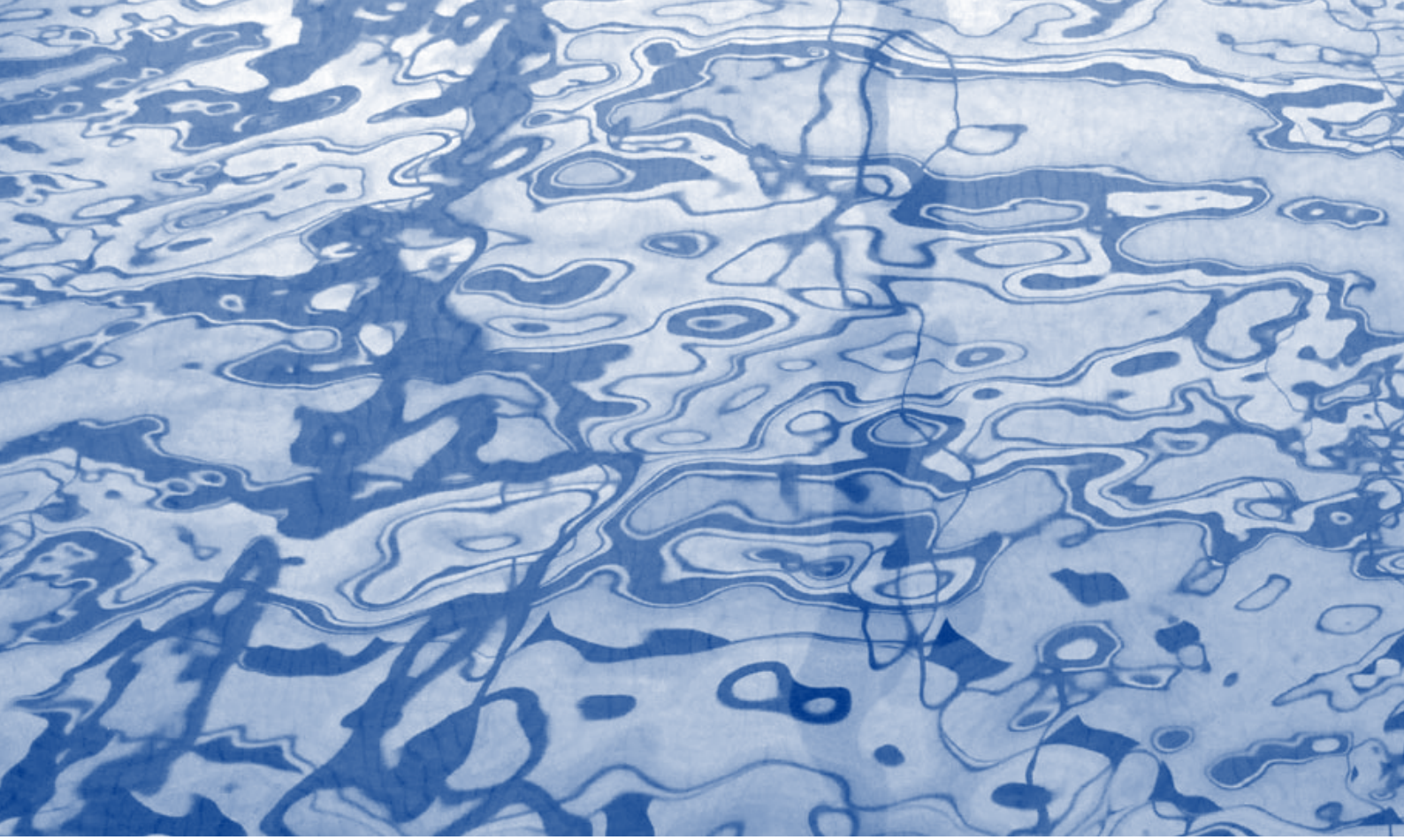
# The Shetland experience

## *Rights based management in the ` - the Shetland experience*



# The Shetland experience

## Rights based management in the UK - the Shetland experience

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# Introduction

In 2005, Seafish Economics were asked to undertake a study related to the Shetland community quota (CQ) scheme. The overall aim of the research was to evaluate the impact the scheme had on the Shetland fish catching sector and related onshore industries since its introduction in 1998. The study also formed part of a larger research programme designed to evaluate the effectiveness of CQ schemes in the UK. In 2006, the author used the findings of that research to prepare a paper considering the future of the market-based approach to quota management in the UK, using the Shetland CQ scheme as a case study. The paper was subsequently presented at both the 'Sharing the Fish' and 'IIFET' conferences, generating a wide range of interest from delegates. Since then, renewed consultation with the Shetland Fish Producers Organisation (SFPO) took place so that this latest edit of the IIFET paper could be included in this Food and Agriculture Organisation (FAO) technical series on 'self-governance' in fisheries.

This is not the first time the Shetland CQ scheme has been discussed in an FAO publication. In 1998, John Goodlad (then CEO of the SFPO) authored a paper which was published within 'Use of property rights in fisheries management vol. 1'. Goodlad's paper, called 'Industry perspective on rights-based management: The Shetland experience'[1], discussed the development of the UK quota management system, the role of POs (producer organisations) and the workings of the SFPO 'new entrants scheme' as it was then known. The objectives of my paper are to continue the story post 1998 by detailing the development and subsequent abolition of the original Shetland CQ scheme, and to discuss what lessons can be learned from this experience as the UK and EU are both committed to improving the effectiveness of the current rights-based management (RBM) approach to quota management.

1 Goodlad, J. *Industry perspective on rights-based management: the Shetland experience.* http://www.fao.org/docrep/003/x7579e/x7579e0b.htm

# Shetland's seafood industry and whitefish sector

The Shetland Isles, a group of islands approximately 150 miles north of Scotland, have traditionally been one of the most fisheries-dependent communities in Europe. With a population of around 22,500[2], the islands have historically been heavily involved in fish catching, fish processing and, more recently, have developed a sizeable aquaculture industry focusing mainly on the production of farmed salmon. Shetland seafood products are considered to be of premium quality and are exported throughout the world. Around 2,000[2] people are employed in the Shetland seafood industry, accounting for approximately one sixth of the total employment in Shetland. In 2003, the combined output of all the fisheries related sectors was £243m[2], four times the output of the oil sector and over half the total output of the entire Shetland economy.

Over the last decade, the number of whitefish vessels in Shetland has greatly reduced, with the catching capacity of the fleet decreasing by approximately 40% as a result of three rounds of decommissioning and vessels being sold out with Shetland due to a poor financial climate. Shetlands whitefish fleet now consists of 26[3] vessels using traditional trawl, gill-net and seine methods. In 2005, the combined sales turnover of the fleet was £11.6m[4], primarily comprising approximately 10,000 tons of high value haddock, cod, hake and monkfish.

Shetland's whitefish fleet is also supported by a well-developed and long-established shore-based infrastructure that is undoubtedly amongst the best in the UK. Support services include vessel agents, an auction market, quality inspectors, ice providers, engineers, net menders, stores, chandlery and other associated ancillary businesses.

2 Economic Development Unit Shetlands Islands Council. 2005. *Shetland in statistics.* http://www.shetland.gov.uk/council/documents/sins2005.pdf

3 Source: SFPO

4 SEERAD sea fisheries data team

# The evolution of rights based management in the UK

UK fisheries management decisions are bound by international obligations under the EU Common Fisheries Policy (CFP). The main aims of the CFP are the sustainable exploitation of fish stocks controlled through management policies specifically designed to protect the commercial fish species targeted by the EU fishing fleet. The main 'output control' of fisheries management in Europe is the annual allocation of total allowable catches (TACs) and quotas. TACs for each fish stock are determined by species and area, and are then divided into national quotas according to a set allocation mechanism known as 'relative stability'. This mechanism ensures TACs are allocated to each member state based on their historic fishing patterns.

The UK, like most other EU countries, employs a rights-based management (RBM) approach to the allocation of commercial fishing quota. The UK system has evolved in just over 20 years from a 'Sectoral Quota' (SQ) system of allocation to a 'Fixed Quota Allocation' (FQA) mechanism. Prior to 1999, UK quota allocations were based on the individual track record (recorded landings) of fishing vessels over the previous three years. Formalising this allocation method led to a system of FQAs being introduced. The FQA system was based originally on the track records of vessels during a fixed reference period (1994 to 1996). The perceived advantages of the FQA system were greater year-on-year stability in both predicting and managing annual quota allocations, less pressure on fishermen and POs to maintain their track records by utilising their full quota allocation (a disincentive to record "paper" or "ghost" fish), and the more rapid issue of the allocations at the beginning of each year.

FQAs (measured in quota units) are set annually for specific stocks and areas (eg North Sea cod) based on the current year's TAC. The FQA is a percentage allocation of the total quota available for a particular species within a defined area, and each UK registered vessel that recorded

landings of quota species during the reference period has a fixed number of FQAs. If, for example, the European Commission (EC) decides North Sea cod quota requires to be halved between 2007 and 2008, then the volume of catch associated with each vessel's North Sea cod FQA unit should also halve.

## Formation and function of POs in the UK

The devolved management of fish quota in the UK is predominantly conducted through POs. There are currently 19 Producer Organisations in the UK (and one pelagic management group – Lunar Fishing) which are responsible for distributing fishing quota to approximately 95% of UK vessels (termed 'the sector') on behalf of the government. This could be interpreted as a form of regional 'self-governance'. In the UK, the first seven POs were set up in the 1970s, and the SFPO was created in a second wave of PO formation in the early 1980s, when vessel owners started splitting off from the established POs, mainly due to geographical location. Then, in 1985, POs were given the opportunity for the first time to directly manage fish stocks subject to TAC restrictions. This move meant that POs could plan the optimal uptake of quota allocations for the benefit of their members.

The SFPO is currently the second largest UK PO in terms of output, with 34 member vessels and an annual turnover of around £34m[5] in 2005. The Scottish Fishermen's Organisation (SFO) is the largest UK PO, with over 200 vessels and an annual turnover of around £115m[5] in 2005. Both POs have significant pelagic interests. The SFPO is responsible for the uptake of approximately 8%[6] of the annual UK whitefish TAC, compared with 30%[6] for the SFO.

Although the primary role of the POs is to implement CFP market regulations (eg marketing, withdrawal prices), in reality, quota management is now the main function for the majority of UK POs, with little attention paid to market and demand conditions[6] as vessel agents have more influence in those areas and therefore POs argue their intervention is unnecessary[6]. The SFPO and the SFO are the exceptions with marketing remaining their

5 A review of UK producer organisations: The effectiveness of service in quota management, quota trading and market/price support. Prepared for the UK Fishery Administrations August 2006 http://www.defra.gov.uk/fish/sea/manage/qmcp/pdf/060929-study.pdf

6 SEERAD Sea Fisheries quota uptake figures

primary function. Managing quota is seen by these POs as a secondary, but equally as important, responsibility. Both POs have invested heavily in fish processing facilities. The SFPO is a major shareholder in Shetland Catch, the largest pelagic processor in the UK. It is also a shareholder in Shetland Fish Products, and is active and influential in supporting other local strategic investments – in fishmeal processing, quality management, electronic auction trading and CQ.

POs operate different allocation systems, largely based on the preferences of their members. In order to become a member of a PO, a vessel must usually demonstrate that it has enough fishing opportunities (or FQAs) in relation to the catching capacity of the vessel. Although FQAs are associated with the licences of individual vessels, POs administer the FQAs on their behalf. Each PO can choose how it allocates the quota deriving from the FQAs of each member vessel, providing their method is compatible with the approach agreed by that PO's membership. There are two main systems of quota management operated by UK POs – pooled or individual quotas (IQs).

An IQ system essentially means that vessels manage the uptake of their own allocation of FQAs based on the vessels track record (1994 -1996). In pooled systems, vessels FQA entitlements are combined and managed collectively by the PO for distribution amongst members. In practice, there are a range of management approaches between these two extremes, meaning that either the pool can operate with some of the flexibility of an IQ system, or that a PO may operate both pool and IQ systems at the same time.

For whitefish opportunities, the SFPO operates a pool plus IQ system, which means that the primary management system is a pool, extended by the facility to ring-fence quota to individual vessels. However, members are also offered the opportunity to operate on an IQ-only basis, and one SFPO vessel chose that option. The SFO operates similarly, except without the IQ-only option. Where POs operate both pool and IQ systems, it is generally larger vessels; in particular those that have accumulated increased FQA entitlements that choose an IQ system, as was the case in Shetland.

## Issues surrounding the UK rights-based management system

Since their inception, RBM systems have been the focus of much debate[7]. Trade in quotas in the UK began in the early 1990s, and increased dramatically in 1999. The current FQA system also facilitates the leasing of quota, which can be either for a single year or a number of years. UK POs regularly trade quotas with each other to facilitate trade between members, and to help ensure the whole quota allocation is taken. Maximum uptake and vessel profitability are not always mutually compatible, but POs try to allocate FQAs in a way that maximizes fishing opportunities for member vessels. Most within the UK industry would agree that the tradability of fishing rights has resulted in a more efficient use of fishing opportunities, and has helped facilitate the concentration of vessel and quota ownership in the UK fleet over the last decade. However, it is also widely recognised that the current management regime is far from perfect.

Although 'unattached' FQA units resulting from the various vessel decommissioning schemes have in most cases been consolidated onto vessels remaining in PO membership, in some cases, FQA units have remained out with the active catching sector. As a result, 'slipper skippers' (retired or ex-fishermen, quota traders and financial institutions) have become increasingly engaged in leasing quota to active fishermen. This obviously impacts on the profitability of active vessels, however most operators would prefer to have the option of paying to lease additional quota rather than discard their catches at sea. There is also evidence to suggest that market forces have resulted in fishing quota being traded away from some fisheries dependent communities, with negative social and economic consequences for the regions concerned. Although some FQA holdings remain out with the active

7 In February 2007, the commission tabled a communication on rights-based management tools in fisheries aimed at launching a debate on fishing management systems http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/245&format=HTML&aged=0&language=EN&guiLanguage=en

catching sector in 2007, the number of units involved has, according to UK fisheries administrations, reduced significantly in recent years.

The current FQA system has some of the features of property rights, and closely reflects an Individual Transferable Quota (ITQ) system. However, unlike an ITQ system where quotas have become private assets, the legal status of FQAs is uncertain. Although FQA units can be bought and sold, the quota holder does not have a legal entitlement to the quota, which remains in the hands of the UK government. Many believe, therefore, that the FQA system is the cause of much uncertainty surrounding investment and long term planning for whitefish vessel owners, some of whom have been unable to use their FQA as security for loans to invest in further FQA holdings.

In March 2004, the Prime Minister's Strategy Unit published a report aimed at securing a sustainable and profitable future for the UK fishing industry. The report suggested that "the FQA system does not provide the required clarity of ownership, and accompanying rights and responsibilities, nor a liquid and transparent market in fishing opportunities that would enable the UK fishing fleet to compete in world markets."[8]

To counter these threats, some regions of the UK have implemented various forms of CQ schemes, in an effort to retain fishing opportunities within their fishing communities. A CQ scheme is essentially a scheme implemented by fisheries dependent communities to purchase and distribute fish quota in a way that benefits local fishermen. In recent years, at least three[9] CQ schemes have operated in various formats around the UK, with other regions considering a similar approach. This report examines in detail the largest scheme, which is operated by the SFPO in Shetland. Similar schemes were also set up in Orkney and Cornwall; however none were of the same scale as the Shetland CQ scheme.

8 Prime Ministers Strategy Unit. 2004. Net benefits: A sustainable and profitable future for UK fishing: http://www.cabinetoffice.gov.uk/strategy/publications/

9 Argyll and Bute council development services; 4th November 2004; Agenda No. 10: Community held fishing quota in the Highlands and Islands; http://66.102.9.104/search?q=cache:V-DereY-_j0J:www.argyll-bute.gov.uk/moderngov/mgConvert2PDF.asp%3FID%3D16026%26J%3D1+orkney+community+quota+scheme&hl=en&ct=clnk&cd=6&gl=uk

## The shetland CQ scheme

Faced with dwindling fishing opportunities, a poor financial climate, and the inability of whitefish vessels to secure bank loans for investment in quota, in 1993, the SFPO borrowed money to fund the purchase of two fishing vessels which had 2,386 tons of whitefish quota holdings. The loan repayments were financed through an extra levy paid by SFPO member vessels. At the time, this equated to approximately 16% of the total SFPO whitefish FQAs. The vessels were then sold again out with Shetland, including the fishing license, but excluding the FQAs. The intention was to allow the quota to be accessed as required by current and future SFPO members, through a 'ring-fenced' pool system. The rest of the UK industry deemed the investment controversial because this bold move by the SFPO meant they became the first PO in the UK to hold quota in its own right. Purchasing the quota proved both necessary and successful for the SFPO and its members. Since 1993, the FQA holdings of five whitefish vessels were acquired using this method whenever an attractive investment appeared on the market, forming what is currently known as the SFPO 'ring-fenced' pool. The ring-fenced quota still creates a strong incentive for quota to remain in the Shetlands, because any vessels who decide to leave the SFPO will also lose the benefit of having access to the ring-fenced quota. This quota pool still operates successfully today.

In 1998, the SFPO, with the financial backing of Shetland Islands Council (SIC), decided to invest in a further 2,445 tons of whitefish FQA through its commercial arm 'Shetland Leasing and Property' (SLAP)[10]. This time, the purchase was funded with £2m[11] from trust funds held by SDT[12] that was generated by the island's oil

10 "Shetland Leasing and Property Ltd (SLAP) is a commercial limited company operated for profit. The company's shares are wholly owned by the Shetland Islands Council Charitable Trust (SICCT), the trustees of which also are the councillors of the SIC plus two other persons. The funds of this trust originate from oil companies"

11 "To assist SLAP in the purchase of track records, SDT procured, in 1998, a loan of GBP 2 million for SLAP at a rate of interest equal to the return required by SLAP from SFPO for the lease of quotas to fishermen (on average 9%). The purchases were made during the years 1998 and 1999."

12 "SDT is a discretionary trust set up to foster economic development in Shetland and is operated with funding from the SIC. The trustees are the councillors of the SIC plus two independent trustees. The principal source of funds is the Reserve Fund, established and operated by SIC; the Reserve Fund is funded from the surplus revenues of the Council's harbour undertaking"

reserves at the Sullom Voe oil terminal. The main purpose behind this quota purchase was to safeguard fishing opportunities for current and future generations of Shetland fishermen, while at the same time creating a way for young fishermen to affordably gain entry to the Shetland whitefish industry. The purchase again proved successful, and a further 2,000 tons of whitefish FQA were also purchased in 1999. Therefore, in 1999/2000 the SFPO held two pools of quota: the original purchase of 2,386 tons of FQA; and the other 4,445 tons of FQA held by SLAP on behalf of the community. In addition, the fleet (SFPO member vessels) privately owned 12,500 tons of FQA. Therefore, approximately 35% of FQA was held in community ownership in 2000. The current value of the 4,445 tons of community quota is estimated to be £16.9m[13].

The decision to invest in quota holdings for community use was a ground breaking move, although at the time, there were many detractors, particularly other UK POs, who disagreed with what the SFPO were doing. SIC purchased the quota to increase fishing opportunities for the Shetland whitefish fleet and encourage more vessels to enter into SFPO membership. In order to distribute the quota fairly amongst members, the SFPO devised a system that established an allocation method for vessels using both the SFPO 'ring-fenced' and 'SLAP/SDT' quota pools.

The SFPO used a scatter-plot analysis to visually assess the relationship between each member vessel's quota entitlement (FQAs) and catching capacity (measured in vessel capacity units[14] or VCUs), similar to Figure 1. A basic linear regression equation was then estimated[15] to establish the best fitting relationship between both variables, and this was used as a reference point[16]. Those vessels plotted above or around the trend-line were not required to obtain additional quota to be part of the pool, and those vessels that plotted below the trend-line would either have to purchase quota (from other vessels, quota traders, slipper skippers etc) or lease additional quota from the 'ring-fenced' pool (through paying a higher percentage of gross earnings to the PO) to take them up to the trend-line in order to ensure membership and access the 'SLAP/SDT pool'. Lack of finance amongst the Shetland vessels ensured the latter to be more likely. The 'ring-fenced pool' was (and still is) allocated equally amongst all member vessels every two months.

Source: EU state aid decision 3rd June 2003.

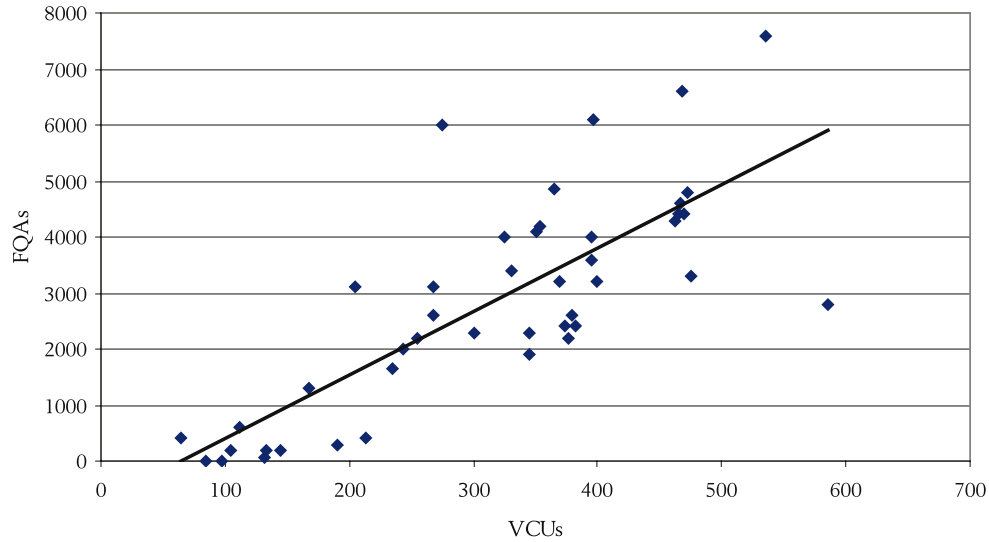
13 Shetland Development Trust investment portfolio; July – December 2006; Appendix 1; page 6

14 VCU (Vessel capacity unit) is calculated as follows: the overall length of the vessel in metres is multiplied by the breadth of the vessel in metres. This figure is then added to the power of the engine in kilowatts and multiplied by 0.45. Source: See UK Sea Fisheries statistics 2005, p146: http://www.mfa.gov.uk/pdf/UKSeaFish2005.pdf

15 Regression analysis is used to try to determine the relationship between two random variables X and Y, i.e. VCU and FQA. Linear regression attempts to explain this relationship with a straight line fit to the data. This procedure was performed using a statistical software package similar to SPSS, the statistical package for the social sciences.

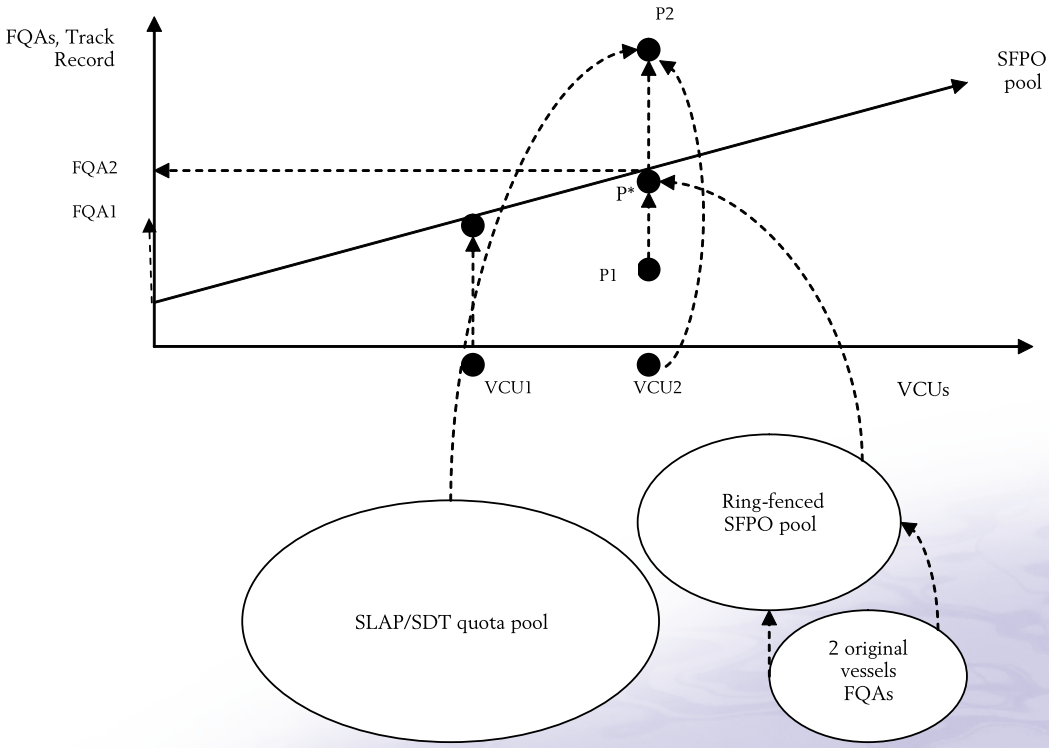
16 The SFPO formulated the following regression equation to describe the relationship between FQAs and VCUs; FQA requirement = 10.87 * (VCU size of vessel) – 605.

Figure 1. Mock VCU/FQA scatter-plot of SFPO member vessels.




To describe how the SFPO administered its quota during this time, consider the scenario of a Shetland fishing crew with a new vessel and license, but without any FQA units. The vessel has a certain number of VCUs but no FQAs (point $VCU_2$ in Figure 2). With no FQA units, the vessel owner must either purchase or lease enough quota to enter the SFPO 'ring-fenced' pool (at point P*, where $VCU_2$ meets $FQA_2$). This system was unique because fishermen could enter the SFPO without any FQAs, providing they paid the required levy.

Figure 2. The 'pooled' Shetland quota system in operation.



It was decided vessels entering the SFPO 'ring-fenced' pool without any track record would be charged 5% to lease the quota (still a significant barrier to entry) in addition to the 1% administration charge (revenue generated from this would go to the SFPO). If, however, a vessel wanted to enter the SFPO pool with half the FQAs required, eg at $P_1$ in Figure 2, in order to reach point P*, the vessel would be charged only 2.5% in addition to the 1% administration charge, and so on. The more FQA units (eg $P_1$ in Figure 2), the lower the levy required. In order to reach point P*, the vessel would be charged on a sliding scale basis.

The SLAP/SDT quota was essentially an additional source of quota that vessels used to augment individual quota allocations when the need arose and therefore provided a 'safety net' for member vessels. Before the introduction of the SLAP/SDT quota scheme, if the SFPO 'ring-fenced' quota pool was fully allocated, the SFPO would be required to undertake quota swaps with other PO's in order to allow the SFPO members to continue fishing legally. If the SFPO was unable to obtain additional quota on behalf of its members, fishermen had two options, either to dump their catches at sea or attempt to land fish illegally. Under the SLAP/SDT system, if a vessel used up their own quota as well as their share of the SFPO's 'ring fenced' quota, they then had access to the SLAP/SDT quota pool to fall back on (eg at $P_2$ in Figure 2). The ample availability of the SLAP/SDT quota ensured the need for dumping at sea or illegal landings was removed.

Finally, the SLAP/SDT quota was allocated preferentially. The agreement between SLAP and the SFPO stated that 'SFPO shall only lease FQAs firstly approved by SLAP, and SLAP will not allow the leasing of FQAs to a party who is not a member of SFPO or is not a PO.'[17]The agreement also stated that the SFPO would use its best endeavours to obtain, via rental income, a minimum net return (ie after deduction of the management fee) of 9% per annum on payments made by SLAP.'

17 "The agreement also stated that the SFPO would observe the following order of priority when entering into rental agreements: (i) preference shall be given to persons, partnerships or companies newly established and actively operating in the fishing industry in Shetland over persons or partnerships already established in the fishing industry in Shetland, (ii) preference shall be given to persons, partnerships or companies who own and are actively operating fishing vessels registered with a port letter in Shetland, (iii) persons, partnerships or companies already established and actively operating in the fishing industry in Shetland shall be given preference to POs" Source: EU state aid decision 3rd June 2003.

## Enforced changes to the Shetland CQ scheme

In February 1999, the EC was informed by a Member of European Parliament (MEP) about a scheme that involved the purchase of fish quota involving the Shetland authorities. The MEP had received complaints about the Shetland CQ scheme from sources within the UK fishing industry. The sources suggested that the scheme 'distorted competition' and existed 'contrary to the rules governing state aid'. The commission invited interested parties to provide their observations in relation to this case. Comments were received from two other UK POs, a private individual and the SDT.

The commission initially considered that the loan granted by SDT to SLAP to buy FQAs was made on preferential terms, in particular due to the fact that vessel owners were unable to borrow money on the terms available because FQAs could not be used as securities. In addition, the commission believed that the operation of the CQ scheme had the effect of lowering the rental cost of the quotas allocated in respect of the FQAs acquired, as compared with the perceived leasing costs for UK FQAs under normal market conditions. Therefore, through the system of additional levies, the commission believed conditions offered to vessels in the membership of SFPO were preferential to the conditions offered to non-member vessels. On those grounds, the commission considered that the scheme resulted in an economic advantage for SFPO member vessels.

As the scheme was set up in 1998, it was assessed in the light of the 1997 guidelines for the examination of state aid to fisheries and aquaculture. The commission considered that quotas and track records are by nature not durable goods, even though they could be purchased, they did not retain any value at the end of the calendar year. Aid for their purchase therefore appeared to be aid related to operating costs for the running of the vessels which benefit from them. As aid for operating costs in the fisheries sector is allowed only under specific circumstances which did not exist in this case, the aid did not appear to be compatible with the common market. In addition, the commission considered that the scheme could not be

considered as implemented by members of the industry, because its effect of ring-fencing FQAs rather than letting the market forces work, was protective in the context which the industry faces and does not contribute to attaining the objectives of the CFP.

SDT and the SFPO always maintained that the reserve fund (the origin of the loan to purchase the SLAP/SDT FQAs) was, according to Scots law, a public trust[18], not in the sense that it performs public authority functions, but because the potential beneficiaries are geographically linked to the Shetland Islands. However, the private source of funding and the obligation to account to private beneficiaries and third parties indicates the independent and discretionary nature of the activities of the trust. Therefore, the commercial loan by the SDT to SLAP for the purchase of quota was a private transaction with no state aid implications. The SFPO and SDT maintain that the funds are private funds, and therefore, to them, the issues with priority of allocation and preferential leasing costs fell at the first hurdle. The SDT referred to a recent decision adopted by the commission Directorate-General Agriculture which considered that a similar fund operated by the Orkney Islands Council could be regarded as a private contribution. Both SDT and the UK authorities believed that SDT should be classed as a private body.

In its communications with the commission, SDT emphasised that it always invests funds at a commercial rate. The main purpose behind the commercial quota purchase scheme developed by SLAP/SDT was to obtain a commercial return for SLAP whilst at the same time allowing the fishing fleet access to quota at commercial rates. The scheme did not favour local fishermen over others; each was required to pay the same commercial return to SLAP/SDT. SDT provided documentation to the commission that described how the scheme worked, both in the case of vessels in the membership of SFPO, through the system of an extra levy in addition to the normal membership levy and in the case of those who were not members.

The UK authorities also provided information related to quota rental costs that showed the financial implications for a vessel: (a) if that vessel rented its entire quota outside Shetland at prevailing market rates; and (b) if it obtained its quota through SFPO via the levy system.
The data showed that vessels under the SLAP/SDT scheme were actually paying slightly more per annum than other operators who used the market place to rent their FQAs. They concluded there was no presumption in favour of vessels subject to charging by percentage of turnover and therefore, the SLAP/SDT scheme did not distort, or threaten to distort, competition.

The scheme resulted in the buying and pooling of FQAs at a time of decreasing fish stocks. The commission therefore accepted that pooling of

18 For more details of the issues surrounding the status of the reserve fund see the commission decision of 3rd of June 2003.

fishing opportunities could be considered as rationalisation, since the quota resulting from the purchase was made available, at market prices, to existing fishermen whose catch entitlement had been eroded through decreasing fish stocks. The development of viable fishing enterprises was thereby assured. Thus, the scheme accelerated the adaptation of the industry to the new situation it faced. Such limited market intervention simply resulted in some of those smaller fishermen continuing in business in heavily fisheries dependent areas where little alternative economic activity existed. That could equally be considered consistent with the socio-economic dimension of the CFP.

In 2003, after a three year investigation by the EC, and despite the best efforts of SDT, the SFPO and the UK authorities to prove otherwise, the Shetland SLAP/SDT scheme was found to contravene EU state aid law and was deemed incompatible with the rules of the common market. Article 87 of the EC Treaty states that, 'any aid granted by a member state or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between member states, be incompatible with the common market'. According to the council decision, the following four conditions must be satisfied in order to class a measure as state aid:

1. The measure must provide some advantage to the undertakings which benefit from it
2. The aid must be granted by the state or through state resources
3. The aid must distort or threaten to distort competition by favouring certain undertakings
4. The aid affects trade between member states

Without getting embroiled in a detailed technical description of the logic behind the ruling, in arriving at its decision the commission concluded:

> "The operating aid reinforced the competitive position of those involved in the Shetland CQ scheme to the detriment of those out-with the scheme."
>
> "The operating aid provided to members of the SFPO was deemed to be public funds (disturbance payments from the Sullom Voe oil terminal) and therefore constituted state aid."
>
> "As the quotas originated within the CFP, the quotas granted rights to fisheries products sold on EU markets and therefore distorted competition within the community market."

After further information was provided, the commission did, however, agree with the UK authorities that no aid element was included in the £2m loan granted by the SDT to SLAP in November 1998. Therefore, there was no advantage to SLAP or to the SFPO when it acted on SLAP's behalf for the acquisition of FQAs. Also, no action was required to be taken with respect to the original ring-fenced quota pool, as the SFPO used private borrowings to fund that original initiative.

Under normal circumstances, the aid relating to the SLAP/SDT scheme would require to be recovered. However, on this occasion, there was a legitimate expectation by all parties concerned that the funds were believed to be private, and indeed the funds had been treated this way for a number of years. Therefore, the recovery of the aid was not required in accordance with the general principle of community law.

In order to continue using the quota pool, the SFPO were required to make some significant modifications to the SLAP/SDT scheme, including setting quota leasing costs in line with current market rates, and ensuring requests for quota were dealt with on a 'first come first served' basis. SIC and the SFPO are now confident they have satisfactorily addressed the issues affecting compliance with state aid laws. The SFPO were unable to challenge the ruling and were only able respond to the commission decision by revealing what changes they intended to make in order to comply with state aid rules. They maintain that a number of wrong assumptions were made in the decision making process.

Above all, the SFPO strongly disagree that their members gained a competitive advantage in relation to leasing costs over non SFPO members. Although the EC perceived there to be a price preference in favour of Shetland vessels, the SFPO maintain that, in effect, SFPO members were at a disadvantage over other UK vessels. They believe an un-level playing field existed, whereby their member vessels were spending significant sums on quota leasing to catch fish legally, while others within the UK industry were continually under-reporting their catches which meant they avoided paying the additional resource cost. This was an incredibly frustrating period for vessels that did not under-report their landings, as they felt they were being penalised for trying to operate legally and within the confines of the CFP.

How successful was the SLAP/SDT quota scheme in fulfilling its objectives? The SFPO maintain that while the SLAP/SDT scheme and 'ring-fenced' pool were in operation, two new member vessels were introduced to SFPO membership in 2000/2001, creating twelve new catching sector jobs, something that would have proved very unlikely before the CQ scheme was introduced. Further, existing SFPO members kept their association with the scheme because of the increased availability of FQAs. Some members were considering leaving the SFPO to operate through an IQ style PO. Perhaps

most importantly, without the SLAP/SDT scheme, it is likely that a significant proportion of SFPO whitefish vessels would have become unviable, leading to an estimated 20% of vessel owners either selling up or decommissioning their vessels. Lower fleet revenues and expenditures undoubtedly would have caused a considerable negative knock-on impact for the Shetland onshore sector in terms of income and employment. The introduction of the SLAP/SDT scheme has ensured a higher level of income and expenditure by the Shetland fleet by increasing its size, and to some extent abating the considerable decline in vessel numbers that was already taking place within the UK catching sector.

## Conclusions from the Shetland experience

Since the new measures have been put in place to ensure the SLAP/SDT scheme is compatible with the rules of the common market, there has been a debate whether the term 'CQ' applies any longer, because there is no allocation preference for Shetland fishermen. Because the EC ruled that the SLAP/SDT quota constituted illegal state aid, it has become much harder to fulfill the objectives of the CQ scheme in the manner it was originally intended. The problem with SLAP was not the quota purchase, as the ruling was positive about CQ schemes using public money, and other UK POs have also considered purchasing FQAs using public money. The way the quota was distributed was deemed unacceptable by the EC. The SFPO believed the money used to finance the scheme constituted private funds belonging to the islands, and therefore, as far as they were concerned, the whole debate about reinforcing the competitive position of Shetland vessels at the expense of other vessels was irrelevant.

The Shetland experience is not an isolated one. The Orkney CQ scheme and a fish quota company in Cornwall both ceased to operate after unfavourable EC rulings similar to the rulings received by Shetland. In all cases, the regions involved are looking at other ways to allocate the CQ without breaking the rules of the common market.

The majority of the Shetland whitefish sector accept the EC decision and acknowledge that they are not disadvantaged, just no longer significantly advantaged. They simply wanted to have more control over the level of fishing opportunities available for current and future generations, and to ensure vessel numbers were boosted sufficiently to climb above the minimum threshold of whitefish boats currently populating Shetland's fishing ports.

The Shetland CQS was set up to safeguard fishing opportunities and employment for future generations of fishermen in Shetland. Given the prevailing financial climate, developing trade in quotas and significant barriers to entry associated with new vessel business start-ups, it was originally hoped

the system would provide a way for new and young fishermen to enter and progress in the industry without any FQA units. However, because of the EC ruling, young vessel owners must now have a fishing licence with the minimum requirement of FQA units before they can become members of the SFPO. Entry requirements in the Shetland PO are now in line with other UK POs. It is no longer possible for fishermen to enter the industry without a track record, and the leasing costs are now the same as everywhere else in the UK.

In 2007, four years on, the business culture within the UK fishing industry has changed significantly. The introduction of the registration of buyers and sellers (RBS)[19] in the summer of 2005 has been heralded as a major success in helping consign to history the widespread problem of under-reported landings by the UK fleet. As a result, most would agree UK vessels now operate on a level playing field, market prices have rapidly increased, and the financial performance of the UK whitefish sector has improved significantly in a short period of time.

Thanks to RBS, both competition and the prevailing financial climate have improved significantly, and Shetland fishermen are much more content with the current system of quota management. Previously, most were unhappy at the cost associated with having to lease quota through the SFPO when others in the UK industry avoided this transaction cost. SFPO members' attitudes have now changed because everyone in the UK industry is required to pay the market rate for FQAs, and the leasing cost as a percentage of gross earnings has, in most cases, decreased. This is due to the fact that market prices have risen significantly because all fish landings now go through an auction market.

Shetland fishermen prefer the SFPO to operate a more community-orientated approach in managing its quotas, and are happy with the current 'pool plus IQ' system employed by the SFPO. Member vessels, unsurprisingly, are also happy with the investments made by SDT on their behalf. They would like to see quota being taken out of the hands of non-active ex-vessel owners and other non-fishing interests and returned to local communities in a similar manner to the SLAP/SDT scheme. They feel if this happened, quota trading costs would reduce as demand would be much lower, removing, in their opinion, an unnecessary, man-made cost.

19 In September 2005 UK Fishery Departments introduced a scheme of registration for buyers and sellers of first sale fish and designation of fish auction sites. For more information see: http://www.defra.gov.uk/fish/sea/manage/registration/index.htm

## Looking to the future

Although local authority ownership of quota is permitted, and perhaps even welcomed at EU level, as SIC used public funds to distribute FQAs in a 'perceived' uncompetitive manner and as an operating expense, the aid was deemed illegal. The ring-fenced quota pool remains unaffected by the EC ruling because it was purchased using private funds. This could be classed as a successful form of self-governance because SFPO members created an incentive for vessel members, and therefore FQAs, to remain within the SFPO. It does, however, remain unclear how a system could be devised whereby local authorities could legally purchase and distribute quota using public money in a way that retains the economic benefits within the local area. Each case would be subject to the legal interpretation of the scheme.

UK fisheries departments are currently looking at ways to improve the current quota management system in a way that balances both the economic and social objectives of the UK fishing fleet. Given that community schemes, at least in the form of the SLAP/SDT scheme, have had limited success against the backdrop of a poor financial climate and restrictive management regime, fisheries managers appear to be limited in their future choices. The question is: does the UK government try and alter the current system to allow and solidify the individual ownership and tradable rights of quota, or maintain and reform the current system to ensure quota remains a state resource with an emphasis placed on protecting fishery-dependent areas?

A switch to a formal individual tradable quota (ITQ) system would introduce individual ownership rights for quota holders and address many of the problems associated with the current FQA approach to RBM. Ownership of quota could be restricted to specific 'active' fishing interests, and rules put in place to regulate quota trading. However, there would still be insufficient safeguards to stop quota being traded out with vulnerable fishing communities. If the UK moved to an ITQ system with full ownership rights, overseas companies could quite conceivably purchase UK FQAs and then repatriate the profits. In addition, under an ITQ approach, the increased

transparency surrounding ownership rights is likely to increase the cost of quota even further, creating an even bigger barrier to entry than under the current FQA system. In most cases, tradable quotas would simply go to the highest bidder, unless some safeguards were put in place.

Fisheries managers are currently assessing the possibility of introducing smaller scale community schemes compatible with EU law. Pooled systems with member allocation preferences are permitted as long as such a scheme is financed privately. As long as sufficient 'pooled' quota is made available to satisfy the demands of the local fleet, fishermen are safe in the knowledge they have adequate access to quota to ensure their businesses remain viable. As such an operation would be financed privately; the decision on who gets access and at what price could be made locally and for the benefit the local fishing industry. The role of onshore support businesses, such as vessel agents and fish processors, could therefore play a pivotal part in securing future fishing opportunities for the most vulnerable fishing communities.

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