

Fabrizio Cafaggi
Columbia Law school/IUE
Firenze

New regulatory modes in Europe
Proposals for reform
Penn November 30th 2006

Structure of the presentation

- The growing role of private regulators in the EU
- A taxonomy of private regulation
- Different models of relationships between regulators, regulated and third parties. The organisation of the regulatory space
- Accountability of private regulators
 - 1) Market accountability
 - 2) Liability
 - 3) Conflicts of interest
- Policy implications at EU level

Aims and limits of the paper

- The presence of private regulators who have different functions is a reality of many regulated markets. The transfer of regulatory power from public to private has not entailed sufficient accountability mechanisms. The advantages of using private regulation may be undermined by a lack of accountability.
- This paper does not deal with the question of the desirability of private regulation. It starts from the existing reality, i.e the presence of private regulators in some regulated sectors, and asks the following question: what is the best institutional design at EU level given the current situation?
- I share the view that sector specificity significantly affects the preconditions for regulatory competition and the operational modes of regulatory competition. (Van den Bergh, 2000, Kerber and Budzinski 2003) However the analysis does not address a specific regulatory field. Many examples draw on financial markets, professional services and technical standardisation

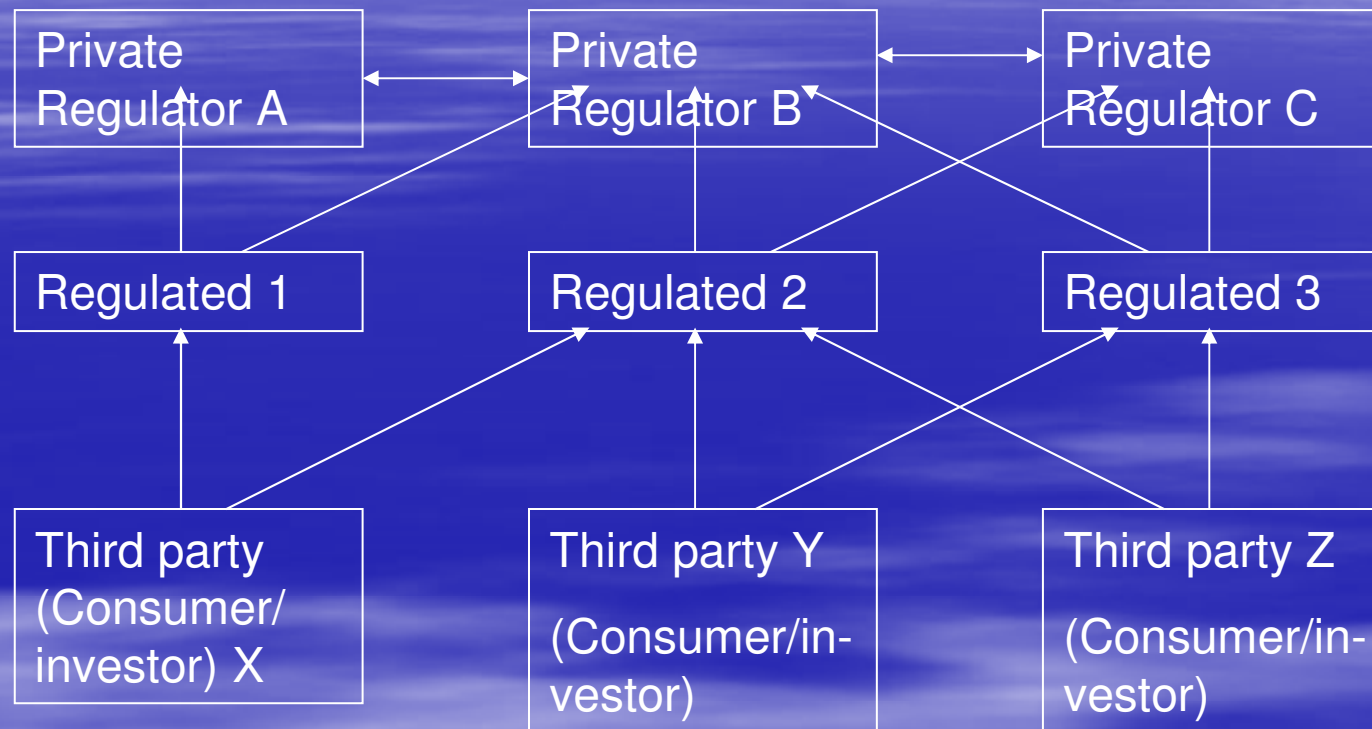
Current examples of multiple private regulators at the international, EU and MS levels

- Stock exchanges (Milano SE, Euronext, London SE)
- Professional organizations (European and national lawyers associations, national lawyers' associations)
- Private advertising authorities (EASA)
- Standardization bodies (ISO, CEN, Cenelec, ETSI)

A taxonomy of private regulation

- Pure private regulation (independent from public regulators)
- Delegated SR (see for example art. 48.2 and 50 directive EC 2004/39 on markets of financial instruments)
- Co-regulation (see for example art. 50 directive on markets of financial instruments, see also dir. EC 2005/29 on unfair trade practices act).
- The growing phenomenon of private regulation mainly concerns hybrids (public-private interaction).

The regulatory space



Lack of accountability

- A) Irrelevance of the choice between monopoly and plurality of private regulators.
- B) Private regulators have enjoyed de facto immunity for liability towards regulated and third parties.
- C) Conflicts of interest regime is designed for productive not for regulatory models

Potential responses

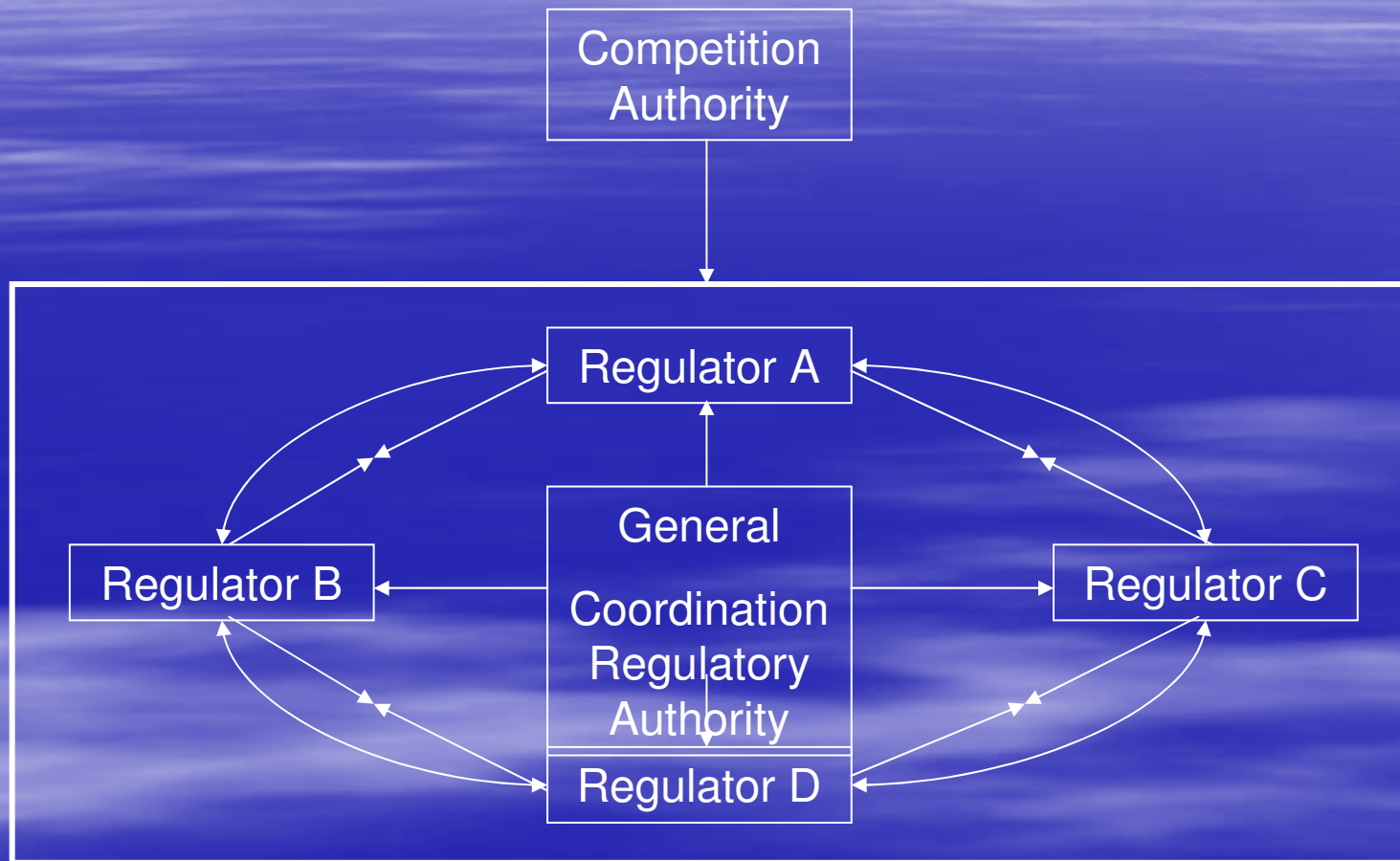
- Different accountability mechanisms for private regulators: market, liability, judicial review, governance, participatory rights
- Distinguishing between pure self-regulation, delegated self-regulation and co-regulation

Market accountability

- How to ensure market accountability?
- To promote a plurality of private regulators across Europe
- To ensure competition among them
- To regulate more strictly private regulatory monopoly

Regulated SR competition and cooperation

A hypothetical scheme for EU



Different contractual models to implement the regulatory scheme

- A franchise model of private regulators
- One network model that enables the different private regulators to coordinate themselves and with the Commission can be a franchising.
- The Commission will provide the general guidelines and the individual regulators will implement them through their own regulatory models
- An alternative model, mirroring the current network of IRAS, is the associational model
- Compare the two models

Liability of private regulators

- The efficacy of a liability strategy for accountability purposes.
- Deterrence and compensation
- Adequacy of remedies
- Liability for what ? Four hypotheses
- Liability towards whom? Regulated and third parties

The liability of private regulators

- Four different hypotheses concerning liability
- Failure to regulate
- Defective regulation
- Failure to supervise
- Defective supervision

Liability towards regulatees and towards third parties

- The nature of a liability system toward regulatees and toward third parties
- The main difference is the combination of accountability mechanisms available for members and for third parties
- Members have voice and can affect the governance of the regulatory body
- Third parties generally have limited participatory rights. Liability may be the only, or the most effective, device

The limits of the liability strategy

- The main weakness is remedies
- Often the main goal pursued by regulated and third parties is to have effective regulation or supervision or to correct the mistakes that have been made
- Specific performance type of remedies are much more effective than damages, but they are not associated with liability regimes

Additional accountability mechanisms

- Judicial review
- Governance
- Participatory rights

Concluding remarks

- The presence of private regulators is an important phenomenon at the EU and international level
- There are different relationships amongst private regulators and between private regulators and public regulators
- In certain markets, such as the financial market, there is a relatively high level of competition among private regulators. In other markets, this level is low or non-existent, as in the area of professional services and technical standards. Starting points are very different and competition law devices should differ as well. When there are several private regulators, mergers regulation best controls the level of concentration. When there is only one regulator, prohibiting abuse of its dominant position is the main instrument of legal control
- A uniform strategy at EU level concerning self-regulatory competition is not appropriate given sector specificity and departing points; comparative analysis shows that in many cases an appropriate combination of competition and cooperation among private regulators may enhance efficiency and effectiveness of regulation

Concluding remarks

- Competition is needed to provide private regulators incentives to regulate efficiently. Competition fosters a process of mutual learning if correctly engineered
- Competition law may ensure that the competitive process is operating and may enhance the welfare of the final beneficiaries of the regulatory process
- Pure self-regulatory competition solely controlled by competition law may be insufficient to provide the optimal level of coordination and to define adequate governance arrangements
- Regulation is needed to define framework rules concerning all the private regulators and their coordination
- Coordination through framework rules is needed to promote positive network externalities and to avoid negative regulatory externalities (i.e each regulator defines standards aimed at externalising costs towards different regulatory jurisdictions).

Concluding remarks

- Regulated competition of private regulators constitutes only a partial response to the need for accountability of private regulators
- Liability of private regulators is a necessary, yet insufficient, condition to improve accountability . MS differ quite significantly in warranting a liability regime. Some uniform principles would be useful, leaving MS wide power for detailed rules
- Liability can have only a limited impact. Remedies available under a liability regime are compensatory but do not redress inaction for which injunctive relief would be more appropriate
- Judicial review should complement liability for private regulators, allowing judges to contrast inaction and to order modifications of regulatory acts
- In addition governance models should be reformed. The law of private organizations such as corporations, foundations, and associations, should be revised accordingly. Many governance models in the field of co-regulation reflect this function (the example of modifications in corporate law to suit the regulatory function of stock exchanges)
- Finally, participatory rights may be granted to external constituencies that should have a right to be consulted in matters relevant for the rights or for the collective interests they represent

Concluding remarks

- Regulation is needed to define governance arrangements that allow preferences of final beneficiaries to be expressed. This result combines efficiency and legitimacy goals associated with the use of private regulators
- A multilevel system such as the European Union needs a framework set of principles to define the threshold to use private regulation as a complementary strategy to public regulation
- This threshold should grant accountability of private regulators and leave MS free to choose internal variables such as the different combination of accountability devices and their effectiveness according to the principle of institutional autonomy
- These principles should be defined in a soft law document at the European level, then specified in legislative Acts sector by sector and implemented by MS according to the specific institutional framework