

SECTOR AND COMPETITION REGULATION CONVERGENCE

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★Views expressed here are personal and cannot be attributed to CCI

Agenda

- Why Regulate?
- What to Regulate?
- Division of Powers between Sector Regulators and Competition Authorities
- Sector and Competition Regulation Convergence? Is it all academic?
- Conclusions

Why Regulate?

- **Protection of consumers**
 - Competitive tariffs
 - Performance Standards
- **Regulation of monopolies**
- **Removing barriers to competition**

Why Regulate?

- Attracting private sector requires a way for the state to credibly pre-commit to not behaving in a capricious way once the private entry has been made
- Creation of independent regulatory institutions is a way for the state to credibly tie its hands
- Achieving the effective functioning of competitive markets and where such markets are absent, to mimic competitive market outcomes to the extent possible

Regulation

- New regulatory economics treats regulation of such industries as a principal-agent problem
- Design contracts for the firm
- Contracts in regulatory practices translate into:
 - ✓ Tariff orders
 - ✓ Standards of performance contracts
 - ✓ Access Rules etc.

What to Regulate?

- ✿ **Unbundle the sector into :**
 - Competitive segments
 - Non-competitive segments
- ✿ **Light-handed regulation for competitive segments**
- ✿ **Full regulation for non-competitive segments**
- ✿ **Regulation also essential when supply is inadequate**

Telecommunications

- Parts of the network where economies of scale are not significant (long-distance, international) facilities-based competition is feasible and now fairly standard
- Important natural monopolies (arguably still in the local loop), vertical integration between call delivery, billing and network ownership is still common
- Positive steps to overcome the advantages of incumbency are then required (such as number portability and carrier pre-selection).
- “competition where feasible, regulation where not” suggests that regulation should be confined to the natural monopoly elements

Market Power

- Value added services mobile platform vs. content providers
- Access to Essential Facility Backhaul/Backbone
- International Private Lease Line Circuits
- Operating Systems and Interoperability issues
- Exclusive dealings : Intel Vs. AMD
- Regulators must first conduct market reviews to determine whether markets are effectively competitive or suffer from Significant Market Power (SMP)
- Only in the latter case is ex ante regulation warranted, and then only if it is necessary, justified and proportionate.

Sector Regulation Vs. Competition Regulation

- 3 distinct aspects
 - ✓ technical regulation
 - ✓ economic regulation
 - ✓ competition enforcement
 - ✓ Competition enforcement generally entails the control of abuse of dominance, anti-competitive agreements and anti-competitive mergers & acquisitions (M&As)
- Competition Agencies focused on enforcing economy-wide competition law
- These laws are designed to enhance overall consumer welfare

Sector Regulation Vs. Competition Regulation

- Technical regulation
 - ✓ setting and enforcing product and process standards
 - ✓ designed to deal with safety, environmental and switching cost externalities
 - ✓ Allocating publicly owned or controlled resources such as spectrum or rights of way

Sector Regulation Vs. Competition Regulation

- Economic Regulation (in-market regulator)
 - ✓ specification of production technologies
 - ✓ granting of licenses
 - ✓ determining terms of sale and marketing practices
 - ✓ continuous monitoring is required to steer a market from a monopoly to a competitive market
 - ✓ continuous access regulation and/or price regulation is also needed

Competition Agency

- 'Off-market' regulator
- Referee ; Relies on market forces
- Independent and objective – detached
- Specialized forum for deciding competition issues
- Applies competition principles uniformly across all sectors
- Uniform competition outcomes across sectors
- Maximum impact with minimal intervention

Very simply put

- Sector Regulators- usually apply an ex-ante approach, tell agents what they should do, control structural aspects, intervene more frequently
- Competition authorities- apply ex-post approach, tell agents what not to do, control behavioral aspects, rely on complaints and gather info only when necessary
- Justice Breyer, regulation and antitrust aim at similar goals:
 - ✓ low and economically efficient prices, innovation, and efficient production methods
 - regulation, however, seeks to achieve them directly
 - whereas “antitrust seeks to achieve them *indirectly by promoting and* preserving a process that tends to bring them about

Methodology and Approach

Competition Agencies

- **Timing:**
 - ✓ With the exception of mergers, functions are ex-post
- **Intervention:**
 - ✓ Investigate firms or sector after specific complaint
- **Remedies:**
- Behavioural and Structural

Regulators

- **Timing:**
- Deal with issues ex-ante
- **Intervention:**
 - Continuously Monitor Regulated Firms
- **Remedies:**
- Structural

Powers & Expertise

Competition Agencies

- Powers:
- Go to court to obtain fines and sanctions
- Expertise:
 - ✓ Legal
 - ✓ Economic

Regulators

- Powers:
- Directly investigate and adjudicate on a range of matters
- Expertise:
 - ✓ Legal
 - ✓ Economic
 - ✓ Accounting
 - ✓ Technical

Not just a line in the sand

- Traditionally, regulation and antitrust served distinct functions and relied on a series of doctrines
 - ✓ primary jurisdiction
 - ✓ implied immunity
 - ✓ state action, etc.—to maintain largely separate spheres of authority.
- Recent deregulatory initiatives:
 - ✓ regulation has begun to serve a parallel function to antitrust (i.e., facilitating competition as opposed to replacing it)
- Raising the question of whether the traditional policy of separation should continue

Overlaps exist and hence conflicts

- Interface between them can be a source of tension
- ✓ competition rules interact with industry-specific rules
interconnection, access, monopoly/incumbent-pricing, anti-competitive agreements and merger control
- ✓ Sector-specific regulatory bodies are often responsible for defining "entry conditions", their actions directly affect the nature of competition, after entry has taken place
- ✓ Economic regulation have a direct bearing on competition which a competition authority may see some reason in challenging
- ✓ Technical regulation may also affect market structure and concentration
- ✓ Competition authority may also recommend remedies that impede the mandate of the sector regulator (non discriminatory open access to wires)

Potential for conflict

- Potential for disagreements/conflict on account of
 - ✓ Legislative ambiguity/overlap/ omission
 - ✓ Interpretational bias
 - ✓ Conflicting approaches
 - ✓ Likely in the absence of clear delineation of jurisdiction and effective coordination
 - ✓ May be spurred by market players/lawyers
 - ✓ Turf protection

Problem

- Sectoral regulator and competition commission are capable of coming up with different prescriptions to achieve the common goal of a competitive service unless these two systems are integrated in a more comprehensive fashion

Advantages of coordination

- Expertise available with either is unique and cannot be acquired easily by the other – healthy respect for each other
- Competition law enforcement can overcome inadequacy in market regulation e.g. predatory pricing
- Sector regulator can respond to specific requirements of the sector e.g. price fixing in public interest, setting standards etc.
- With effective coordination, each can play a distinct and non-conflicting role vis-à-vis the other, resulting in better overall economic regulation

Diverse Institutional set up

- Approach1: Sector regulators or multi-sector regulators deal with competition issues and competition authority has no role
- ✓ Theory of regulatory capture- Stigler and Peltzman, regulation has the effect of protecting monopoly to the detriment of consumer welfare
- ✓ Close proximity of regulators to the industry and distribution licensees, may hinder introduction of efficient services
- ✓ Favor state government monopolies
- ✓ Members' (who come from within the industry) selection process may be manipulated

Verizon vs. Trinko case

- Calling for antitrust restraint when competent regulatory agencies can manage the relevant terms of dealing between an incumbent provider and new entrants
- ✓ “where regulatory agencies are on the scene, antitrust courts should retreat.”
- ✓ Regulatory agencies should displace antitrust courts in the telecommunications industry
- ✓ Antitrust courts should forbear from intervening in monopolization cases in new economy industries more generally

Reasons for forbearance

Judge Easterbrook

- If the court errs by condemning a beneficial practice, the benefits may be lost for good. . . . If the court errs by permitting a deleterious practice, though, the welfare loss decreases over time. Monopoly is self-destructive. Monopoly prices eventually attract entry.
- New Zealand ultimately abandoned its effort to charge courts with ensuring reliable cooperation between incumbents and new entrants on matters such as interconnection arrangements.

Not so clear

- However, challenges in the new economy industries are tremendous to follow restraint by Competition Authorities
- Judge Posner “cases in the new economy present unusually difficult questions of fact because of the technical complexity of the products and services produced by new- economy industries.”
- Carl Shapiro: The opportunity to stall technological innovation by new entrants is particularly pernicious in network industries where an incumbent may find exclusionary strategies to “suppress the new and improved network by selectively signing exclusive agreements with consumers who would otherwise be pioneers.”

And then we have Google!!

- Antitrust bodies are dealing with diverse technical issues
- Search Algorithm
- Search Advertising
- Alleged that Google includes the results from its vertical properties towards the top of results causing direct harm to competitors in vertical markets

Diverse Institutional set up

- Approach 2: Combining technical and economic regulation in a sector regulator and leave competition enforcement exclusively in the hands of the competition authority
- Competition issues are not divorced from technical and economic regulation

E.g. Australia where technical regulation is with the regulator

Diverse Institutional set up

- Approach 3: Hybrid approach concurrent jurisdiction
 - ✓ implies that both competition authorities and sector regulators have mandates in regulatory matters, that have a bearing on competition
 - ✓ implies that the two regulators have to find a way of harnessing their respective expertise
 - ✓ recognise the limitations of giving exclusive jurisdiction in critical matters
 - ✓ adoption of concurrent jurisdiction approaches in various countries
- Advantage: Competition Authorities have an economy wide remit and hence safer from Regulatory Capture

Co-ordination

- Coordination between Competition Agencies and Sectoral Regulators is vital to avoid inconsistent application of policies
- ✓ Informal discussions and information sharing
- ✓ Right to make submissions
- ✓ Legally required consultation
- Necessary to avoid
 - ✓ Duplication
 - ✓ Adoption of competition distorting policies
- Informal Co-operation
- Mandatory Consultation

Formal Co-operation

- Can ensure a good Modus Vivendi between Competition Agencies and Regulators
- Two essential features –
 - ✓ provisions for exchanges of information
 - ✓ provisions allowing one body to forbear to act on the basis that the other will act
- Mandatory Forbearance
 - ✓ Regulator must when market forces achieve legislated objectives

Easier said than done

- Naive to leave this area of potential conflict and gridlock to be worked by the institutional wisdom of each authority
- Need to review these issues in greater detail with a view to defining a workable division of labour between the regulator and the Competition Authority
- Institutional maturity develops overtime and at times highest courts decide

Lack of co ordination

- Dilution in quality of economic regulation
- Delay in delivery – “forum shopping”
- Adverse effects on investments, mergers & acquisitions
- Lessening of effective competition resulting in decrease in productivity, efficiency, economic growth and consumer welfare

If this is all about deregulation

- Competition Agency should be involved in ascertaining when continued economic regulation is justified
- Competition agencies better placed than regulators to decide this question and should have less self-interest in unnecessarily continuing regulation ?
- In some countries, regulators are statutorily required to forbear regulating once a sector is sufficiently competitive,
- Competition agencies are involved in determining whether that threshold has been met

Ever evolving...

- Relying on regulatory oversight alone without the backdrop of an effective antitrust law would leave substantive gaps in enforcement
- “Regulatory gaming” undermines both the regulatory system itself and the longstanding complementary relationship between regulatory and antitrust law
- Complex regulatory systems – particularly those requiring government approval for market entry – can create opportunities for such gaming, by enabling dominant parties to dictate industry standards while delaying entry of competing products

Where do we go from here?

- “Optimal” solution (always a compromise) varies from country to country and across industries within the same country
- If competition protection is separated from access and economic regulation, which is often the case outside Australia, co- operation and co-ordination are needed to avoid inconsistent, investment discouraging application of the two sets of policies
- Co-operative links are also needed to avoid resource duplication and competition law application inconsistencies

Thank you

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OBJECTIVES

- Ensure cohesive and systematic integration of economic analysis into the enforcement of the Competition Act, 2002 (tangible, case analysis, orders)
- Moving away from *per se* illegality to rule of reason by increasing the theoretical and quantitative research capability of the Division (intangible, creation of knowledge)
- Developing conceptual frameworks and toolkits for handling range of economic issues that arise in the cases pertaining to Section 3, 4 and 5 of the Act (intangible, creation of knowledge)

FOCUS AREAS

- AoD cases
- Development of skills and capacity for more rigorous economic analysis
- Identification of appropriate theories of harm
- Establishing an institutional collaboration for economics research
- Provide inputs to the Combination Division for merger cases also (dependent on staff strength and other capacities)
- Provide inputs to papers, briefs, commentaries prepared on behalf of the Commission for journals, conferences, meetings etc.(knowledge dissemination)
- Commissioning and supervising specific market studies
- Providing economic analysis for pursuing *suo moto* cases

CASES HANDLED

- Schott vs. Kapoor Glass
- GKB-Hi Tech
- Prints India
- Onion (cartel)
- Arshiya
- Verca Drugs
- Input for the combination notice filed by Nirma Limited

- Non-Case engagement with the MCA regarding the exemptions sought by the Ship Liner Industry (Note prepared and other regular communications)

DIVERSE INPUTS

- Excessive Pricing: Issues and concerns for OECD Policy Roundtable on Excessive Prices
- Pharmaceutical Industry and Competition (for the deliberations at Planning Commission on increasing M&As in the Pharmaceutical industry and the role of CCI)
- Competition for Manufacturing growth and efficiency for former Chairman (for meeting at the Planning Commission Steering Committee on Industry for 12th Five Year Plan)
- Online Markets in India: Regulation and Competition Issues for CUTS Panel discussion

DIVERSE INPUTS

- Loyalty discounts as exclusionary device for meeting with think tank
- Economic tools and tests for delineation of relevant market: issues and questions for meeting with think tank
- Inputs for Response to Draft National Competition Policy
- Response to Draft Report of the Task Force on National Competition Policy, 12th Five Year Plan
- 'Competition policy: a key component of business regulatory framework' for Planning Commission Working Group on Business Regulatory Framework for 12th Five Year Plan
- FDI in retail, insurance and electronics for a meeting of the CP in the US
- Financing of Infrastructure: Issues in Public Private Partnerships, Inputs for a RITES Journal paper

DIVERSE INPUTS

- Working paper on accounting issues for the purpose of Combinations regulations
- Working paper on revision of 'Merger of Licence' guidelines issued by TRAI and bringing out the Competition aspect of the changes by TRAI
- Competition concerns in sports sector especially arising from Conflict of Interest of the regulator and the commercial exploiter of sport
- Economic Analysis of cement cartel

ECONOMIC ANALYSIS FOR PURSUING *SUO MOTO* CASES

- Pursue this objective more fervently in the months to come
- Had fruitful discussions with Adv. Investigation
- Work in Progress:
- Hi-tech Industry special reference to Mainframe hardware and Middleware
- Petroleum Pricing
- AoD by telcom firms having key infrastructure in the IPLC, especially CLS
- ...more ideas welcome for us to pursue

MARKET STUDIES

- Paper and Steel finalised
- Agriculture Markets- Onions
- Few more to be commissioned already the process has begun
- Views from other advisers solicited
- On the way to establish a Dedicated Research Unit at IDF Gurgaon
- Duly executed agreement is awaited

WORKSHOPS/SEMINARS

- Lectures on Merger Analysis, Prof. Sudip Gupta, ISB now NYU
- Economics of Two Sided Markets and Implication for Competition Policy, Sridhar Vardharajan, Sasken Technologies

HR ISSUES

- Conducted interviews for economics experts, deployment of 3, one is not suitable for economics division work
- Director economics post is vacant
- Office Manager
- How to operationalize inter division case handling teams as sometimes we feel the need for more legal insights?
- Office Manager should be posted in every division who will look after all the administrative work with-in the Div.

MISCELLANEOUS: GENERAL WORKING OF THE COMMISSION

- Comments on Investigation Manual for the office of DG, CCI
- Participation in Advocacy Efforts by officers in the various schools of Delhi
- Contribution to Newsletter
- Contribution to OECD Newsletter
- Terms of Reference for the engagement of a credible HR institution.

FUTURE ENDEAVOUR

- Justice Breyer called for research:
- “I would ask such questions as, how often are harms or benefits likely to occur? How easy is it to separate the beneficial sheep from the antitrust goats?”
- Orient the work programme towards research mentioned in the Action Plan such that:
- Anti-competitive behavior does not outwit legal provisions.
- Statutory provisions do not unduly thwart pro-competitive strategies



Thank You