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The American
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Regulated Industries

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Introduction

I am honored to be here today to participate in the Antirust Modernization Commission's (AMC's) hearings on regulated industries. I will draw my remarks primarily from the comments submitted to the AMC on July 15, 2005 by an American Antitrust Institute (AAI) Working Group, created for the express purpose of responding to the AMC's study issues.[1] I note that those comments were the product of a group effort in which a number of experts participated.[2]

The AMC posed six study issues in their request for public comments. The bulk of the AAI Working Group's comments focus on four of these issues: (1) the role of antitrust enforcement; (2) accounting for regulatory systems and antitrust remedies; (3) standards for applying the antitrust laws where there is no specific antitrust exemption; and (4) the allocation of merger review authority between antitrust and regulatory agencies.

[1] The AAI's Working Group comments on regulated industries study issues are available online at http://www.amc.gov/public_studies_fr28902/regulated_pdf/050715_AAI-Reg_Indust.pdf.
[2] The Working Group is chaired by Diana Moss (AAI) and the other members are: Albert Foer (AAI), Alfred Kahn (Cornell University, emeritus and National Economic Research Associates), Susan Kelly (American Public Power Association), Roger Noll (Stanford University), Jonathan Rubin (AAI), and Philip J. Weiser (University of Colorado).

Role of Antitrust in Restructuring Industries

Most regulated industries, such as natural gas, electricity, telecommunications, and transportation, have undergone fundamental transformation as a result of a transition to lighter-handed regulation and market-driven mechanisms. In contrast to the classic regulatory mechanisms of price, profit, and entry regulation, modern regulation puts more emphasis on a broader set of objectives such as reliance on markets and competitive constraints to achieve its goals. We have enough experience with regulated sector restructuring to realize that the transitional phase between regulation and effective or workable competition can be difficult and protracted. It is still clear, however, that the debate has not been resolved over whether to put antitrust on "hold" until markets are workably competitive, and whether some mixture of regulation and antitrust will hasten the arrival of competition.

The AAI Working Group suggests that antitrust can and should be seen as an important complementary (as opposed to an alternative or substitute) policy instrument for remedying market distortions in transitioning industries. One reason is that underutilization of antitrust leaves regulators to shoulder the burden of detecting and remedying anticompetitive conduct. A cumbersome regulatory process for dealing with issues that are more effectively dealt with by antitrust, however, is costly and risks chilling pro-competitive behavior. Another reason why antitrust plays an important role in transitioning industries is that not all deregulatory schemes are successful. Forced access regimes that delegate much of the load to the regulator do not preclude extensive

litigation and in some cases, regulators find it difficult to promote competition and then withdraw to allow market forces to take over.

Some of the stage has already been set for antitrust to play a more active role in restructuring industries by a more modern interpretation of the regulatory "public interest" standard. Promoting consumer welfare through enhanced economic efficiency, for example, brings the goal of regulation closer to that of antitrust. But figuring out when antitrust can and should play a role depends on a case-specific evaluation of factual circumstances, regulatory context, and the comparative advantages of each type of institution. Antitrust enforcement, for example, is well suited to resolve disputes requiring adjudication of a competitive problem. Regulatory agencies, on the other hand, are better suited to rulemaking and operational oversight because of their consultative mode of operation. The AAI Working Group suggests, therefore, that a closer look at the circumstances under which antitrust can play a stronger role in regulated industries should receive high priority.

Accounting for Regulatory Systems and Antitrust Remedies

The question of how antitrust enforcement should account for regulatory systems is informed by the two major models of regulated industry organization, both of which raise unique competitive issues. One model is the competitive end-to-end network, which we see in mobile telephony. Here, one challenge is determining when there is sufficient network competition to justify deregulation of all or a substantial part of the industry. Another model is a vertically integrated monopolist that faces some competition in

complementary markets, as in electricity and telecommunications. This model presents ongoing issues relating to settling disputes over access.

As complementary markets become more competitive as a result of access and other reforms, regulation should ideally play a lesser but positive role, as long as there are network monopolists in the market. Complementary markets should be subject to lighter handed regulation or left entirely to competition, with antitrust enforcement as the primary means of deterring and remedying anticompetitive conduct. The AAI Working Group suggests, therefore, that a useful antitrust-regulation paradigm for transitioning industries is rooted in the advantage of antitrust in preserving competition within already competitive market structures, and the advantage of regulation in moving markets from imperfectly competitive to more competitive structures.

The AAI Working Group also believes that remedies should be crafted and implemented in restructuring industries so as to take advantage of the relative strengths of regulation and antitrust. Regulatory policy in the U.S. is largely focused on conduct-based approaches to the access problem. This includes developing interconnection standards and the terms of access, and ongoing oversight and monitoring of market functions. The regulatory "surveillance" function makes regulators well-suited to fine-tuning access regimes to accommodate changing technology and market conditions. But involvement by regulatory agencies in administering access regimes poses numerous challenges, such as dealing with rent-seeking, strategic behavior, and imperfect

information. All of this means that regulatory conduct-based remedies should probably not be the first line of defense on remedying the exercise of market power.

In contrast, structural remedies are favored by antitrust enforcement. Divestiture or network expansion, for example, can reduce market concentration, making access less problematic. Remedies are generally a one-time fix for a competitive problem, for which compliance is immediate and permanent. Much like regulatory remedies, the application of antitrust remedies is also not trouble-free. Divestiture requires determining the type and quantity of assets that should be divested, to whom the assets should be sold, and how long the network owner must stay out of complementary markets. And in some cases, the efficiencies achieved through vertical integration will militate against the use of divestiture.

Given the complex technical issues that arise in transitioning industries—particularly as they pertain to remedies—the AAI Working Group recommends that increased collaboration between regulators and antitrust enforcers be given high priority. Such coordination can make use of the superior institutional and technical knowledge possessed by regulatory agencies, inform the factual basis and economic reasoning behind an antitrust violation, and ultimately create a wider range of available solutions to competitive problems.[3] On the other hand, implementation of inconsistent remedies by regulatory and antitrust agencies can be costly and inefficient.

[3] For example, technological developments and economies provide powerful incentives for network owners to re-integrate after divestiture, creating a need for continuing oversight by the relevant regulator.

The AAI Working Group thus suggests that procedures for promoting coordination between courts and agencies be studied, as should methods for encouraging and formalizing interagency dialogue so as to enable agencies to take advantage of the other's expertise. One possibility is the study of a compulsory joinder rule. This rule would require that the regulatory agency be made an indispensable party to a federal antitrust proceeding that relates to market conditions or anticompetitive conduct covered by a regulatory rule. Application of the joinder rule could be based on factors that indicate that antitrust and regulation (if both were applied) would be mutually reinforcing in that particular case. These factors are discussed in the next section. Such a rule would promote coordination and focus regulators on market conditions to encourage pro-competitive exercise of regulatory authority.

Standards for Determining Extent to Which Antitrust Laws Apply to Regulated Industries

There are two instances in which the courts have nullified antitrust enforcement in a regulated industry, even though the regulatory structure contains no specific antitrust exemption. The first is implied immunity, in which regulation "implies" that firms are beyond the reach of the antitrust laws. The second instance in which the courts have nullified antitrust enforcement is a factual presumption (e.g., the filed rate doctrine and *Concord*) which undermines the finding of an antitrust violation.

The AAI Working Group believes that the "harmonization" of the various doctrines under which antitrust laws are precluded in a regulated industry context should be a policy imperative. For example, many doctrines serve essentially the same purpose

and, arguably, plaintiffs should not have to face repetitive and multiple defenses based on similar legal arguments and economic reasoning. Moreover, harmonization is important given the increasing need for antitrust enforcement in transitioning industries. For example, regulators rely heavily on competition to maintain "just and reasonable" rates, markets have special rules and procedures for transitioning to competition, and pro-competitive rules enlarge the potential range of anticompetitive behaviors.

A harmonization approach is essentially a test to determine when regulatory preclusion of antitrust enforcement is appropriate because of a specific feature of the regulatory scheme. This determination is based largely on whether antitrust enforcement and regulatory systems can be reasonably viewed as complements, rather than substitutes.[4] Such an analysis is informed by factors that reflect ways in which regulation and antitrust share common goals and would be mutually reinforcing ("affinity" factors). But the analysis is also based on factors that might argue against the application of antitrust enforcement because of inconsistent goals, mandates, incentives, or policies ("repugnancy" factors).

"Affinity" factors include, among others, findings that regulation serves a pro-competitive policy goal and that the rules and culture of the regulatory agency are important for understanding anticompetitive conduct and market conditions. "Repugnancy" factors would include, among others, active and effective regulatory

[4] In legislation in which Congress has included an antitrust-specific savings clause, the AAI Working Group believes that antitrust should be conclusively regarded as a complement to the regulatory scheme.

supervision of the specific challenged conduct or foreswearing of competition by the regulator or enforcement of a competitive mandate.

The AAI Working Group suggests that suspending antitrust in a regulatory context should be limited to a conduct-specific exemption. Moreover, this exemption would be justified only because active regulatory supervision (pursuant to a specific rule) makes it unlikely that a defendant can prove that the challenged conduct occurred, or renders the effect of the anticompetitive conduct improbable. Under this proposed test, for example, a defendant raising a filed rate doctrine defense must be able to show that the regulatory agency approved the rates in question or exercised close and continuing supervision of the rate regime. Moreover, the agency must be shown to have the enforcement and remedial authority to detect, deter, and remedy anticompetitive behavior.

Allocation of Merger Review Authority Between Antitrust and Regulatory Agencies

The AAI Working Group suggests that in general, antitrust should play a stronger role in merger review in regulated industries. A starting point for this discussion is examining how merger review differs across regulated industries. Regulatory agencies have exclusive enforcement authority (e.g., railroads); major enforcement authority with the antitrust agency a party to the proceeding (e.g., airlines); dual review authority along with an antitrust agency (e.g., electricity and telecommunications); or no statutory or "effective" enforcement authority (e.g., natural gas pipelines). Given that these differences are not always rational and the complications they sometime creates, the AAI

Working Group recommends that merger review be made more consistent across regulated industries.

The debate over allocation of merger review authority between regulatory and antitrust agencies should be driven by a number of objectives. One is that merger review should be insulated from special interest capture of regulatory agencies. A second is that merger analysis should have a high level of quality and transparency, which enhances the ability of practitioners to predict whether a proposed deal will be deemed to violate the law and makes it easier for outside observers to evaluate merger policy or particular mergers. Third, merger analysis should be part of broader competition policy that is relatively free of political pressure and regulatory policy goals, which can create a bias toward mergers. Fourth, the staff and decision-makers should have adequate technical and industry-specific expertise available so that decisions will reflect industry realities. Finally, remedies should not create excessive costs for the merging parties as a result of dual enforcement.

One implication of the foregoing is that regulatory agencies should play a role in merger review, but their function should be limited to the analysis of non-competitive issues while the antitrust agency evaluates the effect of the merger on competition. The AAI Working Group thus suggests that the lead role for merger review be given to antitrust authorities rather than regulators. One way to handle this separation of functions is for the antitrust agency to submit a competitive analysis to the regulatory agency, which would weigh its outcome against other factors in its public interest determination.

Alternatively, the competitive effects analysis performed by the antitrust agency would be incorporated into the regulatory agency's decision without any balancing in the public interest scale. This approach recognizes that the expertise needed to address complex technical and institutional issues in regulated industries resides primarily in the regulatory agencies. Increased collaboration or detailing of legal-economic personnel from the regulatory agency would promote the sharing of such expertise.

Respectfully submitted,

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