



**NEW ZEALAND INSTITUTE FOR THE STUDY
OF COMPETITION AND REGULATION INC.**

Governance and Regulatory Decision- Making at the Commerce Commission

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Contact Energy Ltd

Fonterra Co-operative Group Ltd

Meridian Energy Ltd

Natural Gas Corporation

New Zealand Post Ltd

Powerco Ltd

Reserve Bank of New Zealand

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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 straight forward:
 - 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.



Notes and references

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:
P T Spiller (1997) "Agency Discretion and Accountability in Regulation" *New Palgrave Dictionary of Economics and the Law* Vol 1 30 – 35.
P T Spiller (1997) "Regulatory Agencies and the Courts" *New Palgrave Dictionary of Economics and the Law* Vol 3 263 - 267.
J Tirole (2001) "Corporate Governance" *Econometrica* 69 (1) 1 – 35.

