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MEMORANDUM

Date: May 10, 2019
To: Atlantic Surfclam and Ocean Quahog Committee
From: José Montañez and Jessica Coakley, Staff
Subject: Atlantic Surfclam and Ocean Quahog Excessive Shares Amendment Public Hearing Document

The following is available for Committee consideration on the above subject. Public hearing draft: <http://www.mafmc.org/council-events/2019/scoq-committee-june-3>

Committee Task

The Surfclam and Ocean Quahog Committee will meet on June 3, 2019 (from 1:00 p.m. until 4:30 p.m. at the Doubletree by Hilton New York Times Square West, 350 W. 40th St, New York, NY 10018; telephone (212) 607-8888) to review the Public Hearing Document for the Atlantic Surfclam and Ocean Quahog Excessive Shares Amendment. The Committee is meeting to ensure this document is complete for Council review and approval. This memorandum summarizes the changes made to the public hearing draft of the Excessive Shares Amendment requested by the Council at the April Council meeting.

Additions to the Public Hearing Draft

Excessive Shares Definition (page 2)

For the surfclam and ocean quahog fisheries, the Council defines an excessive share as an ITQ share accumulation for an individual or business that is above the excessive share percentage cap selected by the Council for surfclam or ocean quahog (based on the affiliation and tracking model selected). In identifying this cap, the Council considered the intent of fisheries management as prescribed through the National Standards of the Magnuson-Stevens Fishery Conservation and Management Act (MSA), including both social and economic concerns. The Council considered economic concerns and selected an excessive share cap that is intended to prevent a firm or entity from exerting market power.¹ The Council also considered social concerns for fishing communities

¹ An outcome of obtaining market power could be pricing power in either output (product) or input (factor) markets or the ability to disrupt other firms or entities from participating in the market.

- as expressed in MSA National Standard 8 - which includes community participation, and a sense of equity and fairness that may, in part, be grounded in the history of fishery management in this country.

Court Case (page 40)

The final rule implementing the surfclam and ocean quahog ITQ program became effective on September 30, 1990. Almost immediately, lawsuits were filed by groups of harvesters and processors challenging various features of the program, most notably the formula for allocating fishing privileges among fishery participants. The case *Sea Watch International v. Mosbacher* [Secretary of Commerce], 762 F. Supp. 370 (D.D.C. 1991), illustrates the major legal challenges to the initial allocation. In general, the plaintiffs in the case argued that the initial allocation was not fair and equitable and therefore in violation of National Standard 4 of the MSA and,

“The plaintiffs claimed that the initial allocation allowed particular individuals, corporations, or other entities to acquire an excessive share of fishing privileges. Plaintiffs alleged that the allocation would concentrate 40 percent of the annual catch quota for the ocean quahog fishery in two fishermen, and that fragmentation of the remaining shares would result in further consolidation as holders of small shares sold their interests, creating an impermissible restraint on competition.”²

The court noted the 40 percent number “does give pause” but found the MSA has no definition of the term “excessive shares” and that the judgment of NMFS of what is excessive “deserves weight.” Further, the court stated, “Even if the raw number measured a true economic market - which is by no means clear - a judgment of undue concentration could not be based on the mere existence of such a share possessed by the two largest participants.” With that, the court dismissed the plaintiffs' argument.

Tracking Excessive Shares Concentration Following ITQ Plan Implementation (Page 41)

During the development of Amendment 8, the Council discussed in detail the requirements under National Standard 4.³ During those discussions, the Council was advised by NOAA General Counsel (GC) that in order to address part (C) of National Standard 4, there was no legal requirement to put a specific cap (numeric cap) into Amendment 8. GC indicated that a cap is simply a tool to address the National Standard 4 part (C) and that if the Council could come up with an equally effective mechanism to meet that requirement, they could use that mechanism. The Council's intent under Amendment 8 was to have NMFS annually monitor the concentration of ITQ (as ITQ owners have to apply to NMFS to transfer ITQ) and if it seemed that excessive consolidation was occurring (i.e., an excessive share was being amassed), they would advise the U.S. Department of Justice (DOJ), which would then determine if antitrust laws were being violated.

² Northern Economics, Inc. 2019. Review of the Atlantic Surfclam and Ocean Quahog Individual Transferable Quota Program. Prepared for Mid-Atlantic Fishery Management Council. March 2019.

³ National Standard 4 states that ‘... *If it becomes necessary to allocate or assign fishing privileges among various United States fishermen, such allocation shall be (A) fair and equitable to all such fishermen; (B) reasonably calculated to promote conservation; and (C) carried out in such manner that no particular individual, corporation, or other entity acquires an excessive share of such privileges.*’

As such, during the early period of the of the implementation of Amendment 8, the Council believed that NMFS could effectively monitor the concentration of ITQ ownership.

While the court case upheld Amendment 8 in 1991 - one year after the ITQ was implemented - it became clear over time to NMFS that this administrative process did not work.⁴ The creation of new business entities (e.g., LLC's, etc.) with ITQ ownership, and the lack of a regulatory mechanism (by NMFS) to identify corporate ownership or business partnerships across individuals or entities involved hampered the ability to determine whether there was a concentration of quota ownership, and whether competitive conditions were being eroded in the quota share market over time.⁵ Therefore, the review of industry concentration could not be conducted.

NMFS recognized they could no longer conclude that the ITQ program was carried out in such a manner to prevent someone from acquiring an excessive share of the fishing privileges and advised the Council of these concerns. GC indicated that the Council needed to put at least two regulatory components in place: one to identify the individuals behind the corporate entities listed as the owner of the ITQ, and an ownership cap or other control mechanism to keep individuals from acquiring the level of ITQ ownership that the Council deems to be "excessive." It is important to recognize that MSA did not address this issue by incorporating definitions from antitrust law or simply relying on enforcement of antitrust law. Rather, MSA used the term "excessive share" - a term left undefined in the statute. As noted in a 2007 NMFS⁶ guidance document on limited access privilege programs, while share levels exceeding antitrust standards would clearly represent an excessive share, factors such as other MSA requirements and National Standards can lead a Council to a more restrictive share limit than antitrust law may otherwise permit.

During the development of alternatives for the Excessive Shares Amendment, staff at the Council and GARFO (including GC) spoke with the Antitrust Division of the DOJ about the role that they might play in the monitoring of excessive shares in the surfclam and ocean quahog fisheries. The DOJ indicated that their Business Review Process does provide pre-enforcement review and advisory options for certain select transactions. However, the type of scenarios for which the Business Review Process⁷ has been used in the past have been for much larger, economically significant deals between companies than is envisioned by the Excessive Shares Amendment, making it an unfeasible vehicle for ongoing monitoring of quota share ownership.⁸

For additional steps taken by the Council and NMFS regarding the excessive shares issue, see "*History of this Action*" below.

⁴ As noted in the *Sea Watch International* case, even though the initial ITQ program relied upon existing antitrust law to define excessive shares, NMFS and the Council retained the ability to modify the FMP and associated regulations, "without the permission of the ITQ holders." 762 F. Supp. at 380.

⁵ For example, one person could form a couple of corporations and hold and acquire ITQ and it could not be determined whether or not this represented an excessive share since the ITQs would appear to be owned by legally separate entities.

⁶ NOAA Technical Memorandum NMFS-F/SPO-86, The Design and Use of Limited Access Privilege Programs, at 53-60 (NMFS 2007).

⁷ For a detailed description of the Business Review process of the DOJ see: <https://www.justice.gov/atr/business-reviews>

⁸ Sarah Heil, letter to Chis Moore, PhD, June 1, 2018.

History of this Action (page 42)

This section presents in chronological order major steps taken by the Council and/or NMFS in addressing the excessive shares issue.

1990

- Surfclam and ocean quahog ITQ program is implemented.

2002

- Discussion of excessive shares in these fisheries began as early as December 2002 with a Government Accountability Office⁹ (GAO) report "Individual Fishing Quotas: Better Information Could Improve Program Management." The December 2002 GAO report stated:
 - Surfclam and ocean quahog quota consolidation is greater than NMFS data indicate. According to NMFS officials and others knowledgeable about the fishery, the quota holder of record (i.e., the individual or entity under whose name the quota is listed) is often not the entity that controls the use of the quota. Some families hold quota under the names of more than one family member; some parent corporations hold quota under the names of one or more subsidiaries; some entities hold quota under the name of one or more incorporated vessels; and some financial institutions serve as transfer agents and hold quota on behalf of others or in lieu of collateral for loans.
 - The governing rules of each program may have affected the extent of consolidation and the information collected. However, without clear and accurate data on quota holders and fishery-specific limits on quota holdings, it is difficult to determine whether any quota holdings in a particular fishery would be viewed as excessive, as prohibited by the MSA.
 - NMFS does not gather sufficient information or periodically analyze the data it does collect on surfclam/ocean quahog and Wreckfish quota holders to determine (1) who actually controls the use of the quota and (2) whether the holder is a foreign individual or entity. Furthermore, while each fishery is different, the regional councils have not defined the amount of quota that constitutes an excessive share in the surfclam/ocean quahog and wreckfish IFQ programs. Different program objectives and the political, economic, and social characteristics of each fishery make it difficult to define excessive share. However, without the information on who controls quota and defined limits on quota accumulation, NMFS cannot determine whether eligibility requirements are being met or raise questions as to whether any quota holdings are excessive.

⁹ The U.S. Government Accountability Office (GAO; <https://www.gao.gov/>) is an independent, nonpartisan agency that works for Congress. Often called the "congressional watchdog," GAO examines how taxpayer dollars are spent and provides Congress and federal agencies with objective, reliable information to help the government save money and work more efficiently.

2003

- In 2003, NMFS responded to several members of Congress about the GAO report. NMFS indicated that it would urge the Council to develop a plan amendment that limits the shares that an individual may hold.

2004

- A 2004 NMFS report (by Doug Christel) was written in response to the GAO report, and highlighted some of the additional information needs in these fisheries. “This report concludes that the degree of concentration in the ITQ program described by the GAO is due to the amount of information available. Current data collection by NOAA Fisheries is insufficient to assess ownership concentration to the extent necessary to monitor excessive shares within the ITQ program. This is because limited information is collected on corporate structure or related business entities.” In addition, “This report recommends that further information be collected regarding allocation ownership within the ITQ program.”

2004 - 2011

- During this time period, several FMAT [Fishery Management Action Team] meetings were held to discuss this issue. Periodically, the Council was updated on FMAT activities. But during this time period, no decisions were made to move this action forward to the Council.

2011

- Compass Lexecon Report concluded that, “The evidence we analyzed does not support a conclusion that market power is currently being exercised through withholding of quota in the SCOQ [surfclam and ocean quahog fisheries].” However, the report indicates that, “We do not analyze whether market power is exercised through the withholding of harvesting or processing, or through exclusionary conduct other than conduct involving quota ownership.”
- The Compass Lexecon Report was reviewed by the Center for Independent Experts (CIE). [Summary of Findings by the Center for Independent Experts Regarding Setting Excessive Share Limits for ITQ Fisheries. Northeast Fisheries Science Center Reference Document 11-22]. The review noted that:
 - Measures of industrial concentration in the surfclam and ocean quahog fisheries (the Herfindahl-Hirschman index) suggests that marketing power may exist in these fisheries, particularly in its harvesting and processing sectors, but less so in quota holdings. These concentration measures are only indicative of the possibility of market power. They do not establish that it actually exists.
 - Implementation of the method proposed by the Technical Group requires at least the following data: quota ownership and control, processing volumes and capacity, size of the relevant market.
 - The method proposed by the Technical Group is based on the HHI, which means that evaluation of potential market power is consistent with what is done in other

industries. However, in order to apply the method, more data are needed along with a better understanding of the industry.

- The Technical Group should have paid more attention to the monopsony problem, which is the ability of processors to exert market power on the harvesting sector. This may be of greater concern than the monopoly problem.

2012

- The February 2012 Surfclam and Ocean Quahog Committee meeting discussed next steps for the then-numbered Amendment 15.
- At that meeting, GC Joel MacDonald advised that an information collection program could be implemented by NMFS without a Council FMP Amendment under authority granted in section 402(a) of the MSA.
- The Committee voted to split Amendment 15 into several parts: 1) move forward with cost recovery, essential fish habitat (EFH), and the ocean quahog biological reference point update in Amendment 15, 2) request that NMFS develop an information collection program, and 3) move development of an excessive shares cap to the next Amendment.

2013

- A “Data Collection Protocol” was developed for the Council to consider that would provide the data needed to understand ownership and control of the quota allocations in the surfclam and ocean quahog fisheries.
- The Council approved the “Data Collection Protocol.”

2015

- The data collection protocol was implemented.

2016

- Ownership data collection began in 2016.

2017

- An FMAT was reformed to work on the Excessive Shares Amendment.

2018

- June 2018: Range of alternatives developed and presented to the Surfclam and Ocean Quahog Committee and Council.

2019

- March 2019: Surfclam and Ocean Quahog Advisory Panel and Committee provided feedback on the public hearing document
- April 2019: Council reviewed public hearing document and instructed FMAT to make some modifications to the documents and bring it back to the Committee for review.

Updated HHI Values (page 100)

The term “HHI” means the Herfindahl–Hirschman Index, a commonly accepted measure of market concentration. The HHI takes into account the relative size distribution of the firms in a market. It approaches zero when a market is occupied by a large number of firms of relatively equal size and reaches its maximum of 10,000 points when a market is controlled by a single firm. The HHI increases both as the number of firms in the market decreases and as the disparity in size between those firms increases.

According to the DOJ,¹⁰ agencies generally consider markets in which the HHI is between 1,500 and 2,500 points to be moderately concentrated and consider markets in which the HHI is in excess of 2,500 points to be highly concentrated. According to the U.S. DOJ & Federal Trade Commission (FTC), Horizontal Merger Guidelines § 5.3 (2010), transactions that increase the HHI by more than 200 points in highly concentrated markets are presumed likely to enhance market power.

The HHI of harvesting (2006-2008) and processing (2005-2008) in the surfclam and ocean quahog fisheries estimated by NMFS (NMFS 2009) would be considered highly concentrated by the DOJ. Updated HHI values for the harvesting and processing sectors (John Walden, Pers. Comm., NEFSC 2019) are presented in Figures 1 and 2. These figures indicate that the harvesting and processing sectors for the surfclam and ocean quahog fisheries continue to be highly concentrated (2016-2018). The processing sector HHI values for 2016-2018 were calculated using the same methods as were used through 2008. However, the harvesting sector HHI values for 2016-2018 were calculated using a different method than was used through 2009. More specifically, in order to identify ownership for the 2016-2018 period, vessel ownership data was used in conjunction with permit database to identify all the individuals who own one or more vessels by firm. In addition, online resources provided additional company and vessel information to identify vessel ownership.

¹⁰ <https://www.justice.gov/atr/herfindahl-hirschman-index>

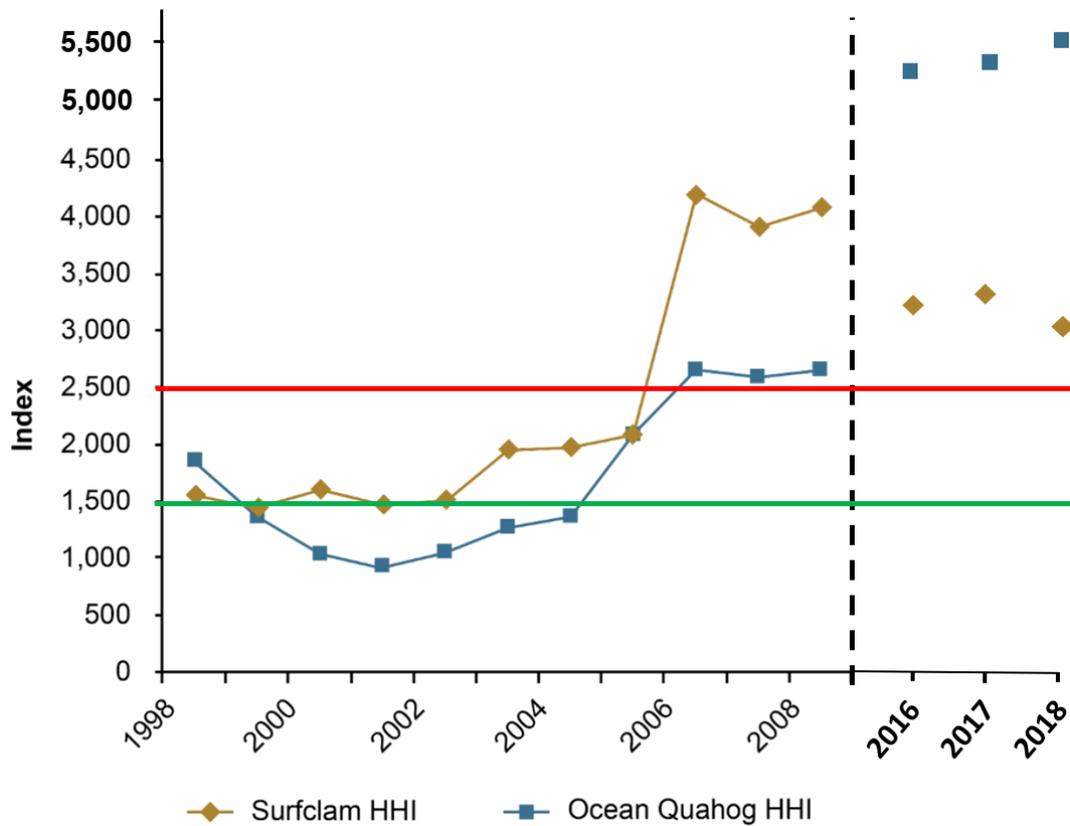


Figure 1. Herfindahl-Hirschman Index (HHI) of Market Concentration in Surfclam and Ocean Quahog Harvesting Sector, 1998-2008 (adapted from NMFS (2009)) and updated 2016-2018. Note: HHI values below the green line (1,500) shows Unconcentrated Markets; HHI values between the green line (1,500) and red line (2,500) shows Moderately Concentrated Markets; HHI values above the red line (2,500) shows Highly Concentrated Markets.

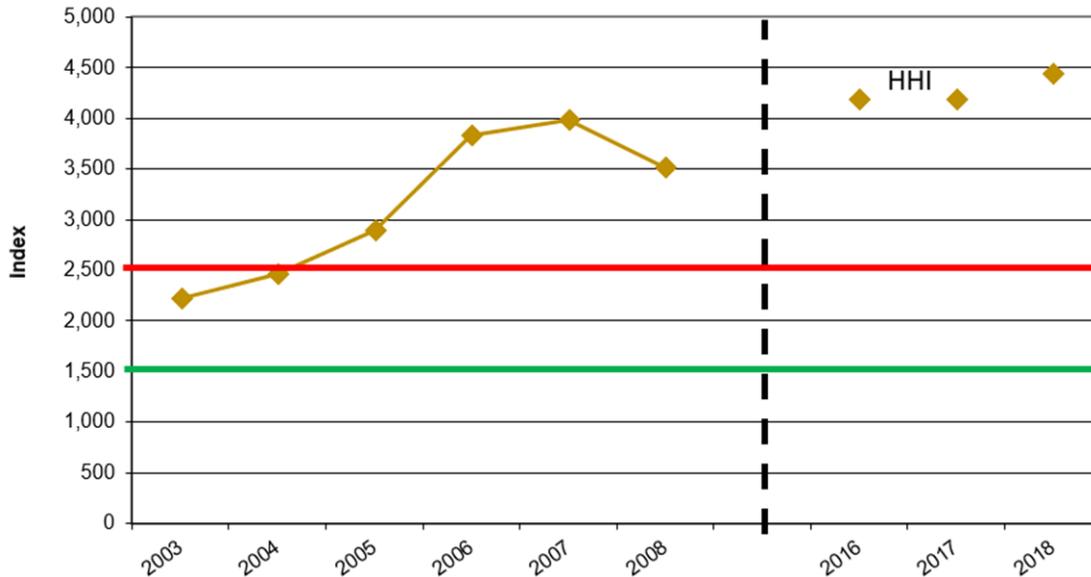


Figure 2. Herfindahl-Hirschman Index (HHI) of Market Concentration in Surfclam and Ocean Quahog Processing Sector (largely Vertically-Integrated), 2003-2008 (adapted from NMFS (2009)) and updated 2016-2018. Note: HHI values below the green line (1,500) shows Unconcentrated Markets; HHI values between the green line (1,500) and red line (2,500) shows Moderately Concentrated Markets; HHI values above the red line (2,500) shows Highly Concentrated Markets.

Improvements to the Descriptions of Impacts (information already included in the public hearing document. This is stated here for clarification)

The range of alternatives incorporated into the public hearing document was developed to provide the Council and the public with a suite of alternative that addresses various issues that have been raised in these fisheries. Six excessive shares alternatives were included in the document. However, the resulting excessive shares caps under each alternative may vary depending on the model, affiliation level, and/or time period used (2016 or 2017). The various models and affiliation levels included in the public hearing document are representative of various methods that have been used to set and/or monitor excessive shares in various fisheries.

When the Council selects a specific affiliate level (e.g., individual/business, family, or corporate officer) and model (cumulative 100% model or net actual percentage model) to monitor any particular excessive shares cap level they wish to implement, the associated cap level from that selection will become evident. In the interim, no cap level has been selected or recommended.

Lastly, all alternatives described in the document were compared to the current conditions in these fisheries as prescribed under NEPA. In general terms, measures that would curtail entities from exerting market power and therefore not decreasing competition would have positive socioeconomic impacts. In addition, measures that would result in community disruptions as a result of additional consolidation (e.g., decrease in the number of independent harvesters, decrease in employment) would have negative socioeconomic impacts.

Regional ITQ Programs (information already included in the public hearing document. This is stated here for clarification)

Appendix A of the public hearing document lists all the catch shares programs in the U.S.A. There are currently 16 limited catch shares programs in the country. 13 of these programs have specific excessive shares cap limits. Two other programs do not specify an excessive shares cap limit, but they have other measures in place to avoid excessive accumulation of share or allocation. The surfclam and ocean quahog fisheries are the only federally-managed fisheries in the country that do not have measures to limit share accumulation.¹¹ See Appendix A of the public hearing document for additional information for catch shares programs in the USA.

References

National Marine Fisheries Service. 2007. The design and use of limited access privilege programs. L. G. Anderson and M. C. Holliday (eds). U.S. Department of Commerce. National Oceanic and Atmospheric Administration. National Marine Fisheries Service. NOAA Technical Memorandum NMFS-F/SPO-86, November 2007.

National Marine Fisheries Service. 2009. Excessive Share Issues in the Surfclam and Ocean Quahog ITQ Fishery. Northeast Fisheries Science Center. Woods Hole, MA.

Walden, John. Personal Communication. April 29, 2019. NOAA Fisheries, Northeast Fisheries Science Center, 166 Water St., Woods Hole, MA 02543.

¹¹ Section 303A of the MSA has additional requirements for catch share programs adopted after January 12, 2007.