Governance and Regulatory Decision-Making at the Commerce Commission

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Outline

• Governance – application to the Commission
• Procedure and regulatory credibility
• Regulatory conferences
• Judicial review
• Summary of problems and solutions
• Overview: Current processes provide limited credibility for the Commission because they do not facilitate a rigorous review of position papers and draft determinations. This is particularly important in the absence of appeals on merit. Fortunately a range of solutions are available.
Governance

• Governance = the design of institutions that induce or force management to internalize the welfare of stakeholders (Tirole 2001)

• Regulatory agencies have complex stakeholder relationships – multiple stakeholders and conflicting interests.

• Stakeholders include legislators, interest groups (including “the public”) and the courts (where appeal rights exist).
Governance and Procedural Rules

• Procedural requirements provide for ample participation of interest groups.

• Regulatory agencies must:
  – provide notice
  – inform about proposed rule makings
  – make decisions taking into account the submissions of interested parties
  – not make decisions in the absence of supporting information.
Procedural Rules and Credibility

• Procedural requirements reflect the pursuit of credibility.

• Credibility is critical if regulation is to be welfare enhancing:
  – In the absence of credible regulation, private investors require higher rates of return, and will favour investment in generic rather than specific assets.
Requirements for regulatory credibility

- Credibility is enhanced where
  - Process provides for scrutiny of the views of all interested parties, including a rigorous analysis of the views of the Commission staff,
  - The decision-makers are independent of the parties, and
  - The decision-makers are not easily influenced by the legislators
Requirements for regulatory credibility #2

• Credibility is also enhanced by strong incentives for regulators to make quality decisions
  – Loss of professional integrity with poor decisions (people with substantial reputational capital make the best regulators)
  – Impairment of future career prospects with poor decisions, and
  – Right of appeal on “merit” as well as on “law”
Role of the Commissioners

• Are the Commissioners
  – Assessing a report that they have written (with assistance from staff)? **or**
  – Assessing a report written by the Commission staff against other available evidence?

• There is little credibility in the claim that the Commissioners can assess their own report.

• Whether Commissioners can assess a report of their staff depends on standard governance problems: principal agent relationships and management capture.
Regulatory Conferences

• Conferences are designed to provide a forum for stakeholders to participate and to increase the credibility of regulation

• Regulated firms, entrants and interest groups play two important roles:
  – Provide regulator with information about the state of the world
  – Provide regulator with information about interest groups’ preferences
CC Conferences: The theory

- Conferences are not adversarial – no cross examination
- Representatives of interested parties may be heard at the conference
- The conference discusses the draft determination or issues paper of the Commission
- Commissioners use the information from the conference to inform their decision.
CC Conferences: The reality

- Conferences are adversarial, but rights to cross-examine are asymmetric.
- The conference discusses the submissions of the parties but provides no direct examination of the Draft Determination.
- The extent of the involvement of the Commissioners in writing the Draft Determination, and therefore their credibility as independent assessors of the Draft, is unclear.
Examination of the Draft Determination

• The Commissioners do not ask the staff questions about their report.
• The parties are not allowed to ask questions of the staff or Commissioners
• The conference therefore cannot provide a rigorous mechanism for reviewing the Draft Determination.
  – This would require the authors of the DD to answer questions from Commissioners and the parties.
Absence of Cross-Examination

• Designed to reduce the time and expense associated with conferences?

• In the absence of cross-examination is it possible for the conference to
  – Elicit all relevant information needed to make the welfare-maximising decision? and
  – Provide incentives to make the welfare-maximising decision?
Asymmetric Cross-Examination

• Conference proceedings are adversarial: cross-examination is in fact allowed.
  – Commission experts and staff undertake extensive cross-examination of parties.
  – Normally do so without reference to the constraints that would apply to cross-examination in a court.

• This asymmetry in rights of cross-examination serves to limit the influence of stakeholders.
  – Consistent with consultation rather than examination.
Independent Experts

• Commission views independent experts as speaking on behalf of parties.
  – No consideration of the qualifications of individuals to act as an expert.
  – Views experts as having less weight than non-expert testimony provided by third parties.

• Consistent with a process designed to consult stakeholders rather than a process designed to maximise scrutiny of the draft determination.
A Consultation Process

• Commission’s approach to conferences is consistent and logical when viewed as part of a consultation process.

• But:
  – Consultation processes do not promote rigorous analysis of the Draft Determination, primarily because the information flow is one-way and neither the Commissioners nor the parties can ask questions of the authors of the DD.
  – Consultation is therefore not likely to provide the optimal level of regulatory credibility or maximise the chance of a welfare-enhancing decision.
Judicial and Legislative Review

• Legislation requires substantial interpretation
  – Regulators have wide discretion

• Legislative review will rarely be case-specific, so legislative review is rare.
  – Leaves regulators with wide discretion on individual cases.

• Judicial review puts substantial limits on the discretion available to the regulator in individual cases (Spiller 1997).
Judicial and Legislative Review

• In New Zealand: “merit” and “law” for the Commerce Act (except electricity and price control provisions) but not for decisions under industry specific regulation:
  – Appeals under the Telecommunications Act and under Electricity Industry price controls are provided only on matters of law.

• In the US: merit and law for decisions of all administrative and regulatory agencies (Spiller 1997).
Judicial and Legislative Review

• Where the threat of judicial review is largely absent, regulatory credibility requires that much greater emphasis be placed on the process, especially the quality of governance and decision processes.
  – Credibility will be enhanced where the structures are clearly designed to make the Commissioners independent adjudicators of the views of the Commission staff and other parties.

• Judicial review improves credibility even where the Commissioners are independent
  – Tests the quality of the Commissioners’ analysis.
Summary of the Problems

• Governance and decision structures relating to regulatory determinations are unclear.
• Conference procedures create a consultation process:
  – Asymmetric rights of cross-examination and information flows provide scrutiny of submissions but not of the work of the Commission.
• In the absence of judicial review, these governance and decision problems reduce the credibility of the regulatory process.
Solutions

• Solutions are straightforward:
  – Right of appeal on merit and
  – Symmetric rights of cross-examination
  – Recognition of the independence of experts
  – Separation of staff and commissioners
    • Staff present and defend their report
    • Commissioners write the decision themselves.

• Each of these solutions would provide benefits but all would be present in the optimal environment.
Costs and Benefits

• Some resource cost associated with most of these proposals, but those costs are likely to be small compared to
  – recent increase in the Commission budget that has been required to facilitate regulatory functions
  – the cost of making decisions that are not optimal.

• Appeals are costly, so primary emphasis in any reform should be given to improving the integrity of the Commission’s governance and decision processes.
1. Disclosure of potential conflicts: Neil Quigley has appeared at a number of regulatory conferences as an expert for Telecom NZ, and has engaged with the Commerce Commission as an expert adviser to several other parties.

2. I thank participants in the ISCR Workshop on Regulatory Theory and Practice 22 March 2005 for helpful comments.

3. References cited: