



Economic Regulation

Competition Authority response to the Draft Consultation on the Government Statement on Economic Regulation

May 2013



The Competition Authority
An tÚdarás Iomaíochta

Introduction

- 1.1 The Competition Authority welcomes the opportunity to respond to this consultation. The Authority is not a sectoral economic regulator but has instead a broader mandate to ensure that competition works well across all sectors of the economy. This response will therefore concentrate on the general principles of regulation and the political and legal context in which economic regulation operates.
- 1.2 In any discussion which addresses the impact of economic regulators it is important to set out some important points on the context in which economic regulators work.
- 1.3 The Authority is amongst those institutions which have concerns regarding powers afforded regulators in Ireland when compared with other jurisdictions, particularly other EU Member States. In the Authority's view, the relative weakness of Irish regulators' enforcement powers with regard to the imposition of fines and other sanctions means that structural reform in regulated sectors in Ireland will likely lag behind that experienced in other EU Member States.
- 1.4 Economic regulation is a policy response to a market failure. In some cases, the need for regulation could be lessened by restructuring previously State-owned monopolies in advance so that only those areas that cannot support competition are left subject to regulation. In cases where these choices have not been made regulation will necessarily be more complex and as a result more costly. Consumer welfare will also be reduced relative to its potential.

The Importance of Economic Regulation

- 1.5 Economic regulation plays a key role in the economy as it presents a very important opportunity to introduce competition in previously monopolised sectors, such as aviation, telecoms and energy. The introduction of competition in these sectors has delivered lower prices and greater choice for consumers, as well as improved product and service innovation.
- 1.6 Even in areas where there are enduring monopoly elements such as in telecoms and energy networks, there are opportunities for competition to be introduced. Every effort should be made to open up competition even in so-called "natural monopolies" so that as much of the value chain will be exposed to competitive stress.
- 1.7 The introduction of competition to previously monopolised sectors of the economy such as telecoms and energy does not obviate the need for strong regulatory oversight, particularly during the early phase of market liberalisation. This requires a delicate balance to be struck between ensuring that well-informed consumers derive the benefits of competition and also ensuring that vulnerable consumers are protected. However, it is very important to ensure that the relevant regulatory regimes are correctly designed and operated so as to avoid – or at least minimise – the risk that regulation itself may delay the establishment of normal competitive markets.
- 1.8 Since the onset of the economic crisis the role of regulators has moved a considerable distance from the efficiency based model of pure

economic regulation. In sectors such as financial services and energy, regulators have been forced to grapple with wider public policy issues involving value judgements regarding the extent to which consumers should be exposed to the risk of unfavourable market outcomes.

- 1.9 The reiteration in the Forfas review of the importance of separating the policy making responsibility of the State and the narrower remit of the regulators (while respecting the independence of the regulators in discharging their functions) is therefore welcome since the dividing line between the roles of Government and regulation seem to have become increasingly blurred. Competition and regulation can deliver only certain social objectives. There remains an important role for Government to deliver a wider social policy agenda, often using other policy instruments that can address problems more directly.

Articulating and Balancing Broader Policy Priorities

- 1.10 It is a tendency of all political systems, especially in times of economic hardship, to have a preference for the concept of 'fair prices' over market generated outcomes. However any interpretation of fairness is subjective and is likely to come at the expense of less competition and therefore higher prices over the longer term.
- 1.11 Protection of certain groups of consumers in the interest of fairness, can pose a conflict with regulators' principal duty which should be to encourage competition. This raises questions of how to achieve an appropriate balance.
- 1.12 Regulators have a difficult job in balancing a number of policy priorities. For example, there is widespread concern about the problem of fuel poverty and there have been calls for regulatory intervention to force down prices. However, fuel poverty among vulnerable groups may persist even in competitive markets, so this problem is best addressed by direct Government intervention to provide subsidies for those groups most at risk.
- 1.13 Regulators seeking to protect consumers interests should instead invest in initiatives which help consumers make better choices such as ensuring that the switching process operates as simply as possible and by providing cost comparison tools.
- 1.14 Consumer protection, particularly of vulnerable groups, is becoming increasingly important. The setting of universal service obligations is an important tool for policy makers and represents a means of ensuring a particular level of service funded through the industry. Where possible competition to provide such services should be encouraged so as to ensure that these obligations can be met at minimum cost.

Reviewing Mandates

- 1.15 Regulators need to have clear mandates. Where policy conflicts may arise, they need to be guided by legislation which clearly prioritises their objectives.
- 1.16 It is important that measures designed to encourage the introduction of new products and services (and new ways of selling existing services) are given a high priority as these lead to the greatest

increase in consumer welfare. Firms are only driven to act in this manner by the stress imposed upon them by competition, so regulators should always place a strong emphasis on promoting competition in the sectors they regulate.

- 1.17 Economic regulation is a process and as such the regulatory approach should change as market conditions evolve toward a competitive industry structure. For example, as the supply of electricity and gas is now open to competition, the CER has assumed a more hands-off approach involving market monitoring rather than direct tariff regulation. The liberalisation of retail energy supply does not however obviate the need for the CER to take an active role in regulation but rather to reorient its activities to help consumers make better choices. The same process is very much further advanced in the communications sector and in line with the EU Directives covering this sector, regulation is being removed once it is no longer necessary.
- 1.18 Energy policy aims to achieve three different things: to ensure that sufficient investment in power generation and infrastructure is made to keep the lights on; to ensure Ireland meets its carbon emission reduction targets; and to ensure that our electricity and gas are supplied at reasonable prices. As a previously monopolised market is liberalised and begins to operate as a competitive market, the need for regulation (or at least for certain forms of direct intervention) diminishes and, in some markets, may disappear completely. Reflecting this, it is generally regarded as good practice internationally to incorporate 'sunset' clauses in regulatory legislation which require legislators to consider at certain intervals whether the regulatory regime needs to be modified or dismantled altogether. The Authority would recommend that consideration be given to incorporating such provisions in relevant Irish regulatory legislation. The regulatory system in telecommunications already has much the same process deliberately built in as the regulator has to continually re-assess the need for regulation every few years and remove regulation where it is no longer required.
- 1.19 However in recent years the CER has played an increasingly active role in addressing social needs as part of the regulatory process. This raises issues of how far competitive markets and regulators can be used to deliver social objectives.
- 1.20 It is clear that regulators with multiple mandates face a difficult balancing act and that any extension of their role will not only add to the costs of the regulatory process and but also raises the risk that the performance of their core functions will no longer be their principal priority. Given the growing number of tasks expected of regulators, Forfas's recommendation that mandates should be streamlined and ancillary functions moved to the parent Government department is a sensible one.

Compliance and Enforcement

- 1.21 The cost and effectiveness of regulation varies country by country. Ireland is a particular example where regulators have little power to act quickly and cheaply to force compliance with their directions. Irish regulators do not have the power to make determinations of breaches and impose fines on regulated entities in the sectors considered by Forfas. In contrast to other EU Member States, the lack of

enforcement powers and the reluctance to break up monopolies creates opportunities for regulated entities to 'game the system' with the result that regulation in Ireland will inevitably be slower to deliver competition and will be more costly than it would be otherwise. This process will be further delayed as regulated entities delay change through resistance to compliance, appeals or threats of appeals to the courts etc.

- 1.22 The Authority believes that standardising the general enforcement powers of the various sectoral regulators could be a practical way of ensuring effective and efficient enforcement of the law. (The Authority recognises that certain regulators may require specific enforcement powers. For the purpose of ex ante regulation of their particular sectors; but that should not prevent a high level of standardisation of general enforcement powers.) Standardising the approach to enforcement would require a single set of enforcement options for investigating and sanctioning undertakings
- 1.23 The availability of binding commitments which can be enforced as Orders of the Court would be a useful *addition* (as opposed to an alternative) to the array of sanctioning measures available to regulators. Section 14B of the Competition Act 2002, as inserted by section 5 of the Competition (Amendment) Act 2012 is a good example of how voluntary commitments agreed between an undertaking and a regulatory agency can be strengthened by having them made an order of court. If the undertaking is breached, the party in breach will be committing a contempt of court.
- 1.24 The current enforcement tools/sanctions available to regulators and to the Competition Authority are inadequate. The Authority has argued elsewhere¹ that there is a need for the introduction of 'civil fines'; that is fines that can be imposed by the Court on undertakings at the end of civil enforcement proceedings. In the areas of law that Regulators are expected to enforce, it is simply impractical to expect that sanctions can be imposed using the criminal standard of proof. Given that such cases tend to be extremely lengthy, complex (often involving technical and economic evidence from expert witnesses) it is very unlikely in the extreme that errant undertakings will ever face any form of sanction if such sanctions can only be imposed – as at present – where a jury has convicted the undertaking of a criminal offence. The Competition Authority joined with a number of other regulatory agencies recently when submitting a proposal to the Law Reform Commission to consider the issue of civil fines as part of their programme of work.²
- 1.25 Administrative fines could be a possible alternative to civil fines. These fines could be imposed by a body such as a regulator at the completion of an investigation and would be fully appealable to the Courts.
- 1.26 The Authority is aware of the constitutional law issues that might arise if legislation providing for the possibility of civil or administrative fines were enacted. However, such sanctions exist in virtually all, if not all,

¹ Filling a gap in Irish competition law enforcement: the need for a civil fines sanction" Fitzgerald, G and McFadden D Available to download at: <http://www.tca.ie/>

² Submission to the Law Reform Commission Proposed New Programme of Law Reform. Available to download at: <http://www.tca.ie/images/uploaded/documents/S-12-007%20-%20Submission%20to%20Law%20Reform%20Commission.pdf>

other EU Member States and are regarded by them as an essential mechanism for the effective enforcement of regulatory laws. Even in Ireland, provisions in current legislation relating to some regulators (e.g., the Central Bank) providing for the imposition of administrative fines highlights the anomaly of the absence of such sanctions for other regulators.