial Diamonds Antitrust Lit.*, 167 F.R.D. 374, 383 (S.D.N.Y. 1996)(collecting case law certifying class actions where plaintiffs have alleged that defendants conspired to artificially set the benchmark price too high).[21] An antitrust violation could occur if the processors agreed to use the benchmark price, even if an independent body established the price and it was fair. An agreement by a group of competitors to set a price is treated as a *per se* violation of the Sherman Act because it lacks any redeeming effects. *See United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 218-22 (1940)("An agreement to pay or charge rigid, uniform prices would be an illegal agreement under the Sherman Act. But so would agreements to raise or lower prices whatever machinery for price-fixing was used."); *see also Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332 (1982). Even if competitors agreed on using the benchmark only as a starting point and the final negotiated prices deviated vastly, it would still constitute a *per se* violation of § 1. *See In re High Fructose Corn Syrup Antitrust Lit.*, 295 F.3d 651, 656 (7th Cir. 2002)(stating that an agreement to set the list price is a per se violation even if all transactions occur at a lower price); *Plymouth Dealers' Ass'n of N. Cal. v. United States*, 279 F.2d 128, 132 (9th Cir. 1960).

Despite these concerns, we do not believe that changes in the non-binding arbitration provision are warranted. First, the announcement of a preseason benchmark pricing formula could have procompetitive benefits by rendering negotiations between harvesters and processors more focused and efficient by leading the participants to the

[21] Although not a direct antitrust concern, if the benchmark price were set inefficiently high or low, it could convey faulty information to market participants and thereby lead to inefficiencies.

market price more quickly.[22] Moreover, it could encourage more efficient investment and dampen price fluctuations, thereby increasing predictability for harvesters and processors. *See* Herbert Hovenkamp, *Antitrust Law* ¶2111b (1999). Second, the announcement of a pricing formula alone does not necessarily amount to an antitrust violation.[23] In its current form the announcement of a benchmark pricing formula amounts to little more than the legitimate dissemination of pricing information by a third party. It is not necessary to prohibit information flow likely to occur in a competitive environment. For example, in the current Alaska crab market the harvesters' cooperative, the AMA, hires a market analyst to establish a benchmark price before negotiating with processors. Regulatory Impact Review – Appendix 1 (March 2004), at 113. The non-binding arbitration would differ only in that harvesters and processors would agree to hire a single market analyst.

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[22] Distancing the timing of the price announcement from the harvesting season could make the information more stale, decreasing its reliability as a pricing tool as well as the likelihood for price stabilization. However, the efficiency benefits would also be commensurately smaller.

[23] The mere "fact that a standard product is priced according to a standard formula does not indicate that a conspiracy exists." *Reserve Supply Corp. v. Owens-Corning Fiberglas Corp.*, 971 F.2d 37, 53 (7th Cir. 1992); *Market Forces Inc. v. Wauwatosa Realty Co.*, 906 F.2d 1167, 1173 (7th Cir. 1990)(holding that absent an explicit agreement to use the pricing formula, the exchange of pricing information by itself is an insufficient basis to infer an agreement to fix prices). In an advisory opinion, the FTC determined that the mere promulgation and publication of a relative value pricing scale for internal medicine procedures would not have a probable or foreseeable anticompetitive effect. *See American Soc'y of Internal Medicine*, 105 F.T.C. 505 (1985). However, if practitioners had reached an agreement to use the pricing formula to determine their fees, they would have violated antitrust laws. *Id.* Further, even if one processor adopted the pricing formula and others followed suit, absent an agreement among the parties to use the formula, such conduct is permissible. *See United States v. Phelps Dodge Indus., Inc.*, 589 F. Supp. 1340, 1349 (S.D.N.Y. 1984)(holding that the issuance and adherence to identical price sheets in the highly oligopolistic paper cable industry is not alone sufficient to establish collusive behavior).

Third, concerns that the announcement of a benchmark pricing formula is likely to result in price fixing may be lessened because the parties negotiate a final price that hinges on several different variables. The parties negotiate over the specific services offered by the processors, delivery date and location.[24] Moreover, if either party determines those negotiations are not resulting in a fair price, an arbitration will occur. Finally, the program does not provide an antitrust exemption; thus price fixing could be challenged by private plaintiffs or government authorities.

The non-binding arbitration also calls for an independent market analyst chosen collectively by the harvesters and processors to produce a market report providing an analysis and description of the market for products of that fishery. Draft Council Motion, at 11. The analyst is permitted to gather information from any party or source in order to make its report. Although some of the information included in the report is public information that has been submitted to NOAA and made available in an aggregated form, it is likely that to some extent the analyst will collect sensitive cost and pricing data from both harvesters and processors. Telephone Interview with Mark Fina, Senior Economist, North Pacific Fishery Management Council (May 6, 2004). If the market analyst included this sensitive information in the report, it could present an antitrust risk by facilitating collusion or other anticompetitive conduct.

The Department of Justice and Federal Trade Commission have issued guidelines for disseminating price and cost data among competing firms. U.S. Dep't of Justice & Federal Trade Comm'n, Statements of Antitrust Enforcement Policy in Health Care 6

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[24] As the Court held in *Wilcox v. First Interstate Bank of Oregon*, a bank's announcement of its prime lending rate does not enable competitors to conspire to fix prices in a market where negotiations frequently lead to a deviation from the announced figure. 815 F.2d 522, 527 (9th Cir. 1987).

(1996)("the Guidelines").[25] The Guidelines create an antitrust "safety zone" around exchanging price and cost information when:

1) the collection of the data is managed by a third party, including a government agency;
2) the information shared is based on information more than three months old; and
3) there are at least five providers reporting data such that recipients would be unable to identify the prices charged by any particular firm.[26]

Id. We recommend that the market report adhere to the Guidelines in that the individual parties should provide the information only to the analyst and not to each other, that the information be historical in nature and that the data be aggregated in the report so that the prices not be identifiable with the party offering that price.

In sum, although the announcement of the benchmark price could lead to price stabilization, we believe that the risks of coordination are small and are heavily outweighed by offsetting efficiency justifications. Further, as long as the market report complies with the Guidelines, we foresee low antitrust risk. Therefore, we conclude that the non-binding arbitration procedure can remain in place as proposed.

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[25] Although originally promulgated for the healthcare field, the principles endorsed therein have been applied more broadly. *See, e.g.*, *Todd v. Exxon Corp.*, 126 F.2d 321, 324 (2000).

[26] We understand that each processor is allowed to own up to a 30% share of the processing market. Thus, there could end up being only four processing firms. There might still be more than four prices provided if processors entered into different agreements with different harvesters. It therefore might be possible for the market analyst's report to fit within the Guidelines. Nevertheless, if there do end up being only four processors, it may be necessary to reconsider whether the arbitration program needs to be modified in any way to comply with the antitrust laws.

B. Binding Arbitration

As discussed above, the Council proposed binding arbitration in the event of failed price negotiations between holders of Class A IFQ shares and processors with IPQs. Overall, we believe that the binding arbitration program would pass muster under the antitrust laws.[27] However, some aspects of the information exchange permitted under the binding arbitration program as currently proposed could raise antitrust concerns because they go beyond the information sharing typically found in a competitive market.[28] These include: 1) making information from past arbitration sessions available to other arbitrators;[29] 2) sharing the information the arbitrator receives, potentially including information derived from previous arbitration sessions, with all participants in the arbitration; 3) permitting the processors to share historical pricing information; and 4) publicly announcing the results of each completed arbitration. The regulations will ultimately need to be specific about activities that would be permissible under the antitrust laws and those that would violate the law. Information exchanges among processors occurring outside of the narrow exchanges permitted under these regulations would violate the antitrust laws.

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[27] Under the proposal, harvesters and processors must agree on their choice of arbitrators. Such an innocuous collaboration among competing harvesters on the one hand and competing processors on the other hand does not pose an antitrust risk.

[28] Although the information exchange would occur through a mandated arbitration procedure, the form of the pricing information exchange, whether via trade association, public announcement or another channel, is not determinative of its legality. *See In re Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Lit.*, 906 F.2d 432, 447 (9th Cir. 1990)(citing R. Posner, *Antitrust Law: An Economic Perspective*, 146 (1976)).

[29] We discuss the sharing of information from past arbitration sessions with other arbitrators in section 2(a) and determine that no antitrust concerns arise.

1. Antitrust Risks of Information Exchanges

"The exchange of price data and other information among competitors does not invariably have anticompetitive effects; indeed such practices can in certain circumstances increase economic efficiency and render markets more, rather than less, competitive." *United States v. United States Gypsum Co.*, 438 U.S. 422, 443 n.16 (1978). Additionally, information exchanges "can have significant benefits for . . . consumers. [Companies] can use information derived from price...surveys to price their services more competitively." Guidelines. Because of these potentially procompetitive benefits, information exchanges are not subject to the *per se* rule, but to the rule of reason. *See United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 113 (1975). Under the rule of reason, an exchange of price information not part of a price fixing scheme may be legal if it is unlikely to have an anticompetitive effect on price or a legitimate business reason for the exchange offsets any negative effect. *See Wilcox*, 815 F.2d at 526-27; *see also Beef Indus. Antitrust Lit.*, 907 F.2d 510, 513 (5th Cir. 1990).

Despite potential benefits, in some contexts an exchange of current pricing information, absent an agreement to act on the information, can be a violation of § 1 even under a rule of reason analysis. For example, in *Container Corp.*, the Court held that competing sellers exchanging recent pricing information constituted an antitrust violation where certain structural conditions exist. 393 U.S. at 334. Those characteristics include: 1) a highly concentrated market; 2) a fungible product; 3) competition that is primarily based on price; and 4) inelasticity of demand because the buyers tend to buy to fill their immediate, short term needs. *Id.* at 512. The Court stated that the exchange "had an anticompetitive effect . . ., chilling the vigor of price competition." *Id.* at 37. *See also In re Petroleum Prods.*, 906 F.2d at 447-48 (holding that a jury could infer that the

exchange of price information among competitors was intended to promote collusive pricing absent additional proof of an agreement); Hovenkamp, *Antitrust Law* ¶ 2113e ("we would consider direct interseller communication of current prices on specific transactions to be a 'nearly naked' restraint").

The Guidelines, discussed above in § V.A., also provide further parameters regarding information exchange among competitors. These restrictions are designed to ensure that competitors do not use the exchange of pricing information to facilitate pricing coordination. In the absence of these safeguards, information exchange among competitors can raise antitrust concerns. *Id.*

2. Applying Antitrust Law to the Proposed Binding Arbitration Program

a. Providing arbitrators with access to information from prior arbitration sessions does not raise antitrust concerns.

Under the proposal, arbitrators are able to "gather additional data...on the completed arbitrations." Draft Council Motion, at 14. This clause permits arbitrators to access the information supplied to other arbitrators during earlier arbitration sessions, in addition to the materials submitted directly by the parties involved. We do not believe that this provision alone raises antitrust concerns.

First, the arbitrator should not be precluded from information that could have been otherwise available to parties in the open market through casual interaction or through the exchange of pricing or cost information during initial negotiations. Moreover, in a competitive market, parties frequently monitor competitors' pricing tactics or gather competitors' pricing information, a practice regularly condoned by courts as consistent with independent competitor behavior not posing an antitrust risk. *See, e.g., Wallace v. Bank of Bartlett*, 55 F.3d 1166, 1169 (6th Cir. 1995)(holding that

banks that gather information about competitors' service fees and then set similar prices do not violate antitrust laws); *Stephen Jay Photography Ltd. v. Olan Mills, Inc.*, 903 F.2d 988, 996 (4th Cir. 1990)(holding that defendant yearbook photographer's possession of competitors' price lists and fact that defendant charged similar prices for its products did not support an inference of price fixing); *Amey, Inc. v. Gulf Abstract & Title, Inc.*, 758 F.2d 1486, 1505 (11th Cir. 1985), *cert. denied*, 475 U.S. 1107 (1986)(granting summary judgment for defendant on a claim that the defendant title company's circulation of title insurance rate cards among competitors had the effect of restraining trade). Even direct pricing exchanges among competitors may not violate the antitrust laws if the exchange occurred among individuals lacking authority to set prices. *See Krehl v. Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348, 1357 (9th Cir. 1982)(holding that evidence of sporadic exchanges of shoptalk among field sales representatives insufficient to survive summary judgment). Second, access to information from prior arbitration sessions will help the arbitrator confirm that the information presented by the parties is accurate. Accurate information from the parties is critical to achieving a fair outcome in the arbitration hearings. Although the benchmark price will help guide the arbitrator to some extent, access to information from other arbitrations will provide the arbitrator with a broader understanding of pricing in the market. Accordingly, we believe that providing arbitrators with access to information from past arbitration sessions does not pose an undue antitrust risk.

b. Providing all information provided to arbitrators, possibly including information derived from previous arbitrations, to current arbitration participants *does* raise antitrust concern.

Although providing the arbitrator with access to information presented during the completed arbitrations is antitrust neutral, it becomes potentially problematic because the

proposed system includes a clause providing every party to an arbitration "with access to all information provided to the arbitrator(s) in that proceeding." Draft Council Motion, at 12. This provision implies that all parties involved in an arbitration could have access to competitively sensitive information submitted to an arbitrator by every harvester and processor during all prior arbitration sessions. Since parties will be providing arbitrators with pricing and cost information, this could give parties in subsequent arbitrations access to their competitors' *current* cost structure and pricing information. This sort of information sharing raises serious antitrust concerns.

First, "[e]xchanges of current price information, of course, have the greatest potential for generating anticompetitive effects and although not per se unlawful have consistently been held to violate the Sherman Act." *United States Gypsum*, 438 U.S. at 441. This is especially true in concentrated markets similar to this one involving a fungible product where competition is based largely on price. *See Todd v. Exxon Corp.*, 275 F.3d 191, 201 (2d Cir. 2000). Second, as this provision could result in the exchange of current pricing and cost data, it would violate the Guidelines' safe harbor provisions that restrict price exchanges to historical information. Third, the dissemination of current pricing and cost information allows for competing sellers to verify each other's actual prices ("interseller verification"), facilitating collusion. Hovenkamp, *Antitrust Law* ¶ 2113b. This is especially true here because the information is submitted in the context of an arbitration where parties are likely subject to penalties for misrepresentation. Therefore, the information is potentially more accurate than if firms simply agreed to exchange information. Moreover, as mentioned above, the possibility for collusion among processors is especially strong because crab is a fungible product and the market is conducive to collusion because of the limited number of firms with processing shares.

See Federal Trade Comm'n v. H.J. Heinz Co., 246 F.3d 708, 724 (D.C. Cir. 2001)("The combination of a concentrated market and barriers to entry is a recipe for price coordination."); *Federal Trade Comm'n v. University Health, Inc.*, 938 F.2d 1206, 1218 n.24 (11th Cir. 1991)("Significant market concentration makes it easier for firms in the market to collude, expressly or tacitly, and thereby force price above or further above the competitive level."). If processors exchange crab product price data, they may be able to reach an agreement on product price -- explicit or tacit -- as well as monitor compliance.

Finally, this information exchange would not be able to pass muster under a rule of reason analysis because we see insufficient procompetitive or legitimate reason for its inclusion. While the parties claim to seek access to this information in order to ensure that the data provided to the arbitrator is accurate, we believe there are sufficient safeguards already in the program to deter parties from presenting inaccurate information. These safeguards include providing the arbitrator with access to information derived from prior arbitrations as well as the announcement of the benchmark price. Further, the announcement of the benchmark price renders less important two possible procompetitive benefits of price and information exchange: 1) it allows a firm with poor knowledge of its own relative costs to learn about them; and 2) it prevents a firm dealing in perishable commodities from missing out on sales if it were to set its price too high. *See* Hovenkamp, *Antitrust Law* ¶ 2113c. Interseller price verification is "rarely justifiable, if at all, when reasonably accurate information about generally prevailing market prices is available from other sources." *Id.* ¶ 2113e. Accordingly, this exchange goes well beyond the information sharing needed to achieve the goals of the regulation.

Given these concerns and the dearth of benefits, we recommend that the Council adopt and the Secretary approve an amendment to the arbitration system to prevent

dissemination to the parties of all information provided to the arbitrator. Instead, access should be limited to information supplied to the arbitrator directly by the parties to the arbitration. We do believe it is appropriate to provide parties access to the information presented to the arbitrator in their proceeding to ensure a fair proceeding. It would also allow a party to submit rebuttal information. Moreover, as is typical with most arbitration sessions, a confidentiality agreement would be necessary to prevent the parties from disseminating competitively sensitive information learned from the arbitration. This safeguard will help minimize the risk that the arbitration sessions will facilitate collusion.

c. Harvesters who are not members of a harvester cooperative should be prohibited from collaborating with harvesters who are members.

The proposed procedure calls for harvesters to act collectively during the arbitration procedure to the extent permitted by the FCMA. Letter from the Council to Congress of 8/5/02, at 17. The FCMA authorizes the establishment of cooperatives composed of fishermen. 15 U.S.C. § 521. Pursuant to the FCMA, cooperative members may freely exchange information, agree among themselves on the price they will accept for their products, bargain jointly and agree on the basis for negotiations without risking antitrust liability. *Id.* However, if the cooperative or members of the cooperative share sensitive competitive information or attempt to collaborate with non-member harvesters on any issues related to price or costs, they would risk antitrust liability. *See National Broiler Mktg. Ass'n v. United States*, 436 U.S. 816, 823 (1978)(under the Capper-Volstead Act, a defendant, in order to avoid antitrust liability must establish more than just the fact that it is qualified to act collectively under the Act, but it must also establish that all entities with which it allegedly conspired are also entitled to the Act's protection);

United States v. Hinote, 823 F. Supp. 1350, 1353, (S.D. Miss. 1993)(same). Accordingly, we recommend that non-member harvesters be prohibited from participating collectively with cooperative members during the arbitration procedures. However, we believe that permitting non-member harvesters to participate in arbitration procedures with co-op members and a single processor does not pose a serious antitrust risk so long as the non-member submits an independent bid and is allowed access only to information provided to the arbitrator by itself and the processor.

d. Permitting processors to engage in a common dialogue concerning historical price information raises antitrust concerns.

The proposed procedure permits processors "to participate in common discussions concerning historical prices in the fisheries." Draft Council Motion, at 12. This provision was included to facilitate the development of information about historic division of revenues, the basis on which the arbitrator will render decisions. Appendix 1 – Regulatory Impact Review (November 2003), at 401. This clause seemingly would allow processors to engage in collective, direct discussions regarding pricing information. Moreover, the only limitation on the discussion is that it must be about historical prices. It is our view that this limitation is insufficient.

First, encouraging competitors to discuss pricing information, even if historical, is a dangerous proposition that poses serious antitrust risks. The risk is high that competitors will move beyond a "historical" conversation and the availability of price information often serves to facilitate collusion. *See Verizon Communications Inc v. Law Offices of Curtis V. Trinko*, -- U.S. --, 124 S.Ct. 872, 879 (2004)("Compelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion."); *In re Mid-Atlantic Toyota Antitrust Lit.*, 560 F. Supp. 760, 775 (D. Md. 1983)("While meetings

among competitors without more are not *per se* illegal, it is certainly not rank speculation to observe that a meeting [or phone conversation] provides an ideal device for facilitating horizontal agreements once the anti-competitive idea is jointly planted in the minds of those competitors present at the meetings"); *see also In re Plywood Antitrust Lit.*, 655 F.2d 627, 634 (5th Cir. 1981), *cert. denied sub nom., Weyerhaeuser v. Lyman Lamb*, 462 U.S. 1225 (1983)(finding a pattern of interfirm communication a "plus factor" supportive of a conspiracy inference).

Second, the direct exchange of pricing information goes beyond measures needed to achieve the goals of the arbitration program. Because we can discern no procompetitive reason to include this provision, it likely would not pass muster under a rule of reason analysis. To the extent that the purpose is to ensure that a "fair" split of revenues between harvesters and processors is achieved, that role is served by the market analyst and the arbitrators. Third, the proposed communication among processors would run afoul of the Guidelines by permitting the exchange of pricing information directly among competitors rather than its collection and dissemination by a third party. The provision also violates the Guidelines' principles because it does not prevent the processors from being identified with the prices they charged. This allows for easy identification and punishment of the cheating party and therefore could facilitate collusion among the processors.

In sum, the presumption of unlawfulness is strong where, as here, there appears to be little procompetitive benefit and few limits placed on a direct exchange of pricing information among competitors. Accordingly, we recommend that this provision permitting processors to discuss directly pricing information be removed from the proposed arbitration plan.

e. Publicly announcing the results of the arbitration sessions to the arbitrators or harvesters that have not committed their shares does not raise antitrust concerns; others should not receive the results.

Finally, although it is not stated in the Council's motion, it is our understanding that the proposal calls for the public announcement of the outcome of each arbitration session after its completion to appraise the holders of uncommitted Class A shares of the results so they can decide whether to opt-in.[30] If the results of an arbitration are announced before all sessions are completed, it could influence what the parties ask for in the other arbitrations, resulting in price stabilization. Despite these concerns, we believe arbitrators and non-vertically integrated harvesters[31] that have not committed to a processor and may wish to opt-in to an existing contract should be permitted to access the results of completed arbitration sessions.

First, providing the arbitrators and non-vertically integrated harvesters that may wish to opt-in to a previous contract with access to the results of prior arbitration sessions serves a beneficial purpose within the proposed program. For arbitrators, as discussed above, it permits verification that information being presented is reliable and can provide additional guidance when deciding between offers. For harvesters, learning the results of previous arbitrations is necessary under the proposed arbitration structure because it allows a harvester to determine whether to opt-in to any contract resulting from a completed arbitration. Second, to the extent harvesters are members of a cooperative,

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[30] Although the proposed arbitration procedure does not contain an explicit provision requiring that the results of completed arbitrations will be publicly available, Mark Fina explains that the release is implicit because of the need to make the information available to IFQ holders so they can choose whether to opt-in.

[31] Under the proposed arbitration provision, the "participation of processor affiliates in binding arbitration as IFQ holders will be determined by any applicable rules governing anti-trust.... No antitrust exemption should be made to enable processor affiliated IFQ holders to participate in arbitration." Draft Council Motion, at 12.

they are allowed to set prices among the members with immunity under the antitrust laws. FCMA, 15 U.S.C. § 521; *United States v. Maryland & Va. Milk Producers Ass'n*, 362 U.S. 458, 466-67 (1960). Providing harvesters with access to the real-time results of completed arbitrations does not present any additional risk of price stabilization or collusion since they could already share the information with the co-op members. Third, even if the harvesters were not members of a harvesting cooperative, the large numbers of harvesters fishing in each region reduces concern regarding possible collusion among the harvesters whereas the relatively concentrated processor market would not. *See* Hovenkamp, *Antitrust Law* ¶ 2111d1 (for undifferentiated products, data dissemination among a market of 10 or fewer firms of equivalent size poses a risk of collusion or oligopoly).[32]

In contrast, we believe that releasing the results to processors or harvesters that have no need to opt-in may pose serious antitrust risks without compelling countervailing benefits. The processors would run the risk of violating the antitrust laws if they shared the results of the completed arbitrations with other processors. As discussed above, sharing this type of current pricing information absent the statutory protection afforded cooperatives could facilitate illicit price stabilization or even collusion. Moreover, if processors shared the results before all arbitrations were complete, a processor could alter its final offer to the arbitrator to make it closer to the price in previous arbitrations in a manner similar to what would occur if the processors coordinated on prices. There is also

[32] We conclude that providing harvesters who are not members of cooperatives with the results of the completed arbitration proceedings does not pose a competitive threat because of the large number of harvesters as well as the fact that provision of the information can be justified because it permits the harvesters to participate in the opt-in program.

the concern that sharing arbitration price results among processors could facilitate price coordination for other types of seafood or in future crab seasons.

The risks are less significant for unintegrated harvesters obtaining this information. The increased number of harvesters may make coordination less likely. Nevertheless, there are always risks inherent in allowing the sharing of price information among competitors. In light of even a slight risk, and no countervailing benefits, we see no reason that harvesters should obtain information about prior arbitrators in this fashion. Harvesters who are members of a legitimate FCMA remain free to share this information among the membership.

We believe that a harvester vertically-integrated with a processor presents similar concerns in this context. While the law is unclear whether such a harvester can be a member of a harvesters' cooperative without the cooperative losing its antitrust immunity, there would be many risks in allowing a vertically-integrated harvester to have access to the results of the completed arbitration proceedings.[33] The primary danger would be that the vertically-integrated harvester would share the results with its affiliated processor. As stated above, if the processor had access to the arbitration results, it could influence the processor's final offer to the arbitrator in other proceedings or facilitate pricing coordination for other seafood or in future crab seasons. Accordingly, we believe vertically-integrated harvesters should be denied access to the results of the completed arbitration sessions.

In sum, because the direct sharing of arbitration results among processors or among harvesters that have already committed their shares would raise antitrust concerns

[33] The Supreme Court explicitly decided not to rule on the question of whether a fully-integrated producer could be a member of an agricultural cooperative. *See National Broiler Mktg. Ass'n*, 436 U.S. at 828, n.21.

and because we are unable to determine any procompetitive justification for providing these entities with the results, we believe that the release of arbitration results should be limited to arbitrators and harvesters who have not committed their shares.[34] We believe the alternative of allowing processors access to arbitration results could facilitate collusion and subject processors to significant risk and injure the limited competition that exists.

VI. CONCLUSION

The proposed arbitration component of the BSAI Crab Rationalization Program does raise some antitrust concerns. However, overall we believe the arbitration can be implemented with relatively few changes. Our main concerns focus on provisions regarding the exchange of information that would not be permitted in an unregulated, competitive environment. We believe several of these provisions, including publicly announcing a pricing formula, circulating a market report and providing arbitrators with access to information from prior arbitration sessions pass muster under the antitrust laws as long as they are conducted within the parameters laid out in this memo. However, elements of other provisions raise some concerns. These include the provision giving both harvesters and processors access to all information provided to their arbitrators, the stipulation permitting processors to engage in discussions regarding pricing and the unlimited publication of the arbitration results. To address the possible anticompetitive effects of these provisions, we recommend that the harvesters' and processors' access to information during an arbitration be limited to materials submitted directly by the parties,

[34] We do not foresee significant competitive concerns arising from the sale of Class B shares in the context of the arbitration system. The risk of coordination for Class B shares is lower because the market for processing the crab is broader.

the clause permitting processor pricing discussions be narrowed or eliminated altogether, and only arbitrators and harvesters who have not committed their shares be allowed to access the results of other arbitration sessions.