CONSULTATION PAPER ON REGULATORY APPEALS

SUBMISSION BY

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1: INTRODUCTION.

1.1: Background.

This submission has been prepared in response to the Consultation Paper on Regulatory Appeals published by the Department of the Taoiseach in July 2006. The publication of the Consultation Document stems from a commitment contained in the Government's January 2004 White Paper, *Regulating Better,* to consult with interested parties in developing proposals for an improved approach to appeals mechanisms for regulatory decisions.

1.2: Overview of the Consultation Document.

The document states that the Group's main focus was on appeals of decisions of the various economic and sectoral regulatory authorities, namely:

1. The Commission for Communications Regulation (ComReg);
2. The Commission for Aviation Regulation (CAR);
3. The Commission for Energy Regulation (CER);
4. The Financial Regulator;
5. The Competition Authority; and
6. The Commission for Taxi Regulation.

The consultation document is relatively brief, just 49 pages, for a topic that is complex and of major economic importance. It was prepared by a group comprising individuals from various regulatory agencies along with officials of certain Government departments. The document would probably have benefited from the inclusion of some representatives of firms operating in regulated industries along with lawyers and other advisers with direct experience of regulatory appeals.

Section 2 of the Consultation Document describes the existing mechanisms for appealing decisions of the regulatory bodies listed above. Section 3 provides a brief description of the regulatory regimes that operate in the UK and Australia along with an outline of the key points of a report on national appeals procedures for the electronic communications sector produced by the International Regulators Group (IRG). The Consultation Paper then considers certain aspects of appeals in Section 4.

Currently a wide variety of mechanisms exist to appeal regulatory decisions while there are also wide differences in relation to the type of decisions that can be appealed. In the case of the CER, for example, the right to appeal is limited to a determination of a network dispute between the operator of the transmission system and a user of the network and decisions regarding licences to generate electricity and authorisations to build power plants. In the case of the aviation regulator, customers, i.e. the airlines, can specifically appeal decisions in respect of price caps for airport charges and terminal services. In addition to the appeals mechanisms established under statute for the various regulatory agencies, regulatory decisions are subject to a general appeal by way of judicial review.

Among the issues considered in Section 4 of the document are:

1. Whether appeals should be dealt with by a court or a specialist body;
2. Whether they should be dealt with by a specialist court, possibly with lay assessors;
3. Whether there should be a single appeals body;
4. The scope of appeals;
5. Time limits; and
6. The powers of appeal bodies.

2: MAIN POINTS.

2.1: What is the Objective?

In order to address the question of what type of appeal mechanism is required for regulatory bodies, it is important to identify what the ultimate aim of such an appeals process is.

Economic regulation, by which we mean, regulatory regimes for regulating public utility industries, such as electricity, gas, and telecommunications, is designed to address two basic issues:

- Part of the industry may constitute a natural monopoly or essential facility and the owner of such a facility may obviously seek to take advantage of this by charging excessive prices for use of the facility. This problem is compounded where the owner of such facilities also competes in the downstream market since it has an obvious incentive to deny access to the network.
- Firms in such industries may have a dominant position, in some cases as a result of having previously enjoyed a statutory monopoly. Firms may abuse such a position by charging excessive prices to consumers. In the latter case, economists generally argue that regulation may be required as a temporary measure, pending the establishment of a competitive market structure.

The economics literature over the last forty years has highlighted the fact that regulation is subject to serious imperfections. In particular, regulators do not have as much information as the firms they are regulating. This tends to make them heavily dependent on those firms, which leaves them particularly vulnerable to "regulatory capture". A second problem is that regulators are prone to favour increased regulatory intervention regardless of whether or not such interventions represent an efficient solution. Incorrect regulatory decisions can have significant adverse effects on the economy as they may result in higher costs to consumers and businesses. **In the case of economic regulation,**

therefore, some mechanism is required as a check against the potential for regulators to make wrong decisions and to expand their activities unnecessarily.

2.2: The Appropriate Appeals Body.

The issue is what form of appeals mechanism is appropriate to deal with the potential for failure of economic regulation. Economic regulation is extremely complex and requires a degree of specialist knowledge. **This would tend to suggest that such appeals should be dealt with by a specialist body rather than by the courts.**

The Consultation Document states that it is concerned with economic regulation. Many of the issues addressed in the document are not concerned with such regulation. In fairness this is because many of the functions assigned to regulators do not involve economic regulation. To take the case of the CAR, the setting of airport charges clearly falls within the definition of economic regulation. The licensing of travel agents, on the other hand, does not.

The consultation paper cites the disparate nature of the functions of regulatory agencies as an argument against having a single appeals body. This argument appears mistaken.

Consider the example of the taxi regulator. The grant of a licence to an individual to drive a taxi and a decision setting fares for taxis are quite distinct in nature and their effects. In the former case an appeal mechanism is necessary to ensure that the particular individual has been fairly treated. In the latter case an appeal mechanism is necessary to ensure that the interests of the industry and, more importantly because they are often overlooked, of consumers have been properly taken into account.

Such different types of appeal require different skills, expertise and processes. Certain common principles apply to the economic regulation of different utility industries. The same basic economic principles and considerations apply to decisions relating to the setting of gas, electricity and telecommunications and airport charges. In other words,

rather than being an argument for having separate appeals bodies for each regulator, **the diversity of issues dealt with by regulators suggests that a different regime may be required to consider appeals of "economic" and "non-economic" regulatory decisions. The fact that common principles can be applied suggests that there should be a single appeals body to consider appeals of "economic" regulatory decisions.**

2.3: The Scope of Regulatory Appeals.

The first issue is the scope that should be afforded for appeals in respect of economic regulation. Should an appeal be on the merits, by which we mean should the appeals body be empowered to embark on a complete review of the regulator's decision and to substitute its own decision for that of the regulator. There are two basic points that should determine the scope for regulatory appeals.

1. There is a significant risk of regulatory error due to the potential for "regulatory capture".
2. Incorrect decisions impose serious costs on the economy.

The fact that there is a high risk of wrong decisions combined with the fact that such wrong decisions involve potentially large costs **would favour a system of appeals on the merits, i.e. one where the appeals body would be empowered to embark on a complete review of the regulator's decision and to substitute its own decision for that of the regulator.**

The paper advances the argument that, if an appellate body is empowered to undertake a full review and substitute its decision for that of the regulator, then this undermines the regulator and makes the appeals body the effective regulator. Such arguments are incorrect. Judges decisions are regularly appealed to higher courts. The fact that a judgment may be overturned on appeal does not undermine the judge. The argument also seems to be based on a misunderstanding of the nature of the appeals process. Even an appeal on the merits is concerned with re-examining the basis of the original decision. An effective appeals mechanism is required because regulators can and do make wrong decisions.

The Court of First Instance has on a number of occasions found that the EU Commission's consideration of merger cases has been inadequate and has criticised the Commission for failing to undertake a proper economic analysis. In *Airtours*, for example, the CFI stated that:

> "…the Decision, far from basing its prospective analysis on cogent evidence, is vitiated by a series of errors of assessment as to factors fundamental to any assessment of whether a collective dominant position might be created."[1]

In July 2006 the CFI was again highly critical of the Commission's decision in respect of the proposed Sony/BMG merger. Echoing views expressed in *Airtours,* the CFI found that the Commission's decision was

> "vitiated by, first, inadequate reasoning and, second, a manifest error of assessment in so far as the elements forming the basis of the Decision do not constitute all the relevant data that must be taken into consideration and are not sufficient to support the conclusions drawn from them."[2]

The Electronic Communications Appeal Panel was equally critical in its decision in respect of the appeal by 3 against ComReg's finding that it had a dominant position in respect of mobile call termination.

> "In the Panel's view this analysis is not sufficient. It does not meet the standard required of a regulator and does not sufficiently explore and analyse the possibility that interconnected parties and in particular, *eircom*, might have sufficient countervailing buyer power. There is no evidence of a "thorough" analysis as required by paragraph 78 of the SMP Guidelines and, as was highlighted in section 6, there is a striking absence of analysis in relation to key areas, areas that the Respondent has now accepted to be of relevance."[3]

[1] *Airtours plc v. Commission*, case T-342/99, judgment of 6 June 2002, para 294.
[2] Para 542.
[3] Decision No: 02/05 of the Electronic Communications Appeals Panel in respect of Appeal No: ECAP 2004/01, para 8.9.

In the case of a subsequent appeal by Vodafone and O2 against a finding by ComReg that the two operators had a joint dominant position in the mobile access and call termination market, ComReg consented to the ECAP striking out the decision and agreed to pay the appellants costs after the opening day's hearing of the appeal.[4]

In October 2006, the acquisition by Topaz of the business of Statoil Ireland was cleared after the Competition Authority had failed to take a decision on the case within the required time frame because it had miscalculated the deadline for making such a decision. Objecting parties had no right of redress in this case.[5]

These cases serve to illustrate the need for a proper appeals system in the case of regulatory bodies. Subjecting regulators' decisions to independent review constitutes an important quality control mechanism and provides a strong incentive for regulators to get it right.

2.4: Appeals Against Pricing Decisions.

A serious weakness in existing appeals mechanisms is the absence of a right to appeal decisions in relation to prices and charges. Setting prices and charges is one of the fundamental tasks carried out by economic regulators and affects the cost of key services such as gas, electricity, telecommunications and taxis. Such decisions have far reaching implications for business, households and for Ireland's economic competitiveness. The CAR is the only regulator whose decisions on pricing can be appealed. It seems incongruous that there is no right of appeal against decisions that are fundamental to the process of economic regulation. The potential for error and the serious costs imposed by such errors suggests that regulated firms and their customers should have a right to appeal such decisions.

[4] Compecon advised Vodafone in this case.
[5] Compecon advised an objecting party in this case.

A mechanism for appealing the regulator's decision on taxi fares might have averted recent protect actions by taxi drivers who currently have no mechanism, other than judicial review, for an independent review of the regulator's recent decision on fares.

Parties and customers should have a right of appeal against regulator's decisions on prices.

3: OTHER ISSUES

3.1: Third Party Appeals for Mergers?

An issue which is not addressed in the document is whether third parties should have a right to appeal merger decisions. Currently only the merging parties have a right to appeal. In the case of mergers two types of error are possible. The Competition Authority might prohibit a merger which is not anti-competitive or alternatively permit a merger which is anti-competitive. In effect only the first type of error can be appealed. Merger controls exist to prevent mergers that reduce competition, since such mergers make society worse off. It therefore seems strange that there is effectively no safeguard against this type of error. This constitutes a serious shortcoming which has been highlighted by two relatively recent events. At the EU level the CFI decision in the Sony/BMG case illustrates that regulatory bodies can wrongly clear mergers that are anti-competitive. The recent Topaz/Statoil case in Ireland highlighted the fact that objectors had no right of redress when the merger was cleared following mistake by the Authority regarding the time available to it to make a decision. A right of appeal is necessary to safeguard against such mistakes. Such appeals would appear to come within the scope of economic regulation and could be heard by a body charged with dealing with other forms of economic regulatory appeals.

Third parties should have a right to appeal decisions by the Competition Authority to approve a merger. This right of appeal should be limited to parties who had made submissions to the Authority on the merger in question.

3.2: A Voice for Consumers.

The other main problem with the document is its failure to give any significant consideration to the role of consumers in the regulatory process. Theoretically regulators are there to protect consumers against firms abusing their market power. The fact that

regulatory bodies are prone to capture means that they may fail to discharge this role. With the exception of the CAR, customers have no right of appeal against price increases sanctioned by regulators. This is compounded by the disadvantage that individual customers and small firms face in trying to counter regulated firms' ability to devote considerable resources to support their arguments to regulatory agencies for higher prices. **The National Consumer Agency should have the right to appeal regulator's decisions on utility and other prices.**

4: CONCLUSIONS.

- Regulators do not have as much information as the firms they are regulating, which leaves them particularly vulnerable to "regulatory capture". Regulators are also prone to favour increased regulatory intervention regardless of whether or not such interventions represent an efficient solution. Incorrect regulatory decisions can have significant adverse effects on the economy as they may result in higher costs to consumers and businesses. In the case of economic regulation, therefore, an effective appeal mechanism is required as a check against the potential for regulators to make wrong decisions and to expand their activities unnecessarily.
- The degree of complexity and specialist knowledge required in the area of economic regulation would suggest that regulatory appeals should be dealt with by a specialist body rather than by the courts.
- The diversity of issues dealt with by regulators suggests that a different regime may be required to consider appeals of "economic" and "non-economic" regulatory decisions. The fact that common principles can be applied to "economic" regulatory decisions suggests that there should be a single appeals body to consider appeals of such decisions.
- The fact that there is a high risk of wrong decisions combined with the fact that such wrong decisions involve potentially large costs would favour a system of appeals on the merits, i.e. one where the appeals body would be empowered to embark on a complete review of the regulator's decision and to substitute its own decision for that of the regulator.
- Parties and customers should have a right of appeal against regulator's decisions on prices.
- Third parties should have a right to appeal decisions by the Competition Authority to approve a merger. This right of appeal should be limited to parties who had made submissions to the Authority on the merger in question. Such decisions by the Authority can be regarded as "economic" regulatory decisions and could be dealt with by an appeals body established to deal with other "economic"

regulation decisions.

- The National Consumer Agency should have the right to appeal regulator's decisions on utility and other prices on behalf of consumers.