

MEMORANDUM

To: Cheryl Sutton, Staff
Joint Legislative Salmon Industry Task
Force

Date: October 9, 2003

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Subject: Preliminary Comments on Draft
Bill 23-LS0324\A

Thank you for inviting us to participate in the Task Force teleconference on Friday. This memorandum briefly summarizes some of the technical comments that we made on the fractional licensing bill at last Friday's teleconference. Per your request, we have included some possible changes to the draft legislation at the end of this memorandum.

Comments:

1. The Required Method for Assigning Permit Shares May Cause Problems.

A. Review of the Methodology in the Draft Law and the Example Provided

In Section 1 of the draft bill under AS16.43.305 (c) describes how the Commission should determine the number of permit shares to issue to each current permit holder and how the Commission should determine the number of permit shares required for a new entry permit. The specified method could cause problems, because it is not precise and will rarely turn out even.

Three pieces of information are needed to implement the method specified in the draft law, the number of permits outstanding in the fishery, the optimum number of permits, and the number of permits to be removed from the fishery. An example, which was included with the summary memorandum discussing the draft law, describes the following situation:

100 is the number of permits outstanding
80 is the optimum number
20 is the number of permits to be removed from the fishery.

The bill directs the commission to divide the optimum number of permits (80) by the number of permits to be removed (20) to determine the number of permit shares to be issued to current permit holders. If the result is not a whole number, the commission is supposed to round down to the nearest whole number. In the example, the result is the whole number 4 (80/20), and the commission would issue 400 permit shares to exiting permit holders (100 permits x (4 permit shares/permit)).

To determine the number of permit shares needed for a new entry permit, the bill directs the commission to divide the total number of permits currently outstanding in the fishery (100) by the number of permits

to be removed (20). If the quotient is not a whole number, the commission is told to round to the nearest whole number. In the example, the quotient is the whole number 5 ($100/20$).

Thus the commission would require 5 permit shares to get a new entry permit. To reach the optimum number of 80, there would need to be 400 permit shares available ($80\text{permits} \times 5\text{permit shares} / \text{permit}$). In the example, there will be just enough permit shares to reach that optimum number of 80 permits, since the number of permit shares initially issued (400) is exactly equal to the number of permit shares needed (400).

B. An Example Where the Methodology Doesn't Work

However, it is easy to come up with examples where the specified methodology will result in more permit shares needed to reach the optimum number than the number of permit shares initially issued (and vice versa). One simple example is the following:

Let:

103 = the number of permits outstanding
80 = the optimum number
23 = the number of permits to be removed

Again, the bill directs the commission to divide the optimum number of permits (80) by the number of permits to be removed (23) to determine the number of permit shares to be issued to current permit holders. If the result is not a whole number, the commission is supposed to round down to the nearest whole number. In this example, that quotient (of $80/23$) is about 3.48 which rounded down to the nearest whole number would be 3. Thus the commission would issue 3 permit shares to each of the 103 existing permit holders for a grand total of 309 permit shares issued.

To determine the number of permit shares needed for a new entry permit, the bill directs the commission to divide the total number of permits outstanding in the fishery (103) by the number of permits to be removed (23). If the quotient is not a whole number, the commission is told to round to the nearest whole number. In this example, the quotient (of $103/23$) is about 4.48 which rounds to 4.

Thus the commission would require 4 permit shares to get a new entry permit. To reach the optimum number of 80, there would need to be 320 permit shares available ($80\text{permits} \times 4\text{permit shares} / \text{permit}$). However, in this example, only 309 permit shares were issued under the specified methodology. Thus the methodology, fails to get to the optimum number since not enough permit shares were initially issued.

C. An Alternative Exact Method for Determining Permit Shares

An exact method for determining the number of permit shares to be issued and the number of permit shares needed for a new permit follows directly from the ratio of the optimum number to the number of permits outstanding.

Again, in the example which accompanies the bill, 80 is the optimum number and 100 is the number of permits outstanding. This ratio is 80/100 which can be reduced to 4/5.

The precise rule is simply to take the numerator as the number of permit shares that should be initially issued to each existing permit holder and the denominator as the number of permit shares needed for a new entry permit. If this rule is used, the total number of permit shares initially issued will always equal the total number of permits needed to reach the optimum number. This is true if you use the unreduced ratio (80/100) or the reduced ratio (4/5).

For example, if the 100 current permit holders are issued 80 permit shares (the unreduced numerator), 8000 shares will be initially issued. If 100 permit shares (the unreduced denominator) are required for a new permit, then 80 permits x 100 permit shares per permit also results in 8000 total shares. Thus the total number of permit shares initially issued would exactly equal the total number of permit shares needed to reach the optimum number.

Similarly, if the reduced fraction (4/5) is used, the total number of permit shares initially issued will also equal the total number of permit shares needed to reach the optimum numbers. The 100 current permit holders would be issued 4 permit shares per permit (the reduced numerator), resulting in 400 permit shares initially issued. If 5 permit shares (the reduced denominator) are required for a new permit, then 80 permits times 5 also equals 400 permit shares. Thus, when the reduced form of the fraction is used, the number of permit shares initially issued again exactly equals the number of permit shares needed to reach the optimum number.

Thus the fraction formed by the ratio of the optimum number to the number of permits outstanding is an exact way to determine how many permit shares should be issued to each permit holder and how many permit shares are needed for a new permit. The method will work if the fraction is reduced and it will work if the fraction is not reduced. The numerator is the number of permit shares to be issued to each existing permit holder, and the denominator is the number of permits needed for a new entry permit.

Consider again, the example above which did not work precisely under the methodology specified in the draft law. There are 103 permits outstanding and 80 is the optimum number. Under this alternative methodology, you would first form a fraction from the ratio of the optimum number to the number of permits outstanding (80/103). Note, that in this case, the fraction cannot be reduced further. Eighty (the numerator) is the number of permit shares to be issued to each of the 103 current permit holders. Thus 8,240 permit shares (103 permit holders times 80 permit shares/pmt) is the total number of permit shares initially issued. The number of permit shares needed to obtain a new entry permit is 103 (the denominator). Thus the number of permit shares needed to reach an optimum number of 80 is also 8,240 (80 new permits times 103 permit shares/permit.)

Indeed, the methodology would work for any two whole numbers.

D. Summary

The alternative methodology assures that the total number of permit shares issued will be exactly equal to the total number of permit shares needed to reach the optimum number. For that reason, the alternative methodology might be preferred to the methodology specified in Sec.16.43.305 (c) of the

draft law. However, because of other complications which are discussed below, it might be better to simply give the Commission the authority to issue an appropriate number of permit shares without specifying the methodology to be used.

II. Optimum Numbers May Be A Range.

Legislation passed in 2002 (see AS 16.43.990(6)), allows the optimum number to be a range of numbers rather than a single number. The commission will likely use this provision in the future because a range may be more easily defensible and a range will provide more flexibility in planning if a buyback program occurs. However, for this draft law, the calculations of permit shares would be different depending upon what number in the optimum number range is selected. For example, the upper bound of the range, the lower bound of the range, and the midpoint of the range would all result in a different number of permit shares.

We think that the midpoint of the range would be a good target for fractional licensing, because if it is missed (due to other complications) by a couple of permits, the outcome likely would still be within the optimum number range.

III. The Issue of Nontransferable Permits

Legislation passed in 2002 (*CSHB288 (FIN) am*), clarified that a nontransferable entry permit issued under AS 16.43.250 (c) could not be permanently transferred under any circumstances and does not survive the death of the holder. It also established that transferable entry permits were the ones to be purchased under a buyback program (since the nontransferable permits will eventually disappear anyway.) (See AS 16.43.320)

This raises the question of whether or not nontransferable entry permits should be considered under a fractional licensing program or whether the exercise should apply to transferable permits only. Many salmon fisheries do not have nontransferable permits, so this will not be an issue. However, in those that do have some nontransferable permits, this is an issue that will need to be considered.¹

Section 1 of the draft bill AS 16.43.305 (b) currently appears to contain conflicting directives that would apply to the permit shares issued to nontransferable permit holders. For example:

One sentence states, “Each permit share is transferable in the same manner as an entry permit under AS 16.43.170.” AS 16.43.170 (e) indicates that permits covered under AS 16.43.250(c) cannot be permanently transferred. This seems to imply that any permit shares issued to these nontransferable permit holders also would be nontransferable.

However, the next sentence states, “A permit share survives the death of the holder and is subject to transfer upon the death of the shareholder in the same manner as entry permits under AS 16.43.150(h). Does this imply that all permit shares fall into this category, even if they were issued to holders of nontransferable permits?

¹ Most of the nontransferable entry permits in the salmon fisheries are in the Bristol Bay salmon set gillnet fishery and the Salmon handtroll fishery.

In addition, Section 1 of draft bill AS 16.43.305(b) seems to imply that any new entry permit issued under the fractional licensing program will be fully transferable. Consider the language in the bill, “A new entry permit for the fishery is fully transferable under AS 16.43.170 and renewable under AS 16.43.150(c).” Thus, it would appear that the holder of a nontransferable permit could convert it to a transferable permit if the person obtains the requisite number of permit shares for a new entry permit. Is that the intent?

At a minimum, this language should be clarified. Should the permit shares issued to nontransferable permit holders be fully transferable or not? Should nontransferable permit holders be required to obtain additional permit shares to continue fishing their nontransferable permit? Should nontransferable permit holders get a transferable permit if they come up with the requisite number of permit shares?

The Task Force might also want to consider whether to include nontransferable permits at all in the exercise. Depending upon the rules associated with the permit shares issued to nontransferable permits holders, it might become impossible to reach the optimum number exactly.

IV. The Issue of Interim Use Permits

Another complication is the continued existence of interim-use permits (sometimes called interim entry permits or IEPs) in some of our limited fisheries. These are temporary permits issued to persons who are still in the adjudicatory process. Depending upon how each case is finally decided an IEP holder may eventually get an entry permit or may be denied an entry permit. Under current law, an IEP holder can continue to fish until the person’s case is resolved.

While the existence of IEPs could potentially pose a problem, there are very few IEPs remaining in the salmon fisheries. The commission is hopeful that any remaining cases could be quickly resolved before starting a fractional licensing program.

V. Joint Entry Permits

The purpose of the joint entry permit is not entirely clear in the draft bill or in the explanation that accompanies the draft. Moreover, it is not clear what happens to these joint entry permits.

Draft AS 16.43.305 (f) seems to imply that the joint entry permits are renewable only one year following the initial issuance of the permit shares. (“ . . . *A joint entry permit is renewable annually under AS 16.43.150 (c) up to and including the calendar year in which permit shares were initially issued for the fishery.* ”) Draft AS 16.43.305 (f) also states that joint entry permits are not transferable and are not forfeited for failure to pay renewal fees. (“ . . . *A joint entry permit is not transferable and is not subject to AS 16.32.150(d).* ”) What is the intent of these joint entry permit provisions?

Draft AS 16.43.305(i) implies that the joint entry permits will be eliminated from the fishery. How are joint entry permits eliminated?

VI. Notice of Intent to Transfer Permit Shares

Section 1 of draft bill AS 16.43.305 (b) indicates that permit shares are to be transferable in the same manner as entry permits under AS 16.43.170. AS 16.43.170 (b) requires a 60 day notice of intent to transfer and that would apply to permit shares unless a different time is established. The original intent of this section was to allow a period of time for reconsideration but the Task Force may want to consider if it is necessary under this program.

VI. Possible Changes to the Draft Legislation:

You asked that we provide some suggestions for changes the draft legislation. The following are some possible changes to the draft bill based upon our discussion above. At this point, the commission does not have a definite position on any of these possible changes.

- 1.) Provide a definition of joint entry permits and clarify their purpose and how they are eliminated.
- 2.) Change all the dialogue that points to “the number of permits outstanding” or “entry permits” to refer only to transferable entry permits. Under current law, nontransferable entry permits will eventually disappear from a fishery. If the number of transferable entry permits is reduced to the optimum number, then those permits will be the permits remaining in the fishery after all nontransferable entry permits have disappeared.
- 3.) In Section 1 of the draft bill, delete AS 16.03.305 (c) and replace with the following:

The commission shall determine the number of permit shares to be issued to each holder of a transferable entry permit and the number of permit shares that a person will need to obtain in order to receive a new transferable entry permit. These numbers of permit shares should be selected so that the number of new transferable entry permits issued come as close as possible to the optimum number. If the optimum number for the fishery has been established as a range of numbers, the commission shall select the midpoint of that range as the target number of new transferable entry permits. For purposes of determining appropriate numbers of permit shares, the commission shall not include any permits that are nontransferable in accordance with AS 16.43.250 (c) and AS 16.43.170(e).

- 4.) Clarify if the 60 day notice should apply to permit shares.