



**Submission of the Business and Industry Advisory Committee (BIAC)
to the OECD Global Forum on Competition
Session 1: Bringing Competition into Regulated Sectors***

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INTRODUCTION

1. This paper has been drafted and submitted without the benefit of reading the Secretariat's paper, which was not available prior to the date of submission of this paper.
2. In principle, the goal of regulatory reform is to foster greater economic competition by allowing marketplace forces (rather than government) to govern activity in the industry, the rationale being that economic regulation should be reformed to stimulate competition and eliminate competition-distorting impacts except where clear evidence demonstrates that regulation is the best way to serve broad public interests. Where such evidence exists, the impacts should be minimized in the pursuit of other public interest goals.¹
3. Whether or how well the goal of pro-competitive regulatory reform is achieved, both from the government and the business community perspectives, is a function of various factors including the motivations and goals of regulatory reform, and the

* This paper has been prepared principally by Crystal L. Witterick and Kikelomo O. Lawal, Blake, Cassels & Graydon LLP, with the input of members of the BIAC Competition Committee. A. Paul Victor, Weil, Gotshal & Manges LLP provided significant input, particularly from a U.S. perspective, for the framework and substance of this discussion. We also draw upon the extensive work of the Organisation for Economic Co-operation and Development (OECD) and the International Competition Network (ICN) in the area of regulatory reform. See OECD Regulatory Reform Programme page at http://www.oecd.org/topic/0,2686,en_2649_37421_1_1_1_1_37421,00.html and the ICN's Antitrust Enforcement in Regulated Sector's Working Group's Report to the ICN's Third Annual Conference, Seoul, Korea, April 2004, available at http://www.internationalcompetitionnetwork.org/seoul/aers_ch3_seoul.pdf.

¹ See OECD Report on Regulatory Reform, Paris, 1997, available at <http://www.oecd.org/dataoecd/17/25/2391768.pdf>; see also "Restructuring Public Utilities for Competition", OECD Policy Brief, February 2002, available at <http://www.oecd.org/dataoecd/0/0/2066164.pdf>.

objectives to be achieved in the administration of the regulatory reform process and post-reform environment.

4. This submission sets forth BIAC's views concerning the challenges in bringing competition to a formerly regulated market. It should be considered in conjunction with BIAC's submission to Session 2 regarding the relationship between competition authorities and sectoral regulators.²

MOTIVATION FOR REGULATORY REFORM

5. The goal of achieving greater competition through regulatory reform may be motivated by a number of economic factors, including protection of competition as an end in itself, promotion of economic efficiency, prevention of wealth transfers from consumers to producers, protection of free markets, advancement of the public interest or special interests, a desire to improve the average standard of living, a desire to stimulate productivity and a desire to increase international competitiveness.³ The actual impetus for regulatory reform of a given industry, however, may vary.
6. Regulatory reform is in many ways a product of globalization and the resulting need to shed protectionist principles in order to adapt to innovation, change and larger trading environments. Regulatory reform may also flow from different jurisdictions' attempts to pull back from policies akin to state aid that were designed to support particular sectors or from government control, as was the case in the former Soviet Union.⁴
7. Another catalyst for regulatory reform is litigation by competition authorities. In the 1980s, the U.S. Department of Justice commenced an antitrust suit against AT&T based on AT&T's anticompetitive activities in the market for long distance telephone

² As discussed more fully in BIAC's submission to Session 2, there are four alternative approaches for managing real and potential conflicts between antitrust and sectoral interests:

- a. vesting competition policy and enforcement authority solely in the federal competition agency;
- b. allowing sectoral agencies to submit their views to the antitrust agency, which retains ultimate competition authority;
- c. allowing concurrent jurisdiction where either the sectoral agency or the competition agency may block a transaction; or
- d. vesting ultimate authority in the sectoral agency, which receives structural input from the competition agency.

³ See Crampton, Paul and Facey, Brian, "Revisiting Regulation and Deregulation Through the Lens of Competition Policy: Getting the Balance Right", 25 *World Competition* (2002) at 25-53. See also Crampton, Paul, "Competition and Efficiency as Organizing Principles For All Economic and Regulatory Policymaking", prepared for the First Meeting of the Latin American Competition Forum, Paris, April 7-8, 2003, available at <http://www.oecd.org/dataoecd/43/26/2490195.pdf>

⁴ See Proceedings of the Sixth Workshop of the APEC-OECD Co-Operative Initiative on Regulatory Reform, Pucón, Chile, May 24-25, 2004 (which contains discussions of various jurisdictions' attempts to introduce regulatory reform), available at <http://www.oecd.org/dataoecd/44/24/33818980.pdf>.

services. This suit was settled by way of a Modified Final Judgment, which became the instrument of regulatory reform and paved the way for the *Telecommunications Act of 1996*.⁵

8. Perhaps the most common driver of regulatory reform, however, is the shifting of political and economic tides and pressures. In the U.S. for example, lobbying efforts by those denied entry to the airline industry led to the dismantling of the Civil Aeronautics Board, which before that time had controlled air traffic, routes, rates and gate access. As studies have shown, airline fares have dropped substantially, the number of departures has risen and air safety has improved as a result.⁶

CHALLENGES OF REGULATORY REFORM

9. Whatever the motivations and catalysts for regulatory reform, some degree of government involvement is required to implement it and to ensure that competition in fact takes place.⁷ Governmental oversight is necessary to ensure that consumer and efficiency gains are not jeopardized and that private anticompetitive restraints do not

⁵ See McLaughlin, Duane, “FCC Jurisdiction Over Local Telephone Under the 1996 Act: Fenced Off?”, 97 *Columbia L. Rev.* 2210 (1997).

⁶ See “Air Safety Improved But Delays Remain A Problem Because More People Flying, Says FTC Study On Deregulation”, FTC Press Release dated February 8, 1988, available at <http://www.ftc.gov/opa/predawn/F88/dereg.txt>. See also, John M. Nannes, Testimony Before The Committee On Transportation & Infrastructure U.S. House Of Representatives Concerning Antitrust Analysis Of Airline Mergers (June 13, 2000), available at <http://www.usdoj.gov/atr/public/testimony/4955.htm> (“The deregulation of the airline industry illustrates both the dividends that freeing regulated markets can have for American businesses and consumers and the role of sound antitrust enforcement. The deregulation of the nation's airlines in 1978 resulted in vigorous price competition and an astounding expansion of capacity. Today, more people are flying to more places than ever before.”); Anne K. Bingaman, Address Before The Commonwealth Club of California (July 29, 1994), available at <http://www.usdoj.gov/atr/public/speeches/innovate.htm> (“The salutary effect of competition on innovation has been demonstrated repeatedly in this country when a variety of previously regulated industries have been deregulated, either in whole or in part. . . . For example, the entry and subsequent growth of Southwest Airlines stimulated price competition that has benefitted air travellers.”); and Adam M. Golodner, “Antitrust, Innovation, Entrepreneurship And Small Business,” Address Before the SBA Conference On Industrial Organization (Jan. 21, 2000), available at <http://www.usdoj.gov/atr/public/speeches/4200.pdf> (“In airlines, . . . our faith in competition has led to more open markets, new competitors and opportunities for entrepreneurship, better and cheaper products, and a better economy within which all businesses, including small businesses, can compete, innovate, and thrive.”)

⁷ See generally APEC/OECD Integrated checklist on Regulatory Reform, (a checklist prepared to assist member economics evaluating their regulatory reform efforts and determining the process of development and implementation, available at <http://www.oecd.org/dataoecd/43/26/2490195.pdf>. See also “Integration and Infrastructure in the Americas”, remarks made by A. Paul Victor at the 2nd Latin American Regional Conference, Rio de Janeiro, May 10 – 13, 1998, at 3.

replace regulation.⁸ It is also necessary to ensure that dominant market positions are not inappropriately entrenched during the transition phase.

10. There are also a number of threshold issues that must be addressed before beginning the transition:
 - a. Governments must fully understand the different social policy outcome of regulated environments as opposed to competitive markets. This entails an examination of the goals sought to be achieved and motivations and catalysts for regulatory reform, but also the potential adverse consequences such as higher prices for higher cost consumers.⁹
 - b. The transition phase must have a predictable and disclosed end, or at the very least, milestones that should be reached before the transition period can be considered complete. Although some impediments to free competition can be removed fairly quickly, others involve a longer-term plan. A delicate balance must be struck to ensure that conditions conducive to competition are not undermined, while ensuring that the process does not continue indefinitely. For example, regulatory reform in the telecommunications industry in Canada is currently in its third decade.¹⁰
 - c. When considering these and other issues related to the transition process, governments must also be attuned to the fact that errors can have a significant long-term detrimental impact on competitive markets. Examples of potential costly missteps include: failure to deregulate upstream or downstream (a problem that plagued regulatory reform of the California electricity sector), failing to consider implications for collaterally affected industries and creating an environment with too much duplication and overlap of regulatory functions.¹¹
11. Although the degree of government involvement is informed by whether the regulatory reform is to be complete or partial, there are unique challenges associated with regulatory reform that are present in both circumstances.
12. These challenges can be divided into four basic categories: (i) fostering a competitive marketplace; (ii) determining the amount of government involvement; (iii) determining the government institutions involved in the regulatory reform process; and (iv) determining the role of competition authorities vis-à-vis sectoral regulators and in the regulatory reform process generally.

⁸ See generally Prepared Statement of the Federal Trade Commission, presented by Chairman Robert Pitofsky before the House of Representatives Committee on the Judiciary, June 4, 1997.

⁹ See Crampton *supra* note 3 at 10-11.

¹⁰ See Crampton and Facey, *supra* note 3 at 38; Crampton *supra* note 3 at 13.

¹¹ See Crampton *supra* note 3 at 13-15.

Fostering a Competitive Marketplace

13. The power and influence of vested domestic business interests often operates as an obstacle to regulatory reform. As can be expected, these industry participants may attempt to preserve their protection from the full forces of competition,¹² including by:
 - a. Endeavouring to forestall regulatory reform through intense political lobbying efforts;
 - b. Engaging in monopolistic or cartel behaviour to exclude new entrants who would otherwise have been excluded as a result of some regulatory process;
 - c. Attempting to exercise horizontal market power by raising prices above competitive levels;
 - d. Attempting to exercise vertical market power by engaging in discriminatory access practices; and
 - e. Exploiting their ability to learn about rivals' upstream, downstream or adjacent markets.
14. Vigorous competition law enforcement should be encouraged to prevent anti-competitive practices, particularly during the transition process. Other transitional safeguards may be required. For example, price controls may be appropriate as a discipline to keep prices down while competition takes root. It may also be necessary to mandate access to markets for new entrants through legislative means. It must be recognized that competition law authorities are not likely to have the jurisdiction, experience or skills to implement and/or supervise certain aspects of these transition measures. In any event, these regulatory requirements should be phased out once competition has indeed taken root.
15. Accordingly, regulatory reform should not be undertaken unless there are basic competition laws and resources and institutions in place to facilitate its enforcement. Ensuring these protections exist improves the prospects for successful deregulation and promotes transparency and predictability for the business community.

Determining the Right Amount of Government Involvement

16. As government seeks to remedy potential abuses and facilitate a transition, the question then arises: what level of involvement is required? As some commentators have observed, withdrawal of traditional regulation may in fact require more activism

¹² *Id.* See also Prepared Statement of the Federal Trade Commission, presented by Commissioner Mozelle Thompson at the House Judiciary Committee Hearing on July 28, 1999; Crampton, *supra* note 3 at 12.

on the part of government to ensure that competition on equal terms can develop, both to ensure competitive access and to protect consumer interests.¹³

17. Although the objective (i.e. partial or complete regulatory reform) somewhat dictates the level of government involvement from a regulatory perspective, common approaches typically require agency-specific oversight of the deregulated industry combined with generalized competition law enforcement during and after regulatory reform.
18. Where the government role involves a distinct regulatory presence in the market, issues related to promoting competition, controlling the prices for natural monopoly products which are not yet subject to competitive supply and establishing competitive terms of access take precedence.
19. Where the government role is competition law enforcement, issues related to fostering competitive environments which provide consumers with a variety of products at efficient prices are paramount.
20. The ICN has noted that the main areas where competition rules interact with industry-specific rules are interconnection, access, monopoly/incumbent-pricing, anti-competitive agreements and merger control.¹⁴
21. As discussed in BIAC's submission to Session 2, the post-regulatory reform environment can at times reflect uncertainty, inconsistency and lack of transparency for the business community as competition authorities and sectoral agencies pursue their sometimes conflicting mandates.
22. As the ICN's work reflects, jurisdictions employ different means of managing conflicts between sectoral regulators and competition authorities, ranging from informal co-operation to legally required referrals.¹⁵

Determining the Right Government Institutions Involved in the Regulatory Reform Process

23. The challenges of regulatory reform are complicated further by the potential number of government institutions.
 - a. In the U.S. for example, the electricity industry is governed by the Federal Energy Regulatory Commission (which regulates the interstate transmission of electricity), state public utility commissions (which have the power to set retail prices) and by the FTC or the DOJ (which enforce the *Clayton Act*).

¹³ See Meyer, John R. and Tye, William B., "Toward Achieving Workable Competition in Industries Undergoing a Transition to Deregulation: A Contract Equilibrium Approach", 5 *Yale J. on Reg.* 273 (1988).

¹⁴ See ICN Antitrust Enforcement in Regulated Sectors Working Group's Report to the ICN's Third Annual Conference, Seoul, April 2004, available at http://www.internationalcompetitionnetwork.org/seoul/aers_ch3_seoul.pdf at 5.

¹⁵ *Id.* at 6.

- b. In Canada, the airline industry is governed by the Canadian Transportation Agency, and is also subject to special provisions in the *Competition Act* relating to predatory pricing in the airline industry.¹⁶
 - c. Further, in some countries, such as Canada, there may be a form of regulated conduction exemption or defence which exempts certain business conduct from the purview of competition law enforcement. Defining the scope of the exemption can be problematic; the objective must be certainty for the regulatees.
24. The higher the number of regulatory authorities involved, the higher the likelihood of varying degrees of monitoring, differing compliance requirements and unique competition and non-competition policy goals, and the lower the likelihood of predictability and fairness for the business community.¹⁷
25. Even when one regulator assumes primary responsibility for the industry subject to regulatory reform, other substantive issues can arise:
- a. Instincts of self-preservation can motivate sectoral regulators to entrench their supervision and monitoring role.¹⁸
 - b. The potential for “regulatory capture” (i.e., the development of a regulatory orientation that is more reflective of the objectives of the regulated entities than it is of the initial regulatory objectives) is generally recognized to be greater when a single sector regulator has been given a mandate to implement a transition to competition.¹⁹

Determining the Role of Competition Authorities

26. Unlike industry-specific regulators who have a much narrower interest to serve, competition authorities have a broader mandate of promoting competition generally. Implementing this mandate can take the form of advocacy, rendering of advice, active participation in the regulatory reform process and facilitating/maintaining competition

¹⁶ See e.g. sections 78 (1)(j) and (k), which prohibit anticompetitive acts in the operation of a domestic service, and section 79 (3.1), which provides for administrative monetary penalties for abuse of dominant position by an airline. There is currently a set of amendments to the *Competition Act* under consideration that would eliminate these and other airline-specific provisions. The text of this Bill C-19 is available at: http://www.parl.gc.ca/common/Bills_ls.asp?Parl=38&Ses=1&ls=C19.

¹⁷ See generally “Relationship Between Regulators and Competition Authorities”, OECD Directorate for Financial, Fiscal and Enterprise Affairs, Committee on Competition Law and Policy (1999), available at <http://www.oecd.org/dataoecd/35/37/1920556.pdf>.

¹⁸ *Id.*

¹⁹ See generally, “Relationship Between Competition Authorities”, published by the OECD Directorate For Financial, Fiscal And Enterprise Affairs Committee on Competition Law and Policy, June 29, 1999, available at <http://www.oecd.org/dataoecd/35/37/1920556.pdf>.

through merger review or enforcement of abuse of dominance laws.²⁰ The following are some examples of the approach taken by competition authorities in the regulatory reform process.

- a. In the U.S., the antitrust authorities have acted as commentators in the regulatory reform process, beginning in the early stages of the U.S. regulatory reform wave. A former FTC Chairman has remarked that the Commission's aggressive competition advocacy through speeches and formal submissions to regulatory agencies and legislative committees helped create a policy climate ripe for regulatory reform in various sectors.²¹ Such submissions could advocate that during transition periods, regulators should ease the burdens on incumbents rather than imposing burdens on new entrants.²²
- b. When the *Telecommunications Act of 1996* led to deregulation of radio mergers and expanded U.S. DOJ oversight of these transactions, the DOJ found that many of the Joint Sales Agreements that had been initiated under the Federal Communications Commission's watch were problematic under the antitrust laws. Rather than seek enforcement against a large segment of the industry, or selectively enforce in a discriminatory fashion, the DOJ effectively decided to grandfather the pre-existing agreements and use its advocacy role in counselling the radio broadcasting industry toward future compliance.²³
- c. In Canada, the Competition Bureau promotes competition in deregulated industries through competition policy and legislative advocacy,²⁴ regulatory

²⁰ For example, in May 1998 the U.S. DOJ challenged Primestar's acquisition of the Digital Broadcast Satellite (DBS) assets of News Corp. on the basis that it would have allowed five of the largest cable companies (which controlled Primestar) to prevent new entry. *See United States v. Primestar Inc.*, Civ. No. 1:98CV01193 (D.D.C. filed May 12, 1998).

²¹ See Muris, Timothy, "Creating a Culture of Competition: The Essential Role of Competition Advocacy", prepared remarks for the International Competition Network Panel on Competition Advocacy and Antitrust Authorities, September 28, 2002, available at: <http://www.ftc.gov/speeches/muris/020928naples.htm>.

²² *See* Debra A. Valentine, General Counsel Federal Trade Commission, "Antitrust in a Global High-Tech Economy", 8th National Forum for Women Corporate Counsel, Washington D.C. (April 30, 1999).

²³ *See*, Joel I. Klein, "DOJ Analysis of Radio Mergers." Address Before the ANA Hotel (Feb. 19, 1997), available at <http://www.usdoj.gov/atr/public/speeches/jik97219.htm>; and Lawrence Fullerton, "Current Issues in Radio Station Merger Analysis," Address Before the Business Development Associates Antitrust 1997 Conference (Oct. 21, 1996), available at <http://www.usdoj.gov/atr/public/speeches/8210.pdf>

²⁴ In 2004, the Competition Bureau appeared before the House Standing Committees on Canadian Heritage, on Industry, Science and Technology and Banking, Trade and Commerce to provide its views on the future of broadcasting, foreign investment restrictions and Bill C-249 (an act to amend the Competition Act with respect to consideration of efficiencies), respectively. *See* relevant portion of the Bureau's Annual Report 2004, available at <http://strategis.ic.gc.ca/epic/internet/incb-bc.nsf/en/ct03010e.html>.

interventions under authority of sections 125 and 126 of the *Competition Act*,²⁵ enforcement of the *Competition Act* and through education of businesses as to the benefits of competition.²⁶ The Canadian Competition Bureau has indicated that it views its policy advice and analysis role as key to achieving the objectives of the *Competition Act*.²⁷ Recognizing the inherent conflict where there is competition law regulation as well as industry-specific regulation, the Competition Bureau has articulated a set of core principles governing the joint regulation. These range from developing mechanisms for inter-agency cooperation and coordination, to expressing its preference for relying on competition law to prevent anticompetitive business practices unless regulation is demonstrably better.²⁸

- d. The Canadian Competition Bureau's involvement in the regulatory reform of electricity markets involved several measures, including (i) intervening in electricity market structure reviews and hearings; (ii) supporting structural separation between transmission and distribution systems and regulatory oversight of access and pricing; and (iii) supporting separate electricity market surveillance.²⁹

²⁵ Sections 125 of the Act authorizes the Commissioner to make representations to and call evidence before federal boards, commissions or other tribunals where such submissions are relevant to the tribunal and the matters before the tribunal, and to assume a similar role with respect to provincial boards, commissions and other tribunals where she has been invited to do so.

²⁶ “The Complementary Role of Regulations and Competition Law in Deregulating Industries”, speech given by Andre Lafond, Deputy Commissioner of Competition of the Canadian Competition Bureau, at the Canadian Bar Association Annual Fall Conference on Competition Law, October 3-4, 2002.

²⁷ *Id.*

²⁸ *Id.*

²⁹ See Ronayne, Mark “Canadian Competition Law Roles, Responsibilities and Relations in Emerging Electricity Markets”, paper prepared for the Canadian Bar Association Annual Fall Conference on Competition Law, Ottawa, Ontario, September 20 – 21, 2001.