

# Legal aspects of regulation in South Asia

(Proceedings of the SAFIR workshop held from  
3 to 4 August 2002 in Dhaka, Bangladesh)

Editors

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## Foreword

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Regulatory institutions in the infrastructure sectors are unique: these are neither administrative nor judicial bodies, although their duties are carved out from the functional framework for policy-makers, service providers, and the judiciary. In the early stages of liberalization in the infrastructure sectors, particularly in developing countries, regulators experience lack of information as well as asymmetry in the negotiating strengths of the operators. These make the regulation process complex as the regulator's objective is to maintain a level playing field, mainly, in terms of access to scarce resources, and access to consumers and existing infrastructure.

While regulators are independent, they must be accountable for their decisions. Thus, regulatory decisions are subject to appeal. Often, due to delay in traditional judicial process, some vested interests use the normal appeal and review process to delay implementation of regulatory decisions. It is, therefore, necessary to ensure that adjudication is not misused to promote such interests. Obviously, there is a need for more accommodative dispute resolution framework to facilitate quick decisions in the infrastructure sector, where timely implementation of the regulatory decisions and long-term relationships amongst players are important.

In this regard, ADR (alternative dispute resolution) approaches such as mediation, conciliation and arbitration, play an important role. Certainly, ADRs will not replace the judicial process, but will supplement it by narrowing down the range of disputes. While ADR mechanisms have their basis in contracts, the judicial institutions have a constitutional basis. Further, while a judicial appeal is possible even if one of the parties approaches the court and also in absence of any contract or agreement, the ADRs are applicable where both the parties have agreed to the procedure. The effectiveness of ADRs and the areas of their applicability in business dealings are now well recognized. However, the efficacy of the mechanism, particularly in developing countries, needs to be tested in different circumstances. How can the process be made really effective? What roles can the regulator and judiciary play? Should there be a compulsory time-bound ADR process before the appeal to courts? These are some of the issues that would require debate and discussion.

Given this background, SAFIR (South Asia Forum for Infrastructure Regulation), constituted in 1999, felt a need to bring in important stakeholders – namely, regulators and judicial authorities – by organizing a workshop in Dhaka on 3–4 August 2002 to discuss various legal aspects of regulation in South Asia. In particular, the workshop aimed at understanding various legal aspects of regulation by examining alternative regulatory processes, and relevance of alternate disputes resolution mechanism in infrastructure regulation, and understanding viewpoints of regulators and judiciaries on independent regulation by critically understanding their roles and responsibilities.

The publication of the workshop proceedings is expected to assist capacity building in the region and would assist various stakeholders, including regulators, policy-makers, and judicial functionaries, to take further action for making independent regulation in the infrastructure sector a smooth process. We expect that the book will be useful to all those associated with infrastructure sectors in South Asia.

I hope the book will meet expectations.



M S Verma  
Chairman of SAFIR and  
Chairman, TRAI, New Delhi



## Preface

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The proceedings of the SAFIR Workshop on Legal Aspects of Regulation in South Asia, which are published in this volume, represent a major step forward in creating and disseminating knowledge on a subject that would be of critical importance to the South Asian region. Several sectors of the economy in South Asian countries are undergoing major reforms, and particularly in those sectors where pricing and related decisions would now lie in the hands of independent regulatory bodies. Therefore, there is a need to define and comprehend the role of different actors involved in the process. Essentially, these actors would include the regulatory bodies themselves, decision-makers in the sectors that are to be regulated, the public at large, and, of course, the judiciary.

Independent regulation in most countries of South Asia is being initiated on the foundations of legislation bringing into existence regulatory bodies and processes, which have clearly resulted in changes in the legal framework under which these sectors have performed in the past. It is, therefore, necessary now to understand the laws and the limits related to the functioning of these sectors within a regime of independent regulation. Since this is an area of equal concern to every country in the region, and since experience on decisions within the revised framework is evolving in every country in the region, there are great benefits in sharing experiences and knowledge as it is generated. The workshop in Dhaka was, therefore, a landmark event in the South Asian region, and given the high level of participation from the judiciary and other relevant sectors, the material presented and discussed provides considerable addition of substance to existing knowledge and experience in the field.

It would be useful to say a few words about SAFIR which has evolved as a unique body of expertise and understanding in the field of independent regulation, linking the countries of South Asia in a mutually productive relationship. The workshop in Dhaka was an extremely useful event in a series that has been organized during the past three years under the guidance and direction of a group of decision-makers drawn from various countries of this region who are responsible for the overall functioning of SAFIR. I am sure the proceedings of the Dhaka workshop included in this volume would be of great interest not only

to professionals from the South Asian region, but also to potential investors from other countries who are looking at opportunities in South Asia. This material would also be of value to other developing countries which are in the process of bringing about changes in their economic structure with accent on independent regulation.



R K Pachauri  
Director-General, TERI

## Acknowledgements

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SAFIR (South Asia Forum for Infrastructure Regulation) expresses thanks to all the authors who have contributed to this publication, and gratefully acknowledges the help, support, and guidance that it received from various sources in publishing this book. Special mention must be made of the guidance and support provided by Mr Clive Harris, Private Sector Advisory Services, the World Bank, Washington, D C, Mr M S Verma, Chairman, Telecom Regulatory Authority of India; and Dr Leena Srivastava, Director, Regulatory and Governance Division, TERI. SAFIR also acknowledges the support received from PPIAF (Public–Private Infrastructure Advisory Facility), a multi-donor technical assistance facility aimed at helping developing countries improve the quality of their infrastructure through private sector development (for details see the web site at [www.ppiaf.org](http://www.ppiaf.org)), in publication of this book.

The Publications Unit at TERI has been responsible for the production and publication of this book: Mr Sagar Singh for copy editing; Mr R K Joshi for cover design; Mr R Ajith Kumar for typesetting; Mr T Radhakrishnan for supervising the production; Mr P K Jayanthan for indexing; and Mr K P Eashwar for managing the publication of this book. We would like to thank Ms K Radhika for technical assistance.



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## Inaugural session

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Welcome address

M S Verma

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Opening remarks

Apurva Sanghi

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Special address

Syed Marghub Morshed

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Inaugural address

Barrister Aminul Haque

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Vote of thanks

S K Sarkar



# Welcome address

M S Verma

Chairman, Telecom Regulatory Authority of India and  
Chairman, SAFIR (South Asia Forum for Infrastructure Regulation)

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I consider it a very special honour for SAFIR, TERI, and BTRC (Bangladesh Telecommunication Regulatory Commission) that we have the opportunity of organizing this workshop in Dhaka. I extend to you, on behalf of SAFIR, TERI, and BTRC, a very hearty welcome. I thank the Hon'ble Minister for Post and Telecommunications, Barrister Aminul Haque, for sparing time, despite his very busy schedule, and agreeing to be with us.

In the last half a decade, we have all experienced the emergence and growth of regulatory institutions in the region. These institutions have their duties and powers carved out from the functional framework of policy making, provision of services, and adjudication, giving it a unique character. The objective behind providing sector-specific regulators with a unique mix of power is to institutionalize the independent management of the sector, keeping in view the policy objectives and judicial guidelines of the established constitutional authorities. The process of defining the powers and its exercise, thereafter, has itself undergone an evolution in this short span.

In the early stages of infrastructure liberalization, our main task revolves around the management of legacy, as the asymmetry in negotiating strength and information availability is immense. In such circumstances, a long-drawn plan of sustainable liberalization, effective competition, and consumer interest protection forms the background of regulatory decision making. At times, it even calls for asymmetric regulation to ensure a level playing field—mainly, in terms of access to scarce resources, existing consumers and existing infrastructure, which have traditionally been the privy of incumbents, are an absolute must for any competition to come about. In the course of managing these sectors, which are in such a dynamic phase, circumstances warrant quick decision making, often calling for a regulator's judgement in absence of sufficient information. I am sure such regulatory judgements, based on long-drawn history and quick estimates, will continue for some time because of the changing requirements and the enormity of the information gathering task.

However, the judicial basis for examining the appeals, which is objective, does not always take into account these aspects. Further, the procedural time in getting a decision is used as a pretext by vested interests to delay implementation of regulatory decisions. This is especially so in the network infrastructure sectors such as telecom, where maintenance of the status quo and/or gaining any time before the inevitable change, means temporary advantage for some of the players. While there can be no dispute as regards the requirement of an appeal process – as independence and accountability have to go hand in hand – it is necessary to ensure that adjudication is not misused to foster such interests. Even in situations where the dispute is amongst equals, the adversarial approach of the whole process leaves little room for an amicable solution, as, mostly, the outcome of these proceedings results in a ‘winner’ and a ‘loser’.

In the infrastructure sector, where long-term relationships amongst players and timely implementation of the regulatory decision is critical, there is a need for a more accommodative dispute resolution framework that would facilitate these kind of quick decisions. What are the possible options? Two approaches that come to my mind are

- 1 providing specialized judicial courts for the specific requirements of the sector, such as TDSAT in India, and/or by having a time-limit for addressing the appeals as in the case of Appeals against decisions of the Pakistan Telecommunication Authority in Pakistan;
- 2 narrowing the range of disputes by adopting ‘alternative dispute resolution’ mechanisms.

While the first approach addresses one part of the problem, it still carries the adversarial attitude towards redressal. Also, it entails a public process where a decision not in favour could have damages beyond the extant case.

There is now a growing trend to adopt the second approach—at least, as the first line of dispute resolution, if not the final. ADR (alternative dispute resolution) approaches such as mediation, conciliation, and arbitration are now established procedures that one can adopt, depending on the requirement of it being preventive, collaborative, facilitating, fact-finding or mandatory. Alternatively, new approaches, tailored to meet sector-specific requirements, are being evolved and practised by regulatory institutions.

Amongst established approaches, mediation and conciliation are non-binding, and are applied to reconcile differences and bring about clarity, while arbitration is a formal dispute resolution process that is binding. International institutions such as UNCITRAL have well laid legal norms applicable to ADRs. Most countries have an institutionalized arbitration process established through a Commercial Arbitration



Act and Rules. An example of the growing popularity of ADRs is the interconnection agreements in India. These agreements have an arbitration clause, where disputes or differences not solved through mutual negotiations shall be referred to arbitration by three arbitrators—one to be appointed by each party; the two arbitrators so appointed would nominate a third arbitrator. Codified negotiation processes generally precede such arbitration and the awards are binding. In USA, Telecommunications Act of 1996 has provisions related to ADRs, wherein it provides for the state commission to act as the mediator or arbitrator under circumstances where negotiations to seek interconnection fails.

Some of the new approaches that regulators are practising as a means of ADR are mutual/guided negotiations and two-stage decision making. In the first approach, a time frame is provided for arriving at a mutual agreement, failing which the regulator takes the decision. Alternatively, some countries also publish guidelines/regulations on key issues, which guides the negotiation process. A variation of this is a two-stage decision-making for resolving disputes. The first stage is to form an ADR committee (conducted by consultants and staff members) that submits its recommendations to the authority, which then takes the final decision. These approaches have been effectively used to resolve interconnection disputes in India and Sri Lanka.

While arbitration procedures are more effective for business and commercial transactions, the preferred approach for consumer disputes is an ombudsman mechanism. They are privately funded organizations having established procedures. In the telecom sector such an ombudsman mechanism is already working effectively in Australia. In Europe, a well-developed ombudsman mechanism for financial sectors in line with commission recommendation 98/257 is in place. These schemes are generally voluntary, privately funded and have a financial limit for the decision. While the decision of the ombudsman is binding on the bank/insurance company in Europe, the individuals have a further right of appeal in a court.

India, too, has an ombudsman working effectively in the financial sector. In countries in which market forces are more active, self-regulatory codes for dispute resolution are being formed. These self-regulatory codes further lessen the pressure on the adjudicatory process.

At this stage, I would like to clarify that the role of ADRs is not to replace the judicial processes, but to supplement it by narrowing down the range of disputes to those where no other alternatives exist. The importance of the judiciary can be well appreciated on the very basis that the two streams rely on. While ADR mechanisms have their basis in contracts, the judicial institutions have a constitutional basis. Further, ADRs are applicable where both the parties have agreed to a procedure,

whereas a judicial appeal is possible even if one party approaches the court/in the absence of any contract or agreement.

The effectiveness of ADRs and the areas of its applicability in business dealings is now well recognised, however, the efficacy of the mechanism needs to be tested in circumstances where the dispute is amongst unequals. Light-handed approaches such as mediation are likely to yield little. A mediation process started by TRAI to effect an interconnection agreement took two years and, in the end, required determination on two key issues. How do we make the process effective? What roles can the regulator and the judiciary play? Should there be a compulsory time-bound ADR process before the appeal to courts? These are some of the issues that we will be discussing in the next two days.

I believe we can pro-actively involve ourselves in guiding the process, setting up procedures and establishing institutions. In the US, the FCC has released the *Arbitration Procedures Order*, which delegated authority to the Chief, Common Carrier Bureau, to serve as the Arbitrator in Section 252(e)(5) arbitration proceedings, with the assistance of the staff of the Common Carrier and Enforcement Bureaus. Should we evolve such an approach? What are the essential legal aspects of these quasi-judicial bodies such as regulators should keep in mind while establishing procedures?

In this seminar, we have the unique opportunity to share our viewpoints with luminaries in the judicial field and obtain their perspective on establishing ADR mechanisms in infrastructure sector. I am confident that solutions will emerge. Solutions that can strike a balance between the two forms of dispute resolution, both effective in their own sphere.

In the end, I conclude by welcoming all the participants and leaving my thoughts open for review.

# Opening remarks

Apurva Sanghi

Regional Program Officer, East & South Asia,  
Public-Private Infrastructure Advisory Facility (PPIAF), Singapore

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The PPIAF (Public-Private Infrastructure Advisory Facility) is a global multi-donor facility. It was established around three years ago with the aim of helping developing countries improve the quality of infrastructure through private sector involvement. Given the importance and need for infrastructure reform in eastern and South Asia, its regional headquarters was recently established in Singapore. Let me give you an idea of the commitment we have to the region. Out of 50 million dollars worth of grants we have provided worldwide, over 15 million dollars – 30% of them – are in the eastern South Asia region. PPIAF was formed with the recognition that infrastructure was the key to poverty alleviation. On that basis, we support infrastructure in developing countries and strengthen the enabling environment. By enabling environment, I mean a facilitating framework of rules, policies, or institutions provided by the government. That leads to a conducive environment for sustainable private sector involvement.

The crucial part of a strong and enabling environment is the establishment of a credible economic regulator. Now why is regulation *per se* not new? The recent global fraternity dealing with privatization has pushed the regulatory issues to the forefront. In that context, PPIAF is indeed very proud to play a formative role in establishment of SAFIR. We believe that SAFIR is building a much-needed niche in the region by providing a forum for exchanges between regulators, to establish regulators across countries and across different infrastructure sectors. For the emerging success of SAFIR, a lot of credit goes to its steering committee, participating members, and administrative core partner, TERI. We have also established a similar concept very recently in Africa, named the African Forum for Utility Regulation.

There are many topics and issues in the field of regulation. I would like to touch upon one issue in particular, which is the life of the independent regulator. That is, regulatory legitimacy. And here legitimacy is understood to cover recognition of regulators and their independence, accountability as well as their authority. It is our belief that regulators should establish their credibility and legitimacy as quickly and openly as possible. But this is very crucial when it comes to establishment

of authority. The regulators exercise some form of judicial powers but they are not subject to the general judicial system. And unlike the judicial authorities, which deal with two, regulators have to deal with multiple stakeholders at any given time, ranging from politicians and trade unions to private operators and consumers.

Because regulators exercise discretion and because they are not superhuman, they may make mistakes. There is clearly a need for a dispute resolution mechanism to be in place. And this is where the regulatory–judiciary interface becomes so important. What is the appropriate role that the judiciary plays in case of legal appeals, for instance? Should the judiciary confine itself to procedural aspects of an appeal or development of substantive matters as well? Given the technical complexities of infrastructure regulation, should there be specialized appellate tribunals? How should non-legal appeals against a regulator be handled? How can there be alternative dispute resolution mechanisms? Well, I submit that there are no uniform answers to these questions and to a large extent for any particular country, resolution is entirely dependent on the expertise and experience of the regulators, as well as their legal and administrative credentials. So it is in this context that PPIAF hopes to see a fruitful exchange between regulators, members of the judiciary, and other stakeholders gathered here.

In closing I would like to once again voice PPIAF’s continued support to such interesting and important workshops and capacity building initiatives in the South Asia region.

# Special address

Syed Marghub Morshed

Chairman, Bangladesh Telecommunication Regulatory Commission, Dhaka, Bangladesh

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On behalf of the BTRC (Bangladesh Telecommunication Regulatory Commission), it is my privilege to welcome you all to the inaugural session of the workshop on the legal aspects of regulation, organized by the SAFIR (South Asia Forum for Infrastructure Regulation), in conjunction with BTRC. It is a pleasure to find in our midst legal luminaries and eminent authorities on infrastructure regulation from various countries of the South Asian region and other parts of the world. We in the BTRC are grateful to SAFIR for selecting the historic city of Dhaka, the capital of Bangladesh, as the venue of this extremely important workshop. The theme of this workshop is of great relevance to people dealing with legal issues that have a bearing on the development of infrastructure, in this complex world of today.

We are at the beginning of a new era, a new millennium. The last few decades of the preceding century witnessed spectacular advances in the field of information and telecommunication technologies. The world of the 21st century is shrinking rapidly. It is getting smaller, as we move on, by the progress of technology. Distances are reduced, every day, as a result of some technological development. Today's world has become what Marshall McLuhan called 'the global village'. In this ever-changing world that we live in, the role of the regulator is indeed difficult, at times even baffling. The intervention of the regulator, in the interest of the public, is often misunderstood both by governments and ordinary citizens. While the former tend to, in nearly all countries, expect the regulators to play a minimalist role, the expectations of the latter on the regulator's part in alleviating problems is, often, impossibly high. The role of the regulator is something that is specific and therefore limited. It is something that will gradually evolve with the passage of time. Regulators, even of the most pro-active variety, have to recognize the limits of the part they are to play and have to act with caution. They must not allow themselves to rush in where angels fear to tread. There is something fundamentally, intrinsically, inefficient about regulation. It is said that the market is the most effective regulator of quality and price. Some of us would like to see the State wither away and the world to become a single integrated self-regulated

market. In this situation, along with the State and the government, the regulator will become redundant. However, as the State is unlikely to disappear in the immediate or foreseeable future, governments, courts, the police, and the regulator, will have to exist along with the State. Within the State, regulators will have to satisfy the wishes of the people who have a stake in their specific area of work and to reconcile these with those of the government that created them.

The BTRC is the first regulatory body of its kind in Bangladesh. It was created early this year to facilitate development and ensure fair practice in the country's telecom sector. It is the newest member of the club of regulators in South Asia. It has a great deal to learn from scenarios from different countries of South Asia, in approximating its avowed objectives. It has to encourage development and resolve disputes in the country's telecom sector in a positive and prompt manner (in the field of telecommunications, speed is of the essence). The experience of regulators from other parts of South Asia will help the BTRC to work towards these objectives.

In the sessions of the workshop that will begin, once the inaugural formalities are over, the delegates will, I am sure, discuss the different legal aspects of regulation in the South Asian region in depth. I expect these sessions to be lively, in which alternative regulatory practice and alternative dispute resolution will be discussed. They will, I expect, be interesting as well as useful. During these sessions the participants, I hope, will come up with a set of programmatic, innovative, and implementable recommendations that will have an important bearing on regulatory policies in South Asia.

# Inaugural address

Barrister Aminul Haque

Hon'ble Minister for Post and Telecommunications,  
Government of the People's Republic of Bangladesh, Dhaka

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It is a proud privilege for me to be amidst highly distinguished personalities of South Asian countries this morning in Dhaka, participating in an important workshop on legal aspects of alternative regulatory practice. Alternative regulatory practice has emerged as a newly grown concept alongside the traditional legal system, and is being universally accepted as a mechanism for speedy resolution of dispute through non-judicial or quasi-judicial regulatory bodies. The workshop is very important in the context of present day needs and the deliberations of the workshop, I strongly believe, will pave the way for alternative regulatory practice to grow and attain sustainability in the days ahead in this part of the world.

Like other public utility services such as electricity and oil and gas, the telecom sector in Bangladesh is considered a very important sector for the country's growth, and for ensuring its competitiveness in the world. The government's telecom policy has recognized this, and the need for increasing teledensity and telereach to all by 2005 has been accepted as our goal. It has also been recognized that the sector needs revamping, since with the existing arrangement, the services are not satisfactory.

The existing institutional arrangement needed another look in our country. It was felt that competition in telecom services must be introduced, and the government must not regulate the sector, but leave it to a professional agency. It was also realized that the government would not be able to keep up with the changes due to rapid technological innovations, and, in fact, it does not have the expertise to respond to such rapid changes. A professional body, at an arm's length relationship with the government, is called for, for providing a level playing field to the new entrants, and, at the same time, to protect the consumers in the sector. The government thought that it would frame only the policy, and an independent regulator should be mandated to regulate the sector. We have brought about an exclusive legislation in 2001 showing our commitment to independent regulation, and also to demonstrate that the Bangladesh government is serious about providing a level playing field to private players within and without Bangladesh.

Keeping with the philosophy that the government should sit at the back and allow the regulator to regulate the sector, Bangladesh's Parliament delegated important government functions to the new BTRC (Bangladesh Telecommunication Regulatory Commission). It is required to issue licences to various service providers, allocate a spectrum in an optimal manner, ensure that services provided by the players are of high quality, and regulate the prices in the sector so as to promote competition. In fact, the Bangladesh Telecommunication Act, 2001 was enacted for the creation of BTRC so that it can facilitate the growth and development of telecommunication activities in a multi-operator, competitive environment, where the private sector plays a key role. In particular, the new regulator is envisaged to

- 1 Encourage the orderly development of a telecommunication system that enhances and strengthens the social and economic welfare of Bangladesh;
- 2 Ensure, in keeping with the prevalent social and economic realities of Bangladesh, access to reliable, reasonable prices and modern telecommunication and Internet services for the greatest number of people, as far as practicable;
- 3 Ensure the efficiency of the national communication system and its capability to compete in both the national and international spheres;
- 4 Prevent and abolish discrimination in providing telecommunication services, to progressively effect reliance on a competitive and market-oriented system, and in keeping with these objectives, to ensure effective control of the Commission;
- 5 Encourage introduction of new services and to create a favourable atmosphere for local and foreign investors who intend to invest in the telecommunication sector in Bangladesh.

We have seen the changes coming about in these parts of the world, through a wave that has swept other parts of the world in the 1980s. The South Asian countries have by now all embarked on reform of their infrastructure sectors; key components of this reform are the introduction of competition, privatization of existing public sector service providers, and the creation of specialized regulatory agencies.

However, economic regulation by independent bodies, separated from government departments and operating on principles of transparency and cost-reflective pricing, is relatively new in South Asia. In this, the region is following a path that many countries in Europe, Latin America, and East Asia have pursued over the last few decades.

These regulatory bodies are neither administrative bodies nor judicial authorities. In many aspects, they differ from these authorities. For instance, the normal judicial bodies deal with bipolar centric



interests, and in general, apply laws to facts. The regulatory bodies, on the other hand, are required to balance the interests of multiple groups in the overall development of the sector. Naturally, the procedure and processes that these bodies are required to follow would have to be different, and accordingly, the legislation in different countries has addressed these issues in a different manner.

Nevertheless, in many countries, these specialized bodies are also required to adjudicate the disputes among service providers and consumers. To this extent, they enjoy quasi-judicial powers, and do require enforcement powers. But the main regulatory function has to be consultative, and should not be based on pure hearing approach. For example, tariff regulation should not be framed based on adversarial approach, and that is why the role of alternative regulatory practices assumes importance. Normally, alternative regulatory instruments used for rule-making proceedings, include *inter alia*, workshops, advisory committee meetings, public hearings, and negotiated rule making, and for dispute resolution, mediation and arbitration.

Regulatory institutions have been created with a definite purpose. The purpose is to create an environment for sectoral improvement with the objectives of providing a level playing field, introducing efficiency and economy in the infrastructure sectors, and protecting consumer interests in the long run. We are aware that just creating institutions through legislation is not enough. If these institutions are to remain effective, the environment around which these institutions work has to be conducive. We need to pay our attention to this as well.

In our country, as also many other countries in the region, the judiciary is well respected and people have faith in the institution. They are able to adapt its interpretation to changes and the need of the time. In an era of a new form of governance, the concept of provisioning of infrastructure services is undergoing changes. The services are no longer free, and these can now be provided jointly and severally by the public service providers and private providers. We need to remember these, and develop judicial precedents for guidance to these new institutions. As in the case of the judiciary, where the faith of the common man is maximum in most parts of the region, we need to develop the same kind of legitimacy in these new institutions in the infrastructure sectors. Mere creation of specialized bodies does not give much legitimacy. This has to be earned through building expertise, developing simple and transparent procedures, and devising a communicating strategy with various stakeholders, including political executives. I hope the workshop will deal with some of these issues and share the experiences of other parts of the South Asia region for mutual benefit.

Last, but not the least, we are grateful to SAFIR (South Asia Forum for Infrastructure Regulation), TERI and BTRC for taking this initiative in

the region, and also the PPIAF (Public–Private Infrastructure Advisory Facility)/World Bank for sponsoring the event in such a short time. The workshop is a unique one, and gives a common platform for judicial and regulatory officials to exchange views and experiences on the subject.

## Vote of thanks

S K Sarkar

Senior Fellow, TERI, New Delhi, India

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Thank you, Honourable Minister, chief guest of this occasion, Barrister Aminul Haque, for kindly agreeing to deliver the inaugural address. We are extremely grateful to you to be with us on this occasion. The Honourable Minister has indicated and outlined the complexities of regulatory governance. We will certainly work on your advice and discuss important issues raised by you during this two-day workshop.

We are thankful to BTRC, especially its chairman, Mr Morshed, for agreeing to be our special guest, and also for his kind assistance and help extended to SAFIR and TERI for organizing this conference. We are thankful to Mr M S Verma, Chairman, SAFIR, who has taken time off to attend this session and also to giving us his advice from time to time and for making this programme a success. Our thanks also goes to Dr Sanghi who has, within a very short time, been able to activate SAFIR and TERI to organize these kind of conferences and similar activities in future.

We are extremely grateful to our foreign guests from South Asian countries who have participated in spite of their busy schedule, and joined us to deliberate at this conference. We are also grateful to participants from Bangladesh, who have come from remote places to discuss the important issues on this occasion. And we are also thankful to the other distinguished participants coming from Dhaka who have evinced a lot of interest in this session.

## Session I

### Rationale and principles of infrastructure regulation

Chairperson's remarks

M S Verma

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Rationale and principles of infrastructure regulation

S K Sarkar

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Session summary



# Chairperson's remarks

M S Verma

Chairman, Telecom Regulatory Authority of India, New Delhi, India

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Much has been said about the independence of regulators. Each one of the government's, say, now about 110, respective regulators are independent, and that independence in most cases is within boundaries. Within such boundaries, sometimes, regulators have to work, and sometimes do not help other regulators to work. This independence is, therefore, in my opinion, severely limited. The basis of independence has to be legislative, financial, and functional. Whereas legislative independence is there mostly by the kind of acts that are provided, the functional and financial independence in most cases, particularly those which SAFIR (South Asia Forum for Infrastructure Regulation) covers, are limited. For example, in India, for most regulators, including TRAI (Telecom Regulatory Authority of India), the budget is strictly with the government. So far as the functional impediments are concerned, there exist various instances; these regulators will get the staff mostly from the existing government departments, on deputation, as there is no independent cadre development for the operations and functions of most regulators. As a result, to a very large extent, right in the beginning, some kind of a regulatory capture tends to take place. If out of 30 experts, 25 are from the erstwhile operator, which is in the government sector, then, having been trained to think in a particular manner, they continue to think in that particular manner. Therefore, in my view, a certain kind of regulatory capture takes place even at the very beginning. This is something that one has to think of when talking about independent regulators. Second, one has to take into account the kind of operators, and the kind of infrastructure, and the services relating to which are required to be sold and regulated. For example, power, telecom, roads, and water each have their infrastructure with particular characteristics. The role of the incumbent and the control of the incumbent over very important features, like bottleneck facilities, standards, inter-operability in telecom, and others, are factors that come into play while the regulator is trying to take independent decisions. Unlike in telecom, in power, for example, a new power service provider can set up a power plant, or provide service either for generation and distribution, or whatever, independently of any

other partner. But in a service like communication, inter-operability is of crucial importance. Any resistance on the part of the incumbent to facilitate the inter-operability is a matter of very great concern and of considerable dispute throughout the life of regulators. Similarly, standards—there are standards of technology and service and a number of other different standards that need to be in place and introduced for simultaneous execution. So here again the incumbent has a very important contribution to make in getting these standards accepted. Now, all these need lots of effort on the part of regulators. Essentially, to my mind, regulation must ensure fair level of competition. Once we grant these, we grant everything else. For example, in a certain sub-sector in India in TRAI, we have now come to a situation where we think that we are able to introduce competition well enough. And maybe it is time for us to receive gracefully. In the field of cellular mobile telephony, for example, we have started thinking that it has been possible for the regulator to provide sufficient conditions in the market, that have led to fair and open competition. We see it in the way prices have fallen substantially and we see that the scope and coverage has grown well enough. For example, in the case of tariff, it has come down from Rs 16 per minute at a time, to less than Rs 1.6 per minute and is likely to fall even lower. So this is the kind of fall in rates that has come about. And there is such competition now that the next time tariff is due for review, we are also asking in the course of our consultation whether it is time for the regulator to come out completely in tariff setting so far as cellular mobile services are concerned. And now we are leaving the entire thing to the market and saying, 'now you manage'. The ultimate regulator, the market, we think, is now in place in so far as certain services are concerned. So the most important part that the regulator can play is to give rise to proper competition. To give rise to this condition, it is important that the regulator should be able to decide independently. And to be able to decide independently, it has to have legislative, functional, and financial independence.

# Rationale and principles of infrastructure regulation

S K Sarkar

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## Introduction

Network industry is one of those industries that are very important in the economy. For example, the output of this kind of industry, which constitutes a sizable proportion of the GDP (gross domestic product) and share of employment in the economy, is an essential input to production, and a vital input for many consumption activities. It has an impact on the productivity and growth of any country's economy, and is also essential for competitiveness not only within the country but also outside. Also, very importantly, it has an impact on poverty reduction, which we often stress on. This network industry has very generic features. For example, one can think of this industry as a vertical structure where the industry will have the production process, in the upstream, and where the network infrastructure is acting as input to provide services to the downstream customers. Thus one can bring any network industry into this format: railway, power, and telecom sectors, etc. These industries could be of many types. The first type is traditional monopoly where the same player is having activities upstream, in the infrastructure segment, and also in downstream segment. So this is the kind of traditional monopolistic structure of a network industry. Another type could be vertical integration with the competition. For example, the monopoly itself can compete in the downstream side for provision of various services to customers. Another variation in the earlier structure is that unbundling takes place, and there is vertical separation with competition with many players. There could be many variations of the basic structure in real life.

## Characteristics of network industries

There are many characteristics of network industries. Four are listed here. Some of these characteristics must be there in any kind of network. First, a network industry exhibits infrastructure characteristics. By this, we mean that investment is indivisible or lumpy. If you want to have power projects, you need huge investment of funds, and investments are made up of funds that are fixed and have few alternative



uses. Also, the investments are irreversible. The moment one makes an investment, it sinks, and the investment is stranded. It has different implications in regulating or treating this kind of investment in the economy. Second, a network industry has monopoly characteristics. By this we mean that it exhibits economies of scale and scope. The former implies that society will benefit if the same firm will carry out different activities in different segments of industries. The service providers have high fixed cost, and low marginal cost; that means with incremental production of services, the cost of such services decreases. In this industry, some parts of infrastructure exhibit classical monopoly, where a single firm can provide a service that others could not. Some of the network industries are subject to rapid technological innovation, particularly in the telecom sector, and that makes some of the natural monopoly concepts redundant in recent years. Third, this kind of network industry also exhibits oligopoly, because there are sunk costs that often lead to existence of few firms in this sector. Also, one can see the incumbency advantage, which leads to concentration in many cases. On the other hand, the incumbency has its disadvantage. For example, the inflexibility to change the strategy or old technology can be a disadvantage to incumbents as against the new entrants. Fourth, this industry has a characteristic of interconnection of prices. For example, the 'bottleneck service provider' acts monopolistically; there are implications of interconnection, and sometimes, you can come across high access charges. The incumbent always tries to see that the new players do not come into the industry. And the high charges result in bypass as one sees in the electricity sector, also resulting in duplication of resources.

There are many concerns in this type of industry. The first and foremost is productive inefficiency leading to higher cost than in a competitive atmosphere; and there is allocative inefficiency, which leads to excess costs. There are also dynamic inefficiencies, which have an adverse impact on the other producers in the economy. And, of course, distribution concerns also exist in these type of industries. It is true for the telecom sector, as codified through the universal service obligation, or for the electricity sector, where there is concern about poor consumers who are unable to pay the costs of services. These inefficiencies can be seen in varying degrees in different sectors. Take the case of the telecom sector. As is well known, the costs are very opaque and the technology is very dynamic. This makes it difficult to measure the costs of various services at micro level. Tariff is highly distorted, and the prices of international calls in many countries is very high. Further, there is regulatory scrutiny on access charges. If one talks about the electricity sector, the situation is not very encouraging either, particularly in the developing countries, where we see low prices of electricity. This leads to inadequate investment. It also

results in excess demand and outages, and poor maintenance of the system. There are thefts of electricity, over manning of utilities, and unbalanced tariff.

## Regulation

Before one talks of regulation of network industries, one must correctly define what is regulation. It is basically a set of instruments that restrict the behaviour of the players in a market or even citizens. When one talks of regulation, three types of regulation are thought of. First is economic regulation, where the market players are subjected to different kind of rules for prices, output, entry, exit, market share, etc. Second is social regulation—for example, environmental regulation may fall in this category. Third is administrative regulation, where the individuals are subject to orders through rules/procedures. Usually, when one talks of regulation, one has in mind economic regulation. The market and the players and their behavioural pattern are often talked about. If one looks at regulation, we perceive that it seeks to achieve efficiency gains for the consumers. In fact, some of the surpluses are transferred to the consumers. But there is potential conflict between incentives given to the producers and transfers effected to the consumers. In fact, regulation is often inefficient, and competitive outcome is the best optimal outcome. But the issue is—can competition be better? Competition can create an environment that results in reduction in costs, and obviously, it will have a reflection on increased profits. Under competition, innovation is not impeded but rewarded. But the issue here is: is it incompatible with public ownership? Because in most South Asian countries utilities are owned by public undertakings as well as the government. Regulating these utilities poses a different problem to the regulators.

One has to remember that if one were to develop competitive markets, there is a need to have an integrated approach that goes beyond regulatory reforms. One has to have a relevant market structure and competition. One has to have private sector participation, and also reforms in the financial structure. So, for effective delivery of regulatory reforms, one needs a combined and integrated approach. One of the issues is: how can competition be introduced? Through vertical operations or through integration with liberalized access? How do we regulate entries? How does one want sequence in restructuring, regulation, or privatization? Can regulation be static? If it is dynamic, how can it be accomplished? These are the issues that have to be addressed satisfactorily. The Centre for Policy Research in London (in 1998) discussed the intensity of regulation across different markets over time. Markets can develop in different stages. First, in most network industries, the

monopoly characteristics dominate in the initial phases, followed by monopoly plus competition and finally, probably, competition.

In Phase I of market development, where there is a natural monopoly, the intensity of regulation should be different from Phase II, where there is introduction of competition, and the monopoly stays side by side. This will also differ from Phase III, where there is competition in the particular segment and particular industry. For example, in a monopoly, one finds that the regulator is regulating price, quality, and public service obligations. But the moment one introduces competition, another kind of regulation comes in; for example, interconnection. How does one regulate entry? What could be the intensity of regulation for that entry? What should be the public service obligations of different operators comprising public and private operators? How can it be done in a fair manner? So one will find that during the initial years, there is a possibility of having more regulatory intensity in a particular sector. But as the market develops, it becomes the regulator and there is need for less intensity in regulation in the particular industry. For example, in UK, the water services fall under Phase I type regulation, electricity falls under Phase II type, while non-reserved postal services fall under Phase III type, where the regulatory intensity is lower than in Phase II. In most South Asian countries, in the telecom sector, Phase II type regulatory intensity is exhibited, whereas in electricity sector, Phase I type regulatory intensity is the only possibility during the present stage of industry development.

Although regulation of monopoly industry is nothing new, there is no unanimity on the ideal scope of the regulation. However, there are certain guiding principles. The following questions need to be answered. First, can the matter in question be decided under political considerations or by technical competence? Second, who has the best expertise to perform that function? Finally, what kind of confidence the policy-maker has on the regulatory agency? These are some of the considerations that must be borne in mind before the functional jurisdictions of any regulatory agencies are decided. But, by and large, there are certain core functions (e.g., tariff), there are recommendatory functions (licensing), and there are advisory functions (advice to government). The functional activities could vary across sectors. However, the regulation of tariff, quality of service, efficiency, productivity, protection of consumer interests, competition, and, of course, adjudication of disputes are some of the generic functions one can come across in many cases. Why does one need independent regulation? The reason is that this kind of regulation provides a level playing field for the private sector, which has to compete with the public sector or a public utility in a country. It brings the expertise required in regulation, protects consumer interests in monopolistic

situations, and reduces mitigation in the industry. Autonomy is understood in two senses. One is the maximal sense, which is seen in most parts of this region. Under this, autonomy is ensured through laid down qualification and disqualification criteria, prescribed tenure of the members in the regulatory bodies, ability to access expertise and incur expenditure, and criteria for removal. In the minimal sense, which one can see in the WTO (World Trade Organization) context, the regulatory body should be away from the regulated entities, and also should be seen as a fair and impartial body. In the South Asian context, the maximal sense is used as regards independent regulation.

If the regulator is independent, then it must be made accountable. Accountability is ensured through transparent regulatory process, through legislative scrutiny of the regulatory activities, through external checks, and also, more importantly, through appeal to independent bodies against regulatory decisions.

Can or should there be a mechanism for direct regulatory accountability to the minister? In Westminster style of accountability, ministers are responsible to Parliament for whatsoever is happening to the sector. But then the regulators in many countries are not accountable to the ministers. How can one resolve this dichotomy? If the regulators are effective, they should have powers for regulatory intervention. During adjudication, the regulators act as a quasi-judicial authority. They have the powers to pass interim and final orders. Their orders are enforceable in a court of law. And, of course, if there is a violation of the regulatory authority's order, the delinquents should be penalized. Their stature must provide for all these aspects.

When one talks of regulation, one must know the kind of benefits it can ensure. The potential benefits could be many—lower product prices, higher quality of services, innovation, improved access, improved consumer trust and confidence, avenues for better communication among stakeholders, fair returns and utility, and also just and reasonable rates to the consumers. But nothing comes without a cost. So what are the regulatory costs? First is compliance costs; the regulator regulates through orders and directions, and the regulated have to comply. Compliance costs could also be heavy, the degree of which depends on the nature of the regulation. It could have different impacts on regulated entities. Also, there are transition costs, when one is moving towards a competitive era. This has to be recognized by the regulator as well as policy-makers.

### **Conflicting regulatory objectives**

In a regulatory environment, one sees conflicting objectives. First, there are short- and long-term objectives. The infrastructure

investments stretch over a period, and are lengthy. So the investor expects incentives whereby they expect, ex-ante, a price which is higher than the costs ex-post. Only then can they have an incentive for investment in the sector, and thereby improve the quality and bring efficiency. At the same time, the normal economic principles say that ex-post optimality would require that the price has to be equal to marginal cost. If one equates price with marginal or average costs, in keeping with the short-term considerations, then one is creating a disincentive for the utility. So in what way can one balance these two objectives, is a question to be resolved by the regulators. Second, there is a conflict between efficiency and equity objectives. If one wants to improve efficiency of the utility in the sector, the price must reflect the true costs. For example, in a remote village, giving access to telecom services to the poor would result in a price that is too high to be borne by the poor. If cost-effective efficiency is encouraged, the services cannot be demanded by all, especially the poor. It is very costly to them. So one comes across the concept of public service or universal service obligations. This is an issue to be resolved by the regulators. Third is discretion versus commitment. If one introduces rules through licensing mechanisms, one will be reducing flexibility. At the same time, if one implements regulation through competition rules, one may compromise regulatory commitment. Finally, there are other conflicts: how much to rely on market forces versus reliance on regulatory intervention; what could be regulatory independence vis-à-vis regulatory accountability; what could be the certainty for investors versus the flexibility to adjust due to altered circumstances; and, of course, how much external factors will be internalized in the tariff. These are some of the potential conflicts being faced by the regulators.

### **Regulatory developments in South Asia**

Regulatory developments in the region commenced in 1991. Sri Lanka was the first country which positioned the telecom regulator in 1991. Of course, it has been made more effective over time. In 1996, the first electricity regulator was positioned in Orissa, in India, and Pakistan also constituted its regulatory commission in the telecom sector. Nepal in the telecom sector and Pakistan in the electricity sector positioned their respective regulators in 1997. In 1998, India again positioned its two central regulators in the telecom and the port sectors. In 2000 and 2002, Pakistan and Bangladesh constituted their gas and telecom regulators, respectively. In general, in all these countries, the sector was opened, and then the independent regulator was positioned.

## Challenges before independent regulation

The challenges that are being faced in regulatory governance in South Asia are many. First, to make regulatory institutions more effective, there is a need to deepen regulatory reforms. There is also a need to have sectoral restructuring and competition. Without these activities, it is very difficult to get the benefit of independent regulation. How do the new entrants perform in the new environment? If the new entrants perform badly, the effectiveness of the regulatory institutions will be perceived adversely. Second, in order to promote competition, there is a need for legislative reforms in some countries, particularly in India. The issue is how quickly this can be organized.

The third important challenge is: how does one empower the consumers? Without consumer empowerment, and without their involvement, it is very difficult to improve quality of regulations. A need for capacity building of various stakeholders is very essential. Fourth, there has to be regulatory legitimacy and the right kind of political environment. Regulators have to recognize this and take steps to achieve it. In many sectors, during the initial period of regulatory governance, there will be public outcry against change, as now, there could be increase in the prices of some services, if the regulator were to make them cost reflective. So the challenge is how, and in what manner, the political commitment to independent regulation is ensured in a given industry.

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The question of accountability was discussed in depth. There was a suggestion that in the case of India, Bangladesh, and Sri Lanka which are following the Westminster style of democracy, the regulators should be accountable to the parliamentary standing committee which is comprised of the ruling party and the party in opposition. Some argued that there is no need of direct regulatory accountability to ministers, when in most South Asian countries, the ministers would have a role to the extent of being the major shareholders of the incumbent company. If there is direct accountability to a minister, then it could constitute conflict of interest. It was recognized that the entire process of regulation and exercising the regulatory function using transparent procedure will enhance accountability. Further, accountability is enhanced through the appellate procedure. It was felt that the parliamentary steering committee and regulators should have some interaction, and it cannot be formal.

It was recognized that the regulatory mandate is not just tariff fixation, but that its mandate is much beyond all this. It behoves regulators to promote efficiency in this sector, and indeed promote growth of the sector. Whether it be telecom or electricity, overall sectoral development is essentially the responsibility of the minister. So, consultation between the regulator and the minister is necessary, and should be encouraged. The session noted that in the UK there is a practice of informal consultation between regulator and secretary of states. The content of such consultation is published. The publication of consultation ensures that the regulator is not unduly influenced or bulldozed by the minister. The minister would also be responsible for the advice that he gives to the regulator. Some also argued that healthy consultations between the regulator and the minister should take place.

It was noted that accountability to Parliament is the ultimate accountability of government. The government can remove a regulator for stated reasons following a procedure, or Parliament can abolish the regulatory mechanisms altogether and the government has powers to issue policy directives. So if the regulator, in the opinion of the government or Parliament, goes astray, they have enough instruments to deal

with that. By subjecting regulators to a process of ongoing accountability or ongoing consultation with the government or Parliament, some felt that the regulator will unnecessarily expose itself to undue interference. The ongoing accountability, it was suggested, shall be only to the judiciary. In order not to overload the already overburdened judicial system, the regulator must have very clearly stipulated regulations for transaction of business, which shall emphasize concepts of transparency, objectivity, neutrality, consultative process, or everything together so that the need for the judiciary to interfere is minimized. It was also suggested that the whole purpose of regulatory authority would be totally defeated and lost if it is accountable to somebody other than itself. After all, the composition of the regulatory authority is such that mature persons are selected. Therefore, they should not be accountable to the minister who, by the very nature of his job, is subjected to various tugs and pulls. Rather, they should be accountable to the judiciary. A judge is accountable to no one. He is accountable to the Constitution and the law. But they have no such pressure pools, which a politician would have. Now if the regulatory authority is doing anything more than probably just placing the decision before the minister, perhaps with a very peripheral interaction between the minister and the body, some argued, regulatory independence and independent thinking will be lost.

As far as accountability is concerned, the standards against which this is being judged must be clear. Also, the regulator has to be accountable in different contexts for different kinds of tasks; to Parliament or the government itself, as also to the judiciary. And the whole issue becomes, then, one of clarifying the limits of these different types of accountability which the regulator should have. For example, the policy in a sector cannot be set by the regulator. It has to be formulated by the government. Once that policy is set, how well the regulator has fulfilled that policy in general terms is not the task of the judiciary. It is the task of the government. That policy objective might include social and other policies. Then, as far as 'accountability to itself' is concerned, some felt that this is a grey area. The expertise in the regulatory body of the type which might be required in the number of areas of its functioning, may not be fully adequate to begin with. The regulator is actually balancing different objectives. These objectives may be social or may be for introducing competition or they may also be to limit anti-competitive activities, among other things. All these objectives, initially, are to be balanced. Some felt that what becomes more important is the process of decision making of the regulator rather than making the regulator accountable in the judicial sense. Also, the regulator has to be accountable only to the extent that it has the authority to perform a particular task. There are examples where people



perceive a regulator to have powers which he does not. Those powers must be very clearly specified. In the initial years, also, the regulator has to fix priorities. There are several policy areas where the regulator has to decide priority or ordering. In that context, there is a need for some kind of transparency, in terms of which issues are being addressed in what order or with what priority. Beyond that, it becomes difficult to make the regulator accountable.

It was also reiterated by some that subservience to any other authority, however eminent, is incompatible with the concept of an independent regulator. Some disagreed with the points of view that a regulator should be accountable to the minister or even the parliamentary standing committee. It was argued that the regulator should consult the ministers, MPs, and not merely MPs from the parliamentary standing committee that deals with the matter. In its areas of work, the regulator should consult media, and also consult consumers, and citizens at large. The regulator should consult civil society in the area in the country where he is working. The best regulators are those who regulate least. Even in non-infrastructure sector projects, some argued that there was need to put regulatory devices in place to deal with the problems that are not resolved through market mechanisms. The regulator's role will evolve continuously. Ultimately, regulators will be judged by people whom they are expected to serve, and by the quality of the service rendered to them.

Some further clarified that there are two levels of accountability. One is 'action accountability'—a particular action for which a regulator is accountable when it takes a decision. This decision may involve things which may have financial implications. There are implications of fulfilment of policies. There are social and other implications. Second, there is total 'performance accountability' for the whole year, whole term, or whole period. So how did the regulator perform in fulfilment of the policy? So far as 'action accountability' is concerned, the action shall have to be reviewed. In India, again the TDSAT (Telecom Dispute Settlement and Appellate Tribunal), for example, is the appellate authority for all individual decisions. If anybody is aggrieved by a particular regulatory decision based on a particular action, he or she has got a case and can make an appeal. The whole thing is reviewed, and then certain decisions are arrived at. The regulator, while taking that action, knows that there is somebody who can have a review. But for the 'total performance', how will it be understood? Can the regulator be accountable to itself? That is a very moot question, because if it is accountable to itself, there has to be a place where the regulator can go and say he is right. As a part of the government, it was felt that the minister will always have a compulsion. Therefore, to be accountable to the minister would be to negate much of the independence.

It was argued that accountability to Parliament would be a workable solution, and it can be done through the annual reports, which are already specified in some cases. These reports need to be really good. They should not be taken as routine. But if the reports are excellent, Parliament can and should pass judgement on those reports. It will be a good instrument of accountability. Besides, like the American Senate Committee, the parliamentary committee in many countries could adopt a process of hearings on the performance of regulators. In this regard, it was suggested that it could be half yearly, or quarterly, or for a short period. Twice a year, a regulator may make a representation to the parliamentary committee and get its feedback. It should be quite workable. What is important is that the regulator has the processes, and these processes should be standardized. Also, these processes should be transparent. In the US, the FCC (Federal Communication Commission) has rule-making process, and everybody knows that if a rule has to be made, that process is well structured. Similarly, if the regulators have the standard processes, the processes are also a form of accountability. Because being accountable to the process is also a standard way of being accountable.

The session also discussed the implications of emerging competitive market forces for regulation. There were some comments about the regulator pulling back as competition develops. Some felt that perfect competition is a concept in theory. In reality, the market is riddled with imperfection. Scope for manipulation of prices and/or scope for manipulation of quality is immense. In such a situation, some argued that market forces should not be preponderant. In such eventuality, there is a case for an independent regulator in perpetuity irrespective of market forces, or irrespective of the level of competition. However, depending on the nature of competition in the market, the style of regulation can vary. The regulator can pull back, and instead of doing tight-fisted regulation, he may resort to light-handed regulation. A certain degree of overseeing on a permanent basis cannot be done away with at all.

The discussion also centred on other basics such as what is regulation and why it is needed. But to understand why a regulator is needed, there is a need to go into the other areas, which is the non-infrastructure sector. It is very interesting to observe the non-infrastructure sector, where nobody really considers a regulator. The important thing about non-infrastructure industries is that they are inherently competitive in nature. And when there is competition, it does not need regulation. The standards and the tariffs are always balanced by markets. Some felt that, conceptually, if one introduces regulation of prices, and, at the same time, if the regulator is trying to bring in competition, those two activities may create anomalies. The experience of New Zealand

was quoted in this regard. In New Zealand, for a long time in the power sector, there used to be light-handed, as opposed to heavy-handed, regulation, which is being practised by a number of other countries. And light-handed regulation is basically restructuring the industry itself, and putting it out to competition. In New Zealand, there is an office called the Competition Enhancement Office, and there has been no electricity regulator or telecom regulator for a long time. The industry was unbundled. In this regard, it was debated as to whether the job of the regulator should be to unbundle the industry.

On the relationship between the regulator and the government, the Indian example was noted. The ERC (Electricity Regulatory Commission) Act 1998 (India) contains a provision that the state government has got the power to issue directions to the regulatory authorities. There are examples where the government issued some directions; for example, asking the ERC to decide tariff matters in a particular way.

It was suggested that while regulating tariff, the regulator should not ignore social factors. The regulators should not ignore the ability of many consumers to pay up. This is very important in countries such as Nepal, where most people are very poor. So in this regard, the regulator should consider the paying capacity of the consumers.

It was recognized that regulators' main job is not tariff setting. It is one of the many functions that the regulator has to perform. But what does the regulator really do? It is not for the regulator to frame policy. The national policy is and always will be framed by the government. And, therefore, in most legislations, such as the ERC Act 1998 (in India), it is very clearly said that the policy will be decided only by the government. The role of the regulator is to ensure fruition of that policy to ensure fulfilment. Regulators are like umpires, who conduct the games within the bounds of rules/policy. And in conducting the games, the regulator will have to be totally independent as an umpire is.

The session noted that there are many considerations such as availability and affordability, which the regulator should look into. Within these boundaries, regulators have to take decisions. But there is a policy part of it. The policy part is that they must increase availability of the service they are regulating. And, even within these broad outlines, the methodology should be left to the regulator. It should be able to decide which of the actions or which operators can increase affordability and availability. The test at the end of the day will be whether the regulator made it more affordable and more available. Thus, they will have to structure policies on USO (universal service obligation). In a regulatory environment, USO has a very important role to play. In this regard, without discussion or without involvement, the regulator's success is almost impossible. Therefore, for good strategic reason, this has to be done in consultation with various stakeholders.

## Session II

### Alternative regulatory practices and alternative disputes resolution

Chairperson's remarks  
Justice Top Bahadur Singh

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Alternative regulatory practices and alternative dispute resolution  
Rohan Samarajiva

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Session summary



# Chairperson's remarks

Justice Top Bahadur Singh  
Supreme Court, Kathmandu, Nepal

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Alternative dispute resolution now exists in various countries of the world. It has become very popular, as the judicial process takes so much time and people are not in a mood to wait for long. So there must be some ADR (alternative dispute resolution) programme out of court, so that the people may benefit from it.

Generally speaking, the judicial procedure is very lengthy and involves all the legal aspects of the matter. Naturally, it takes more time. Not only in civil disputes, but also in the field of infrastructure disputes, people now want speedy justice. ADR programmes have become a necessity in all infrastructure sectors.

In Nepal, we were involved in court-initiated mediation, and generally the opinion is that there must be some court-initiated but out-of-court settlement of disputes. Recently, Nepal has introduced a new Arbitration Act, with the provision for court-initiated arbitration. That means that arbitrators are appointed if either it is stipulated in the contract agreement, and both parties have consented and will be appointed as it has been mentioned or, if they have not consented, it means that the court will appoint an arbitrator and it is time bound. It has also been stipulated that we have to give our award within a given period.

Technically, the court also intervenes on the petition of the dissatisfied parties. As regards the mediation, we have been doing certain types of mediation for quite some time. In the US, judges themselves initiated the mediation between disputed parties one by one, asking questions over certain points and contention of disputes, and they were settled then and there. I understand that 90% of cases pending before the courts have been settled in this way in the US.

In arbitration, also, the public is not so satisfied with the awards, as they take so much time, and so many economic issues are involved. But how can we reform these matters is an issue that requires to be debated and discussed.

# Alternative regulatory practices and alternative dispute resolution

Rohan Samarajiva

Director of External Programmes, LIRNE.NET, Colombo, Sri Lanka

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For many years, regulation was done in many countries using a non-transparent command-and-control approach. Regulators were also providers of services. For example, when Sri Lanka was trying to get connected to the Internet in 1985/86, the regulator was also the operator. In fact, Sri Lanka did not get connected to the Internet in 1985 as a result. It took some more time. When we are talking about reforming regulation in these kinds of settings, we are seeking to separate explicit regulatory functions that are conducted in a transparent manner, in order to create the conditions for the private sector to invest. And we are trying to use market mechanisms as much as possible. This is the difference between the form of regulation that we engage in now and what existed previously.

Different forms of rule making and dispute resolution are involved in regulation. Now, the moment anyone uses the word 'alternative', we have to ask—alternative to what? So at this point, we have to reconsider how we used to do this regulatory function in the old days. We did it in the administrative context. That is in the way that administrative officials take decisions, without excessive consultation. I have worked with people who are good in administration, and they have told me to write as little as possible. The less you write, the less chance there is that somebody will find fault with you. So that style of decision making is something that most of us who are in the regulatory agencies are familiar with. When we get issues like dispute resolution, you may go to the other extreme of judicial intervention. Legal intervention rests on the principle of natural justice; you hear from both sides and you will make sure that your decisions are well reasoned. You have reasons behind your decisions. And you are procedurally correct.

In actual fact, regulation done well is light-handed and not excessively formal. It has to navigate the middle path between opaque administrative procedure and complicated and formal legal procedure. I feel that if regulation is to be conducted in a highly legal fashion, and if there is to be convergence between the ways in which we do regulation and administer justice, we might as well give regulation to the people who are specialists in legal decision making—judges.

We engage in very specialized regulatory activities, and in fact what we are doing is something called *ex-ante* regulation. And for that kind of activity, the formal legal process – where you rely only on the evidence that is presented before you – is not the most appropriate. In fact, if there is a legal tradition that has some relevance to what regulators actually do, it is the old tradition that has been basically overthrown in the western world. This is the inquisition—and I am not using the term in a negative sense. It involves the active seeking out of information, in contrast to the adversarial process where the judge sits passively, and relies on the information that is provided by the parties, and depends on cross-examination and the adversarial process for the truth to emerge.

Regulation has got some of these inquisition-like qualities. So when we speak of ‘alternative’, we mean an alternative to two kinds of activities: one is the very rigid legalistic formula, which is very difficult to implement in this complex technical field, where not all the information is available, and where more than two parties are involved and so on; and the other is alternative to the administrative procedure where we barely listen to anybody, and we take decisions in a very opaque way. When we look at rule-making proceedings, there are four ways in which we can incorporate stakeholder consultation: workshops, advisory committees, public hearings, and negotiated rule making.

In Sri Lanka, we had a situation where operators were spending considerable energy fighting each other in courts, instead of providing telephone services to people. So you have to create a situation where people remain involved in the central activity rather than get distracted by legal processes. With regard to dispute resolution, I hope to talk more about mediation and arbitration.

If you take the conventional rule-making procedures, it begins with the notice of proposed rule making. You set out the issues in the notice. The only question is that there is an assumption that the regulatory staff know all the issues. Now this assumption does not necessarily hold true. This is particularly true with new kinds of issues that we get in telecommunication, and also in other areas. And thus, if you are making a rule about it, it means almost by definition that we do not know much about it. So while we can theoretically say that the staff of the regulatory commission can frame the issues based on their knowledge, in actual fact, there is a possibility that the process would be influenced by not very transparent processes whereby pieces of information are provided by industry representatives who are in touch with regulatory staff on a day-to-day basis. It is information that is generally not harmful and not counter-productive to the people who provided it. So the idea of workshops is that instead of having some people influence the process in an invisible fashion, you invite all the



stakeholders and let them tell you what they know about it before we make the draft of the notice of proposed rule making.

I have participated in these kinds of events in the US. What you find is that the regulatory agency will run a workshop. But the agenda is more or less negotiated. You can be sure that the incumbent telephone company gets a certain number of speakers and certain number of topics. The entities that are not incumbent companies will also get certain number of topics and a certain number of speakers. I am not saying that we should have workshops for something like conventional tariff reviews every year. Workshops are appropriate for new issues. Capacity building is a major challenge for all our countries and all our agencies. You can use the workshops for capacity-building purposes, in addition to the main purpose. So you can also use this for training purposes.

Another mechanism that you can use to get more involvement, more buy-in, and less hostility in the system is to create an advisory committee. The Telecom Act in Sri Lanka (1991) allows for creation of advisory committees. A number of new Acts are coming up in Sri Lanka, such as the Public Utilities Commission Act, which also create specific consumer consultative committees. However, these committees should deal with policy issues and other broader issues, without getting into details—for example, allocation of spectrum in the telecom sector. I believe that, even in Bangladesh, frequency allocation is a very serious issue. If one takes away the frequencies from Grameen Telephone, they go out of business. It is their lifeline. These people have a lot of expertise. You should bring them in to get the expertise, and talk about the general process of allocating scarce resources. It is not a good idea to get them involved in the allocation of a particular set of frequencies. Because then you have true conflict of interests where you have people who have an interest in the subject who are getting involved in allocation of frequency, implying that one party will get it and another will be deprived of it. So we have to recognize this aspect during the consultation process. The same is applicable with consumer consultative bodies. General issues regarding consumers rather than specific issues involving particular consumers should be discussed.

One of the difficulties in running a regulatory organization in many countries is staff quality. You may not be able to tell the difference between your staff and the operators' staff. There could be problems with them. So one of the things that I tried to do was to keep them separated. We had a policy unit, and we kept the advisory committees under that, rather than have them directly interact with the people who are engaged in regulatory functions.

Another aspect of alternative rule making is the public hearing. In Sri Lanka, we had provisions for public hearings. During 1991–1998, we did not, however, have a single public hearing. From 1998/99 we

had one, and in 1999, we had the second one. Since 1999 we have not had any. We had a very useful public hearing with regard to telephone billing. I have done one informal public hearing. During public consultations on rural telecom issues in Sri Lanka, I got my staff to assemble a large number of opinion leaders in various rural areas. I talked to two hundred of them at a time in two locations. What you get in this kind of process, however, is rather unfocused. In a public hearing, you can have structure and you can focus better, as you have set out the issues, and you have the public notice and asked for written comments. And then you ask people to come and make ordered presentations based on written comments.

In our case, initially we thought that we knew enough about telephone operations. We definitely knew much, especially about the billing system. Because they have been doing it for many years, but doing it very badly, the telephone company staff thought they knew all that they had to know. My staff, who had come from Telco also thought they knew about billing, but after some practical tests, I figured that they did not. So we held a public hearing, and actually learnt a great deal about billing. Then we had a second phase wherein we brought in experts. Even technical knowledge was presented through the public hearing process. And it proved to be extremely useful. In particular, we decided to invite an expert from BT (British Telecom), as they had changed over from the same kind of primitive billing system that we had. We had a pulse-based billing system where the company provided no itemized information to the consumers, even to resolve billing disputes. BT had such a system, and they had gone on to a more modern system in the late 1980s. So I asked one of the engineers who had been in charge of that process to come and assist us. But, again in the spirit of transparency, we sent him to all the parties who were involved in the hearing, that is, all the fixed operators. And he brought in some insights that our people didn't have. Our people were saying, of course, that this could not be done. It would take too long and it would cost too much. He explained how BT did it in the UK. These were the benefits we got and these are the problems that we faced. So you can use a lot of mechanisms in a structured environment.

'Negotiated rule making' is something that we have not formally done in Sri Lanka. I have not been involved in this formally. You have to have a certain level of maturity in the subject. But this is done quite frequently. In fact, it has been done in many countries. Generally, negotiated rule making is conducted behind closed doors for the incumbents only. What I am saying is: 'Let us do it explicitly with the participation of all the parties instead of only some of the parties'. Generally, those who have studied this subject say that you must be able to have less than 10 participants in the room. For example, in the

state of California, when they were using this method for interconnection, they did not include all the parties that could be involved in the process, only the most important, core group. The excluded participants were, however, getting copies of the minutes so that they could intervene later, as they were promised explicitly. They were not involved in the discussion on a day-to-day basis. But they were not unhappy.

So the conditions for negotiated rule making, according to my colleague, Bob Burns of the National Regulatory Research Institute in the US, are as follows: no party should be able to win, and there should be a limited number of parties. If the parties cannot agree – that is always a possibility – there should be some mechanism whereby somebody else, e.g., a regulatory agency, can take a decision. There must be potential for win–win solutions. Fundamental values should not be at stake. For example, in Sri Lanka we had a problem in 1998, when the incumbent did not accept the reality that we had competition in our country, and when they wanted to convert the competitors into some sort of subservient agents. So they did not see them as real competitors with equal standing in law. They saw them in another way. When there is this kind of a problem, it is difficult to proceed with this method.

So, the ground rules should be established at the start. You have to try to remind these people that this is not an adversarial process, and that the objective is not victory but finding a solution. In some cases, you need to have confidentiality rules. Of course, the whole thing is driven by what are known as the ‘Harvard rules’. The first rule says that we should not focus on the position of the particular parties, but focus on the underlying interests. Then, of course, the second most important ingredient is the possibility of mutual gain or win–win solutions. Third is whether the achievement of our purpose can be determined on the basis of objective criteria.

There is a checklist for alternative rule making: rational choice of procedure, issuing an initial notice, ensuring that all the parties are represented, generating necessary data, obtaining an advisory report, reasoned decisions by the regulatory authority, etc.

Now, the regulatory commission in many cases cannot simply say that some group of people meeting in some room somewhere should be able to arrive at decisions on matters within its purview. So you have to allow the parties to negotiate. But you also have to maintain the legal authority that has been given by the statute. So you do allow people to negotiate. They will give recommendations or an advisory report that the regulatory authority will apply its mind to independently to arrive at a decision. Even at that level, it should be a reasonable decision from the regulatory authority rather than simple rubber-stamping. And, as I said, we have to look at our laws. In the case of Sri Lanka, we would have to go very carefully around this one.

Because it was not clear how this particular activity could have been undertaken under the law that we now have. But of course, we are going to change the law and make things possible.

The other main area that the regulatory agencies have to work in – which is very controversial – is ‘dispute resolution’ of various kinds. I was in the Karnataka Electricity Regulatory Commission in Bangalore, India, recently. I walked around the building and was shown a number of places including the courtroom. One could see that there is judicialized thinking that flows through a lot of our regulatory activities. I have not seen it as bad as in South Asia.

We have a huge amount of judicialized thinking in South Asia involving our regulatory processes. We have a courtroom in a regulatory agency rather than a boardroom or sitting room or hearing room, because we are trying to create a court-like structure. One of the few institutions that work properly in our country are the courts. So I think it is reasonable that we try to mimic them, and try to get some of the legitimacy that they have. But I think there are some dangers in going in that direction. My recommendation is to try to do regulation in a more flexible and consent-building manner. That will actually give us better results, and will prevent people from being pushed into adversarial positions that the judicial processes normally create.

We must remember, particularly in infrastructure sectors, that we need a different kind of process. For example, if somebody murders somebody, and if they manage to capture the person who committed the murder, the courts can go through the processes, then punish the guilty. This is a one-time action that the courts are good at. But when it comes to ensuring continuous good behaviour repeated month after month, and day after day, I do not think our legal system is very good at this. Regulation in the infrastructure sectors involves competitors having to co-exist with each other and cooperate with each other on a day-to-day basis. In telecommunication, in a competitive environment, if the competitors do not cooperate, your telephone calls will not be completed. In a decentralized electricity system, with multiple power producers and transmission companies and distributors, if there is continuous conflict in terms of maintaining the voltage, and maintaining the technical security of that system, then there will be tremendous difficulties. So in this kind of environment, we should be wary about the level of hostility, of increasing the level of adversarial relations between parties. And if we judicialize the process, we tend to push people into these adversarial roles. If we want to be effective regulators, we need to keep that in mind, and try to bring people away from the abyss of confrontation.

On the question of arbitration, I think there are some countries such as Guatemala where all regulation is done on that basis. Here, you can

have various versions—third party neutrals who can help you resolve the disputes; you could have a situation where the third party neutral is appointed by the regulatory authority. You can have a situation where there is a panel of three: one side appoints one, the other side appoints the other from some kind of list; and then, those two persons appoint the chairperson.

In arbitration you can have a situation where the arbitration panel imposes the solution, and the parties are bound by the decision that, in most cases, flows from the preceding agreement. Arbitration can also be of conventional and non-conventional types. Under the former, the arbitrators wait for facts to be put up before them by the two sides. The cases are presented, and preferred solutions are offered. It is very much on the model of trial. So what is the difference between these two methods, conventional arbitration and the trial? The former is outside the conventional legal system, and there is less delay. However much we like and respect the legal system in our country, we also know that it has been affected by tremendous delay. Court cases plagued the telecom sector in Sri Lanka starting from 1999. We had, at one point, about 14 cases pending before court. None of them got resolved, but they were all withdrawn a few months ago. In an arbitration system, you can avoid delay, and so the analogy would be like this. We have very congested traffic. So we can build the toll roads on the side, where the traffic can go faster than on a congested highway. In the case of the judicial system, the decision making is done by people who are knowledgeable, wise, mature, and individuals. But they, in general, do not know much about electricity or telecom or another infrastructure sector. We, in fact, assume they can apply the broad, general knowledge of the law to any problem that is given to them. Now, in an arbitration system, we can have expertise as one of the criteria to select arbitrators. The procedures may be less rigid, and you may be able to get over the delays that may come from appeals.

Now I would like to put before you one unconventional mode of arbitration that has actually been applied in Guatemala. This form is technically called final-offer arbitration. It is also called baseball arbitration. It was first used in the US when they had to negotiate with baseball players who were free agents. There is the same selection process, with one difference. The arbitrator cannot make up his own solution. One party says that it wants 10 rupees and the other party says 20 rupees is minimum. Generally speaking, most people who know arbitration can guess that the arbitration rate will be worked out as 14, 15, or 16 rupees. Generally, the arbitrator comes up with a compromise solution that would make both sides equally unhappy. But in this particular variation, you do not give the arbitrator that right. They have to pick one or the other. They cannot come up with their own solution and they cannot modify anybody's

solution. So both sides are told from the very beginning that they have to bring about a solution, and they have to get their arbitrator to accept their solution as the most reasonable solution.

In the earlier system, supposing what I wanted is really 15, and I know that my opponent is going to say 20. So do I say 10 or 5? If I say 5 and the arbitrator does the conventional thing, he or she will find the mid-point between 5 and 20. Then, I might get a decision that is more favourable than I am willing to accept. And if my opponent thinks the same, they will also go to the other extreme. But in this system, you remove that incentive for a party to go to the extremes. You actually create an incentive for them to be more reasonable, to try to accommodate the opponents' view and to come to the middle.

What is the assessment of arbitration? It is a fast-track trial, with expertise thrown in. In the kinds of infrastructure sectors that we are working in, it reduces, to some extent, the risk elements that are involved. We can allow for expertise to be applied to the problem without leaving it to generalists. But it is still adversarial and not cooperative. In the infrastructure sectors, we have to reduce the level of adversarial attitudes if we are to develop the sectors. So parties have to cooperate. The disputes that come before us for regulation have emotional and cognitive aspects. 'My network is used by somebody else,' telecom engineers have complained to me. It is not a rational argument. Somebody else is paying you money for using your network. And why are you so distraught about it? That is an emotional plea. There are emotional dimensions to lots of problems that we are working with. Those who study this say that many of the procedures are not good at dealing with the emotional dimensions of the problems that are part of the regulatory process. In many cases, you can talk of reasons. But because of some expectations about how things should be done, namely the network operator's obligations for the public service, etc., we cannot get the reasoning process to work properly. One of the criticisms of arbitration is that it is not very good at developing long-term cooperation.

Mediation has actually been used in Sri Lanka. Here, we provide a system to the party to resolve conflict. There are various versions: facilitation that guides the consensus-building process, training to prevent escalation of conflict, and coaching. While the negotiations are on you can have specialists in the room who will help the parties to be less adversarial. We can have different kinds of mediation. George Mitchell's reports on the role of settlements in the Israeli-Palestine conflict are one example of mediation. He did not help the Israelis and the Palestinians to negotiate. He was able to establish the fact that Israeli settlements were a factor in the conflict and move the terrain of disagreement. Within mediation, you can have advisory mediation and interest-based arbitration.

There are areas where you can have a binding solution. The difficulty in this is that in Sri Lanka, we could not have binding mediation. Binding mediation is less trial-like than arbitration. You can be a lot looser, can talk to people under confidentiality agreements, and put them in a room to work out a solution.

The regulatory authority has to give the final decision. One of the first things that the mediator does is to say that I cannot guarantee a solution; you have to own your problem. In interconnection disputes, we cannot simply put people in a room and say 'this is your problem and you have to come up with solutions.' We have to ensure that the parties come to some agreement on the terms of interconnection. However, we should make sure that mediation does not weaken the formal decision-making power. We have to make sure that the quasi-judicial power of the regulatory authority is not contaminated. So when we went in for mediation in Sri Lanka, right at the beginning of the process, I split my staff into two groups. One was to do mediation, and the other was to conduct the formal process if mediation did not work out. The first group signed confidential agreements, and they went into the process. All that they could inform me later was that they had many meetings. They could not tell me what was going on inside. At the end of it, we had written in a requirement that an advisory report is to be given at the end of the process. That was the only document that came out of that process. So when you do these things, you have various issues to think about. Do we have the resources to do it? Do we have the necessary expertise? The Denmark Regulatory Agency is very good at mediation. The person who does it is self taught. When you get mediation experts, you should be very careful. Most of the experts of mediation from outside come from marriage counselling. Marriage counselling and interconnection are not really different.

You need communication skills that are culture specific. I think in many cases we do not listen to people properly. We do not read body language. Then we have terminology that is hostile. So, part of the elements of proper mediation, which could be applied to the routine activity of a regulatory authority, is to try to get people to move away from hostile language that does not push people to defensive positions. Listen to both parties, and follow the principle of natural justice.

Regulation done right is what governance should be. If we do it right, this is how we should be running our country. If you think about the basic elements of mediation, where you try to reduce hostility and address the needs of the people and maintain self-respect, you realize that this is how we should be conducting all our interpersonal interactions.

## Session summary

The judiciary does not have the time and knowledge of regulatory issues due to the technical nature of regulatory disputes. This issue was discussed in depth in this session. Earlier, decisions did not require a judicial type of specialization. The session, in this regard, dwelt on the prevalent arbitration system in South Asian countries. In Sri Lanka, when matters are referred to an arbitrator, the arbitrator makes an award. If a party is aggrieved by the award, action is filed in the High Court, and a High Court judge decides. Assuming that parties are aggrieved by this order of the High Court judge, an appeal can be made to the Supreme Court. But generally, it is seen in Sri Lanka that most awards are affirmed by the High Court.

India, too, amended the Arbitration Act in 1996. It was pointed out that earlier, there was far more interference from the judiciary bench as regards arbitration. At present, even an arbitration award is assumed to be correct, and the court does not interfere. Even under the Indian Legal Services Act, mediation is being encouraged. This shows that in many countries there is a move away from the conventional system of dispute resolution. Even in the court system, the earlier view was that the judge must sit passively, listen to arguments from both sides, and give his decision. And if the court tries to mediate, his function as judge has been foiled. Now, mediation is being encouraged in courts, by telling one party that the court cases are not so good. Regulatory bodies may follow the same process, and should mediate.

The session noted that if the regulatory Act uses the word 'appeal', then there is no option for the judge but to go into all the details that led the regulatory authorities to come to a decision. There was an attempt to understand why the legislature intended to take the matter to the High Court, as the courts are buried under litigation and lack time. Nevertheless, even if an appeal does not go to the High Court, regulatory decisions can still be reviewed. It was stressed that the regulator has to come to an unbiased decision, and it is to be seen that natural justice has been applied. If there is an appeal, or there is revision, a judge would see to it that there is compliance to natural justice as far as the regulatory body is concerned. He would check whether proper



procedures are followed, that there is absence of *mala fide*, and that there is no hint of extraneous considerations that may have affected the decision of the regulatory body.

Unlike the judiciary, it was felt that a regulatory body has an advantage of not being formal. This has big advantages, as it can participate in the decision-making process, can mediate, and can conciliate. But if *mala fide* is apparent, then, perhaps a court will go into the case. Then, it is the duty of the court to do it. This is how it has evolved its relationship with arbitration. If the matter has been brought to court and if it is seen right at the beginning, courts will interfere if there is any error apparent on the face of it. For example, suppose the parties have chosen their arbitrators. If there is an error, the court will not interfere. In India, courts' interference in arbitration is becoming almost minimal. Now it has been articulated by amendments in the Arbitration Act. It was suggested that the same relationship which was there between the court and the arbitrator should also be extended to the court and the regulator. It was noted that the conventional adversarial system will not work in a regulatory framework. Apart from the regulatory field, now the thinking is that even in other offences, there should be a move towards ADRs (alternative dispute resolutions) for resolving disputes. For instance, the Lord Chancellor of the House of Lords took a similar initiative last year and litigation has been reduced by nearly 30%. This is the great initiative taken by the British courts in implementing ADRs. In India, the Electricity Authority Act confers power on the Central Regulatory Authority for either adjudicating the dispute or arbitration by itself, or referring the matter for arbitration. Thus, the regulator can sit as an arbitrator, and can bring about an amicable settlement between the parties. If he finds that there are some difficulties, he may refer it to arbitration, or may choose to adjudicate the dispute. The role of the judge would now be limited only with respect to the challenge against the decision given by the regulatory authority and after the matter has been adjudicated by him.

The session contested the views on 'binding mediation'. According to some, there cannot be any binding mediation; mediation is when the parties accept the award of the mediator, and there cannot be any binding on them. Some even doubted the feasibility of the 'Guatemala model' wherein the arbitrator can only choose between two claims, and he has no rights to pass any award which is not consistent with either of the claims. It is felt that adoption of this model may lead to serious injustice, because parties always tend to inflate their claims, and expect that their parties would set up their claims in a reasonable manner.

The power of judicial review was discussed in detail. In judicial review, the court is not concerned with the decision, but with the process of arriving at the decision. If the regulatory decision is so outrageous,

or it is so absurd that no reasonable man would come to such a conclusion, then the court can interfere. An analogy was drawn with various arbitration acts, and the corresponding arbitration award, and its relationship with the courts. Even if there is error of law, the arbitration award will not be vitiated. If a case is made out that the award is contrary to public policy, a court can interfere.

Experience, it was pointed out, has shown that processes like arbitration, mediation, or conciliation, normally succeed when the two parties are equal. But when it is between unequals like two incumbents, say, with one having 98% market share and another who has got only 0.5% market share, the whole situation may change. In this situation, there is a need to ensure that the ADRs can be made more effective. Some efforts have been made in some places such as Pakistan, for example, where certain time limits have been fixed for decisions.

It was argued that whatever the statute contains, within the statute, it could be possible to try to reduce the level of adversity, increase the levels of compliance, and increase the possibility of endless appeals and regulatory game playing. So, within that context, while the Indian regulatory legislation actually has provided for the possibility of referring to arbitration, this is not so in Sri Lanka. They do not have anywhere in the Act of Sri Lanka the possibility of referring anything for mediation either. But the telecom regulator in Sri Lanka attempted this. By offering the choice to the parties, who were extremely unequal, the regulator was able to agree to the procedure's document where everybody agreed that certain actions would be taken and certain deadlines would be kept. So, there was an attempt to build into it a possibility of mediation, and if the mediation succeeded, certain things would be done. It was written into the 'process document', in this particular case, which was negotiated by regulatory staff along with an external consultant, on the one side, and the parties to the interconnection dispute, on the other. In fact, in Sri Lanka, the basic criteria for win-win solution for mediation, did not meet actually in the interconnection dispute. But the benefits of denying interconnection are so great for the incumbent, and the benefits of getting interconnection are so great for newcomers, that it is possible to have a situation as in Bangladesh, where there is no interconnection. In such a situation, the Sri Lanka regulator found very high levels of hostility, but tried to bring it down. In Sri Lanka, in spite of parties being unequal, the mediation worked while going through the process. Thus, even if it is not everything written down in statute, the regulator should try to be innovative. Even in the presence of a highly asymmetric situation, it is possible to use multiple tools.

## Session III

### Appeal and review of regulatory decisions: the challenge of balancing interests

Chairperson's remarks

Justice Suhas C Sen

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Appeal and review of regulatory decisions:  
the challenge of balancing interests

Kamal Hossain

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Session summary



# Chairperson's remarks

Justice Suhas C Sen

Chairman, Telecom Dispute Settlement and Appellate Tribunal, New Delhi, India

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The jurisdiction of TDSAT (Telecom Dispute Settlement and Appellate Tribunal) in India is twofold. One is to hear direct cases where government, semi-government, private operators, and groups of public can directly approach us for settlement. The other is to hear appeals from the authority set up by India under the TRAI (Telecom Regulatory Authority of India) Act of 1997. Now, here because it is twofold, we have to do some tightrope walking in dealing with cases. First, we send the direct cases back to TRAI with remarks that they should not be lodged directly before us. We do intervene in some of the cases. Appeals, of course, may come before us straightaway.

When we hear an appeal, our endeavour is to see whether reasonable hearing has been given. Reasonable hearing means that all authorities have to strictly comply with rules of natural justice. In fact, the importance of natural justice cannot be over-emphasized. It means that every order must be passed after hearing not only the party that has come before the authority, but anybody who is aggrieved or affected by the order. So anybody affected must be given a hearing before any order is passed. The question is whether fair hearing has to be given to both sides and also a party which may be affected by the order. What is known as natural justice has got two aspects. One is that every party is to be heard before any order is passed. Second, no order should be passed in which the judge or arbitrator/regulator has some interest, whether it is financial or otherwise. So if he is interested in the matter in any way, then he should not pass any order. So, these are two basic things to be observed by every authority. Otherwise the appellate court will intervene.

In most countries – developed and underdeveloped – telecom services were initially controlled by the government. Now the government has allowed private players to come in. There are disputes between the government and the other bodies relating to interconnection charges, and charges for using government facilities, which has culminated in litigation. The role of the regulator is important. He has to ensure primarily that the common man has access to telecom services at affordable rates. The regulator has to ensure that the service providers spread

their services to the outermost villages and not confine themselves only to lucrative markets in the big cities. The regulator has to ensure fair competition between the service providers and not to be led by what is called the 'hidden hand' of capitalism. The 'visible hand' of the regulator will maintain order in this open field and curb the anarchy in the market. The regulator should ensure a level playing ground for all the players. And, in the changing market scenario, the regulator will have to be innovative and responsible for whatever is happening.

In the above scheme of things, where is the role of the appellate body? The appellate body only sees whether the regulator is doing his job efficiently in accordance with law, and is achieving the objects of the Act by which it was set up. In every case, we have to find out what is the object of the Act. The object of the Act is to spread telecom service, make it affordable and available to all and sundry. These usually are the statutory objects. With these ends in view if the regulator is acting, I do not think any appellate authority will intervene. Of course, every statutory provision of a country must be followed by the regulator. The duly enacted law of the land has to be honoured by everybody including the regulators under all circumstance.

In the age of liberalism, the overriding considerations must be that the interest of the common man has to be protected. The focus has shifted from a controlled regime to the marketplace. In such an evolving scenario, the function of law has assumed a great deal of importance. Regulation of laws are necessary to regulate a society, and society cannot function if there is no law, or there is no regulation or restriction. If one can do as one likes, that will bring about a state of anarchy which will retard progress and development in a country. For example, if there are no rules of the road, and every motorist can drive as he or she likes, roads will not be safe. Therefore, there has to be regulation in every sphere of life. Whether you like it or not, a regulator's job is to regulate. Now, regulation may not be liked by the persons who are being regulated. This is the price of doing business in modern society. The appellate authority has to see whether the decisions of the regulator are fair and lawful.

The scope of jurisdiction of the appellate authority depends on the provisions creating the appellate authority. Today, we find that regulators are suffering from various constraints. The government and authorities and other laws may have overlapping jurisdictions with the regulator in a given field. For example, if an individual consumer has a grievance about the quality of any consumer goods, he has an alternative remedy under the Consumer's Act. Now if he appeals there, then, to that extent, our duty is shortened. Our Act, of course, provides that the consumer has a specific remedy, and one shall not intervene. Let the consumer courts do whatever they can do.

Furthermore, the terms and conditions of service, manner of appointment of the regulator, and funding of such bodies should also be conducive to the performance of the independent regulator. Here, the government or legislature has a duty to make the regulator as independent as possible.

This morning somebody was saying that law is unfair. My reaction is: you have to inspire the legislators, to tell them, motivate them, and convince them, but so long as law is there it has to be obeyed. The appellate authority steps in, in such a situation, to correct any perceived error in their path. If the appellate authority feels that the regulatory order is being motivated by any other reason than what is there under the strict environment of law or the facts, then it has to intervene.

In the scheme of liberalization, the appellate authority's role is significant. An appellate body can discharge its functions swiftly and efficiently provided it is not circumscribed by a cumbersome procedure. Such procedures have to be involved which contribute to quick decision making and address fully the situation prevailing in the marketplace. These are the basic ingredients for making sound decisions in an expeditious manner.

Another important thing to be borne in mind is a principle laid down by the Supreme Court of India that every decision must be informed by reason. For every order that comes out of an appeal, the appellate court has to find out the reason behind the impugned matter. If it is informed with right reason in the mind of the appellate authority then the order must stand. Thus, the importance of giving reason is great. If an appellate court comes to the finding that the reason is faulty, it will intervene. And if it comes to the finding that that reasoning is right, then the appellate court will not intervene. But if the appellate court can find no reason at all, whenever there is an appeal, the appellate body in such cases will remit the case back to the original body and ask it to pass a reasoned order. And ultimately, all the decisions will follow this, whether it is the regulator or appellate bodies. The fact is that the laws are there, and they have to be studied carefully. The decision is ultimately based on appreciation of fact, degree, and judicial common sense. Every decision is based on these three things. Meggary T. in an English decision pointed out that common sense in this context must be the common sense of a man well-versed in law. It is not ordinary common sense but judicial common sense. This is how all decision-making is done, and how appellate bodies function.

# Appeal and review of regulatory decisions: the challenge of balancing interests

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Regulatory bodies must give reasoned decisions. Where there is an appeal, the person taking the first decision must provide reasons. Without giving reasons, you deny the appellate authority an effective opportunity to exercise its power. So where there is an appeal provided for, our courts have held that they require reasoned decisions. Where you have an appellate authority, the authority that is making and taking the first decision must give reasons, or else, the appellate authority will not in effect be able to exercise its jurisdiction.

There is a need for regulated markets. The market through 'invisible hands' cannot balance all interests, despite contrary claims by its high priests. I once put a question to Jeffrey Sachs who came here from Indonesia, 'You once propagated the view that even without regulation the market will ultimately work out right'. I said this in view of the cost that unregulated markets have extracted. He had returned from Indonesia, and took the point immediately and said, 'You *do* need to have a regulatory framework'.

I will say a few words about the rationale for regulation. First, what is the objective of regulation? When you regulate markets, a basic objective is to try to balance different competing interests. The interests of consumers need to be taken into account. Since substantial markets offered by the service providers can sometimes operate against the interests of consumers, their legitimate interests have to be kept in view. Another interest is that of the investors. An investor needs protection against arbitrary action. There are thus certain legitimate expectations of investors. These need to be taken into account by a regulator. This is in keeping with both the stated objectives of the legislation, and its underlying principles. There are interests that need to be balanced. And, therefore, a regulator must identify and take into account relevant competing interests. The regulator should not deprive any of those interests of their legitimate expectations. He should, at the same time, encourage efficiency of operations. A regulatory authority when exercising its powers should apply the law and inherent principles of fairness which call for balancing of interests. Reasons are to be given.



If you are aggrieved, you should have an appellate authority to whom you can go. If you are one of the parties who feels that your interests have not been sufficiently taken into account, you file an appeal. If certain principles have been overlooked and disregarded or given inadequate weightage, you should be able to move an appellate authority. It is, therefore, important to have an appellate authority. This is lacking in some of our jurisdictions.

In India, before such an appellate authority, as the tribunal in the telecom sector, came into existence, one had a right to appeal before the High Court. That has now been replaced by a statutory appellate authority in 2000 called TDSAT (Telecom Disputes Settlement and Appellate Tribunal). In the Income Tax Tribunal, you can go to a High Court only on a question of law. I think in the case of a regulatory regime, the scope of appeal should be wider. One can be aggrieved by the way different factors have been weighed by the regulators. The reasons given by a regulator could be questioned before the appellate tribunal. That is why I think an appellate tribunal is something which must exist. Most countries do not have it.

Pakistan has this under its Telecommunication Law of 1996. It provides for an appeal to the High Court on the question of whether an order is in conformity with the Act. But that is wider than just an appeal only on question of law. Because if the Act says certain things have to be taken into account and considered, or if the Act says you should take certain factors into consideration, and the order has not taken those into consideration, the appellate authority can deal with this issue. There is also a provision for judicial review. This does not have the same scope as an appellate tribunal. Judicial review necessarily is limited to questions of jurisdiction. An order can be challenged as being beyond the scope of the Act (*ultra vires*) because you have taken into consideration things that are irrelevant, or have not taken into account some relevant considerations or provisions of the Act. In that case you can resort to a judicial review. Judicial review should be available now when you do not have an appeal in most of our jurisdictions. You have in Sri Lanka the concept of public hearing, under Section 12 of the Sri Lanka Telecom Act. In Nepal, there is an appellate committee under Section 47 of their Telecommunication Act, which is basically a three-member expert committee. In Bangladesh, in our new Act of 2001 we do not have an appellate provision. If you do not have an appellate provision, it leaves you only with judicial review. We have a fairly pro-active approach being adopted by our courts, following the Indian Supreme Court, where the court is persuaded to look into orders, and exercises powers of judicial review on the ground of the order being beyond jurisdiction. The Court can require regulating powers to be exercised fairly and reasonably, taking into account relevant considerations.

If there is any factual issue to be decided, such determination has to be made on evidence. Regulatory powers could be treated as quasi-judicial so that the court would exercise its judicial review powers in seeing how its determination was arrived at. And if bias in legal terms is found to have operated, this would also vitiate an order. In Bangladesh, judicial review is the only recourse for a party that feels aggrieved by a regulatory determination.

I am inclined to believe that you should have some kind of an appellate body. This would enable 'errors' made by a regulator to be corrected. No one has many precedents to go by. And so, if you are doing things for the first time, it is quite possible that you may not get it right. Before the appellate body, you could draw attention to things which needed to be examined but in fact had escaped the attention of the regulator.

Everyone is looking back, making a retrospective review of roughly a five-year period to see how regulators have exercised their powers. What kind of grievances have arisen, what kind of interests have been protected or felt to be protected in order give rise to appeals? And with what results? It would also be of interest to see judicial review cases that have been reported. I do not think there is a great number of them. It would be good to collect these and I would say it would be very useful to provide for systematic exchange of information. This can be widely shared. And, in fact, we may even find a common jurisprudence emerging in the area. You can only learn from exchanging experiences – to learn both from the best practices, as well as from the worst – so that one could aim to emulate the best, and avoid the worst.

## Session summary

The session discussed the various experiences with appeal provisions against regulatory decisions. For example, in India, the law provides that if any person is aggrieved by the order of a commission, s/he can go to any High Court. S/he will usually go to the High Court in the respective states. There are about 30 High Courts in India, which can hear appeal cases. The CERC (Central Electricity Regulatory Commission) may not even know what kind of orders have been passed by the courts, because of the communication gap. In the proposed new law in India's electricity sector, an appellate tribunal has been provided for. Now, there is no unanimity on its suitability. For, if all High Courts are replaced by the appellate tribunal of the type in India's telecom sector, it would mean that people all over India have to come to Delhi, thus creating a lot of inconvenience to consumers. Thus, while uniformity will be achieved by this process, one has to come to terms with inconveniences on the part of consumers, unless it is specifically addressed through a regional bench of the tribunal.

In the Sri Lanka Telecom Act, 1991, Section 12 refers to public hearing and procedures. It says that for the purpose of holding public hearings, any of the officers nominated by the authority shall preside at any time any meeting of such committee. And it says that the proceedings at any public hearing have to be conducted in any manner in concurrence with principles of natural justice. In Nepal, the Telecom Act was promulgated in January 1997. In November 1997, the regulations came, and a three-member committee was formed. Until now, there is no case of appeal registered before the appellate committee. In India's port sector, although no mechanism for appeal is provided for in the Act, the regulatory authority has taken a stand that when people are aggrieved by orders, they can go to the High Court. The regulatory authority, in such cases, does not contest any case on merits. The authority has decided to produce records as and when requisitioned by courts.

There is, however, no unanimity whether the regulator should appear before the court to defend his decisions. Some felt that the appearance of the authority would be necessary. First, it would be

necessary to assist the court to arrive at a conclusion. In many cases, particularly when the judges are not familiar with technical matters, the appearance of the commission would help. In India, some state electricity regulatory commissions have appeared before the court. Some did not see any difficulty if the regulator appears before the court and presents the case. There are also instances in India where the High Court judges did not consider it necessary for the regulators to appear, and suggested that if there is anything, they would ask the government lawyer or advocate-general. In India's electricity sector, it was often argued that the regulators are like quasi-judicial bodies and a civil court. As a civil court, it should not go to the High Court to defend its decision, just like a district court does not go to the High Court to defend its decision. It was felt that whenever the courts are dealing with the orders passed by the regulatory authorities, it may not be wise for the judges to pass any *ex-parte* order particularly when there are no contesting parties.

It was also felt that in India's electricity sector, the present provision of appeal under the ERC Act, 1998 is not really satisfactory, which says that appeals shall lie with the High Court. It was argued that in such cases it is possible to take a view whether it is based on facts or law.

In the High Court, the judges and both members of the bench are essentially either from service or from bar, and there is no technical person as compared to the appellate authority under the telecommunication act. Some felt that if the present position is to continue, then the appeal should be confined to points of law.

## **Session IV**

### **Market development and regulatory process**

Chairperson's remarks

Justice Mainur Reza Chowdhury

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Market development and regulatory process

Craig Glazer



# Chairperson's remarks

Mainur Reza Chowdhury  
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It is indeed a great pleasure for me to be with you. This workshop is very important in view of the growing trend of the two practices: alternative regulatory practice and alternative dispute resolution in the perspective of the prevailing global situation, particularly in the context of Bangladesh. These two essential approaches arose out of the pressing need for exploring more effective alternative forums and practice, largely relieving the government from the regulatory functions in some essential areas, on the one hand, and the judiciary from the unusual congestion in almost all the courts in this region, on the other. These two approaches, as alternative mechanisms, have now become recognized and accepted by most countries of the world as the most effective means of easing the problematic situation in the two most important areas of public utilities.

The public provisioning of infrastructure services, as you all know, arose out of the belief that only the public sector could provide infrastructure services efficiently; that the entry of the private sector should be restricted, if not altogether prevented; and that the Westminster style of accountability of the public sector is adequate to ensure efficiency and protection of consumer interests. As a result, the government was both the service provider and policy-maker in various sectors such as electricity, telecom, ports, water, etc. in many countries, including Bangladesh. The results of such provisioning were not encouraging; the quality of service was very poor, access to various infrastructure services was unsatisfactory; utilities were running on non-commercial lines; consumers' interests were neglected; and investments in the sector were not forthcoming.

The 1990s saw the liberalization and privatization of infrastructure services in a big way. The belief that infrastructure services can only be provided by natural monopolies is now broken, and many countries are now able to introduce competition in provision of such services. The inability of the infrastructure sector to deliver services in an efficient and cost-effective manner led to a reassessment of the performance of these sectors in many countries, including Bangladesh, and it was felt that commercialization of the sector could improve

efficiencies and reduce costs in delivery of infrastructure services. There were also certain pragmatic and non-ideological related factors which compelled governments to resort increasingly to the privatization and commercialization of infrastructure services.

Notwithstanding the prospects of commercialization of infrastructure services, and the prospects of competition, the market structure in infrastructure sector tends to have monopolistic tendency in most countries. In order, therefore, to prevent exploitation by monopolies, governments are required to continue to protect consumer interests. There was also a need to create a level playing field between monopolistic incumbents and new entrants. Further, the process of commercialization itself led to high transaction costs, which had to be mitigated. All this called for expertise which the government did not have. Besides, as governments and their agencies continued to be providers of infrastructure services, and as they themselves had to be regulated, there was a need for an institutional mechanism outside governments, with adequate expertise and flexibility to regulate all players, ensure efficiencies, and protect consumer interests. In short, there was a need for a new type of governance, which is what independent regulation aims to provide.

The advantages of this 'new governance' are many. It makes the decision-making process consultative and transparent, takes into account the views of various stakeholders during the regulatory process, thereby reducing compliance costs; making available services at affordable price through creating or mimicking competition; setting quality of service standards; facilitating private sector participation in the infrastructure sector; and making the sector sustainable through tariff reforms. The benefits of independent regulation are beginning to show up in many parts of the region through competitive prices in the telecom industry (such as in India and Sri Lanka), rationalization of tariff, and reduction in T&D (transmission and distribution) losses in the electricity sector.

The regulatory job is very complex, and involves delicate balancing of interests of various stakeholders including consumers and utilities or service providers in a fair manner, after taking into account their legitimate expectations. The regulators are required to introduce efficiency and economy, and promote competition for sector development. They are now important players in conjunction with the government in infrastructure sector development. Conflicts are bound to arise during the process, as a number of players are being brought in. As new kinds of services are introduced, incumbents will attempt to resist, and regulatory authority may be challenged on flimsy grounds. We need to understand this and to recognize that regulatory decisions



are arrived at with due technical competence. They do not apply law to facts, as we do in many cases including judicial review cases.

Nevertheless, we have to uphold the law of the land. We need to see that the regulators follow the correct procedures, do not violate principles of natural justice, do not make gross errors of law, do not breach statutory mandate, and do not violate the constitutional mandate. We examine the regulatory decisions, if required, on these points. However, any regulatory issue brought before the judiciary has to be disposed of with sufficient speed. There should not be a delay in disposing of these cases. Else, sectoral development will suffer, and, ultimately, consumers will be burdened with higher costs.

# Market development and regulatory process

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The year 2001 saw regulation under attack in many ways. Of course, the attack started in 2001 as part of the California crisis. Issues as to the appropriate scope and role of regulation in deregulated generation markets were played out loudly and forcefully every single day on the front pages of newspapers in the largest state in our nation. The other 'bookend' for the year was the Enron crisis, which marked the culmination of a troubled year. And now, most recently, the Worldcom crisis drives many to fundamentally begin to question this market model that we have so fully embraced in the United States. What is the role of the regulator in a deregulated marketplace? What is the proper balance between regulation and the marketplace? As a former regulator of both telecommunications and electricity, I find that these issues have major implications for our future. For one, we are dealing with products that have no respect for international boundaries. We are dealing with products that move at the speed of light, be they electricity or telecommunication signals, etc. Our challenge is to deal with the physics of this product, which again is instantaneous, and meld that with the history of government regulation at the state and local level, associated with this product. We have also to deal with the history of local practices.

All of these challenges have to be met before we create regulatory institutions that support real markets and provide critical information to customers. And all of this has to work successfully in real time. We have been called upon to act fast and keep up with the speed of this product. Interestingly, no regulatory body can operate this quickly nor can any regulator punish as severely at the marketplace. As a result, our ultimate challenge is to build institutions that support the marketplace working effectively. Such institutions include independent entities that earn the trust of the public. Without trust, we cannot succeed.

The concepts of regulation are very deeply embedded in the United States and in English Common Law. Regulation essentially began at the time of the guild movement many centuries ago in Europe. The guilds actually worked together to ensure reasonable prices and reasonable quality of service. In 1670, Sir Matthew Hale, Lord Chief

Justice of the King's Bench, coined the phrase 'products affected with the public interest'. He opined that under the common law, there were certain businesses which were needed exclusively to serve the entire public. And those businesses, unlike others, would, in his view, lose some of their private quality, and in fact, become 'affected with the public interest.'

In the United States the concept of regulation started in the agricultural movement. Farmers had difficulty moving their products to markets because of the poor condition of the roads. Grain elevators were centrally controlled and were clearly a locational monopoly, given the poor state of transportation at the time. The agricultural movement soon picked up on Sir Matthew Hale's 'affected with the public interest' concept from the English Common Law. In the late 1800s, under pressure from farmers, the state of Illinois passed a statute that provided that the prices of grain elevators should be regulated and set by the local authorities. Mr Munn, who owned one of the grain elevators, challenged the law arguing that as an owner of a grain elevator he should be able to charge whatever price he wished. He challenged whether the state had any role regulating the price of his product. And he carried his case to the highest court in the US, expecting to win. In a very unusual move at that time, the court said no. In the landmark case of *Munn vs Illinois*, the court noted the writings of Sir Matthew Hale and found that there are certain businesses that are 'affected by public interest' and as a result are rightfully regulated by the State.

The court went on to define how one would determine whether the industry in question is appropriately regulated. It set forth a two-part test focusing first on whether the product was a necessity and secondly on whether it held a monopoly. The court first inquired as to whether the product in question can rightly be deemed a necessity. It found that because of their location and the poor state of transportation, the grain elevator was, in fact, a necessity for the agricultural industry. When property is devoted to public use, the court found that the owner in fact grants to the public an interest in that use, and must submit to be controlled by the public for the common good. The second test the court adopted was to determine whether the industry can be deemed a monopoly. It defined a monopoly as an enterprise that the public itself might take up or whose owner relies on a public grant or franchise for the right to conduct business. The tests of necessity and monopoly first identified in *Munn vs Illinois* became the basis for regulation in the United States.

Although not discussed specifically in the Munn case, the role of regulation was defined at that time and for many years thereafter as serving as a substitute or proxy for competition. Regulators were to set prices as if the service were competitive and set returns commensurate with those achieved by a comparable competitive industry.

The third bedrock principle underlying regulation is that of the regulatory compact. Basically, under this concept, there is an implicit agreement between the regulator and regulated with regard to price and quality of service. The regulators' obligations are to provide a reasonable return on investment defined as sufficient to attract capital in this industry versus other industries of similar risk. At the same time, there should not be excessive returns so as to constitute monopoly rents. Some other key elements of the regulator's role under the regulatory compact includes regulatory review of service quality, regulatory control over reliability, and the right of the regulated to exercise the power of eminent domain.

In the US, there were a number of alternative models that have stayed with us to this day. In the US, a large part of the industry is not subject to traditional regulation. The Federal Energy Regulatory Commission, and the state commissions were able to regulate 60% of the electricity industry. But the other 40% of the industry were customer-owned cooperatives or municipally-owned enterprises and not subject to regulation by the State. And that steady state exists to this day as well.

Roughly from 1910 to 1970, the regulatory paradigm based on the three principles outlined above remained a stable one. But as a result of the Arab oil embargo on energy and the break-up of the AT&T telephone monopoly in telephony, regulatory commissions in the 1970s began to move from a passive judicial role to a more active legislative role. Suddenly, regulators were driving policy, sometimes with legislative approval, and sometimes in the absence of legislative approval. For example, when I started out practising before the Ohio State Commission in the 1970s, there were lots of evidentiary hearings and very little pro-active policy making. That clearly changed over time. Regulators today are truly setting policy and doing it through notice and comment proceedings rather than through evidentiary hearings. Thus, in the span of just thirty years we have moved rapidly away from the strict judicial model embraced in *Munn vs Illinois*.

Let me give you a brief history concerning the movement towards competition in the US. In the 1970s, as a result of the increase in oil prices referred to previously, the industry embarked on a major programme of construction of nuclear power plants. But, as a result of various safety laws and periods of high inflation, construction of these plants were marked by huge cost overruns and excess capacity. The regulatory commission stepped in and undertook prudence reviews of these investments before they were added to rates. That was, I believe, the appropriate thing to do. The commissions looked back to see if those costs were reasonable. But these prudence reviews, although appropriate to protect the customers, did have an interesting unintended downside. Political and investor fallout from the prudence reviews of the

1970s led to a situation where no utility in the US would dare to build another project and have to face again those regulatory reviews. The risk-averse industry decided it would never build anything again under this regime, because it could not face the risk of regulators 'second guessing' their decisions. There would need to be some other means to build the next fleet of generation. This was not all bad for the customers. From the customer point of view, competition did bring the prospect of no longer placing all of the risk on the backs of the customers. After all, as bad as the Enron fallout was, there was no 'Enron rate case' or petition for emergency rate relief as we were prone to see in the earlier days of regulation.

The movement towards competition in telephony had slightly different routes. Competition in this industry grew out of a perceived failure of the regulator to move quickly enough to embrace new entrants. A federal judge basically wrested regulatory control away from the Federal Communications Commission and broke up the AT&T monopoly in order to enforce the antitrust laws of the United States. Traditional regulatory concepts such as promotion of universal service were left to the regulator to figure out once the industry structure had been mandated by judicial fiat. In both instances, through the unintended consequences of prudence decisions in electricity and in the perceived failures of regulation in telephony, competition was born.

Suddenly, people began talking about markets as providers of commodities to the customer and the vehicle to build this next fleet of infrastructure. In the US in 1992, Congress enacted the Energy Policy Act, which basically created a class of generators called 'exempt wholesale generators' and allowed 'open access transmission' for these entities. In natural gas, the Federal Energy Regulatory Commission moved to the concept of functional bundling, and prohibited pipelines from continuing their traditional merchant functions. The Telecommunications Act of 1996 similarly required unbundling of services.

What is most interesting is that at least in the energy arena none of those Acts of Congress, the Energy Policy Act or the Natural Gas Policy Act, formed the legal basis for the regulator's actions for opening up of competition in these industries in the US. Instead, the FERC (Federal Energy Regulatory Commission) used traditional statutory provisions, dating back to the 1930s that required that all rates be just, reasonable, and nondiscriminatory. They took those few words, rather than all of the far more specific language in more recent Acts, to move towards an open access system for electricity and natural gas in the US. In electricity, first, FERC issued its order 888 to move towards open access transmission, and stressed the need for comparability. Comparability basically required that a utility should provide the same level of service to its customers as it provides to itself.

But what FERC quickly found is again a part of evolution. Just ordering someone to file tariffs for open access is not enough to truly open up these assets that had been built and financed as monopoly assets. As a result, the regulator started to look towards fostering new institutions to help facilitate competition. As a result, at the time, companies such as PJM Interconnection became the nation's first independent system operator of the electric grid. It is one of the first institutions that actually was the market maker, and that actually put together, using the Internet, buyers and sellers of electricity, to form a voluntary spot market and a security-constrained bid based dispatch to deliver energy to load. Institutions like PJM were being created to facilitate the work of the regulator. Suddenly, regulation took its own turn, focusing on creating independent institutions rather than solely trying to move towards competition through either case-by-case adjudication or the mere enforcement of tariff language. The regulator thus became a key part in fostering new institutions to help it do its job.

Regulators are increasingly seeking to build institutions that will serve their goals rather than attempting to police the marketplace single-handedly. As part of the movement towards globalization, we need to begin to think about: do we have the appropriate international institutions available to meet our common needs?

So where does this bring us? This industry began as a competitive industry and then went on to become a regulated industry. We then deregulated the commodity and are now focused on creating institutions that can serve the regulator and facilitate the marketplace. It is an interesting paradigm; where does this leave us? There are many unanswered questions. For example, under this situation, is a regulatory 'backstop' needed to ensure that needed facilities are constructed in places where the market may not deliver solutions? How do we deal with energy security and diversity issues? For both the UK and the US, deregulation of the generation sector has caused an over-dependency on natural gas. Is it the regulator's role to be concerned about the lack of fuel source diversity? Should the regulator subsidize certain industries such as demand side and renewables? Have we addressed the nature of the regulatory role and responsibility? What will we do with regard to market power abuses? How do we remedy them? In a single clearing price dispatch model, if the price goes up in an hour because one entity abuses the market, everyone else, even if they are innocent, gets the benefit of the market clearing price for that hour. The regulator clearly should punish the bad actor, but should he at the same time require those innocent parties to refund their proceeds? And how does he determine what the market price would have been once he decides the actual market price was excessive?

Answers to these questions were much simpler in the fully regulated world where we could count on the adjudicatory process to sort out the facts and provide the recommended solution. In today's environment, with the regulator as policy-maker, the task is far more complex. Together, we must work through these difficult issues and continue to find solutions that provide the appropriate balance that serves the needs of the ultimate customer in this global marketplace.

## **Session V**

**Regulatory interface with judiciary:  
experiences and issues in developed countries**

Regulatory interface with judiciary:  
experiences and issues in developed countries

Craig Glazer

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Session summary





# Regulatory interface with judiciary: experiences and issues in developed countries

Craig Glazer

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In many ways, in the United States, we are going through a very critical period. We are rethinking our regulatory model and the role of the judiciary in that model. I want to share a little bit of that, and a little bit of history relating to some of the issues that regulators and the courts are dealing with in the United States in this post-Enron, post-California and post-WorldCom environment.

It is truly a trying time for regulation in many ways. Both in the telecom as well as in the electricity sectors, regulators are being asked to make policy decisions in areas where the legislature has traditionally not spoken. One could argue that regulation has faced this issue before. To a degree, the legislatures always set forth a broad mandate, but left it to the regulator to fill in many of those details. In the past this has been done through case-by-case adjudication. More and more, regulators are being called upon to set policy. And as regulators are called upon to set policy – something they had not done in the past – the role of the courts in reviewing that policy becomes an issue as well. At some point in all these cases, the debate comes full circle as to the role of the regulator in an emerging competitive environment.

What is most interesting is that, in many ways, we, the regulators, touch the lives of more people in our respective countries than perhaps any other government ministry or segment of government. Everyone uses electricity, and everyone has, or wants to have, access to the roads, the transportation system, as well as the telecommunication system. I used to tell my staff ‘just remember that we touched upon the lives of more people than any other segment of the government’.

In the US (United States), electricity and telecommunications began as fully competitive businesses. By contrast, the transportation industry had always been ‘affected with the public interest’, and had always had, since the 1600s, an element of regulation that electricity and telecommunications did not. What little regulation existed at the start of these industries in the US really were part and parcel of regulation as a legislative function. There was no role for the judiciary in the earlier days of regulation in the US. Local municipal councils negotiated franchise terms, and the franchise set the terms. And the

conditions for licensing were set by local councils. Rates, terms, and conditions were set by the legislature, not by any regulator, and regulation existed in the form of a written contract between a legislative authority and the regulated industry. Franchises in those days could be exclusive franchises or non-exclusive franchises, but the licensing function was seen as a legislative function.

Let me tell you the story of Samuel Insull. Insull was Thomas Edison's lab assistant, but was actually most notable as the father of regulation. One day, Insull went into the office of the Governor of the state of Illinois at that time and said: 'Governor, you can do away with this competition, unsightliness and inefficiency, and create a thing called a regulatory commission. As the utility, it will avoid me having to be subjected to every single city council telling me what to do. On the other hand, as Governor, you will be assured of quality of service at reasonable rates, and you will have some control over this through this entity called the regulatory commission'. And what started in the US and in the state of Illinois around 1911 or 1912, grew quickly. Within a year or two, every state in the US had established a regulatory commission. During this period, the public utility function was seen as a stepchild of the traditional regulation of roads and transportation industry. In fact, if you look at the old books in the early days of case law involving the Ohio State Commission, there were hundreds of cases and issues associated with transportation and barely anything associated with electricity or telecommunications. Well, that system worked pretty well. A few cases were decided on a case-by-case adjudicatory basis by these regulatory commissions. There were standard licences, rate adjustments, depreciation cases, capital structure issues, etc. And this whole system worked very well until the 1970s, when we had the convergence of a number of phenomena including cost overruns in the nuclear power industry. In telecommunications at that time, activist courts stepped in and questioned the regulator being too close to the telecommunications industry. Soon thereafter we had a federal judge literally wresting control of the entire US telecommunication system, and running that out of his courtroom as opposed to out of the regulatory body.

The combination of those two things – the fact that the regulator had undertaken massive prudence reviews of utility construction decisions, and the fact that the industry was unwilling to invest any more money in building new infrastructure, given this level of regulatory 'second guessing' – led to much investor and industry distaste of the existing system and a shift toward a new paradigm as to the role of the regulator. The new paradigm was that the regulator is charged with the task of introducing competition. The thought was that competition, rather than monopoly service, was the way to go. And, once again,

legislative authorities legislated only broad policy, expressing a general desire for competition, but left many of those details to the individual regulators. Suddenly, we had another dilemma on our hands, because the regulator was being charged with the dual task of setting tariff rates and terms and conditions, while also promoting competition. That is a very difficult task.

So, what is the role of the government in establishing competition versus letting the marketplace grow? It is a very difficult question. Taking these industries that have been built, regulated, and financed as monopolies, and suddenly, trusting a group of three or five individuals in regulatory commissions to make it competitive – because that is what the legislature said – really provided a new challenge for regulation. The traditional model of case-by-case adjudication suddenly was not going to work any more. You cannot decide a market model by an individual case adjudication or traditional hearings or evidence-gathering. You could set cost-based criteria using those judicial tools but you cannot set down the preconditions for competition in the same manner. As a result of that, the regulator, not the court or the legislative authority, was charged with addressing some of these difficult issues.

Let me give you some examples of the difficult decisions facing the US regulators. What are the requirements for new competitors? Do we treat them the same way as we treat the incumbent utility? We have had a major effort to establish local telecommunications competition in US. One of the immediate questions that arose was: if we give these entities licences to operate, do we also include mandatory build-out requirements? The state of Texas, for example, said ‘We would require each new entrant to build out and serve residential customers’. Is this a reasonable approach? After all, this is a competitive business. We don’t tell other competitive businesses who they can and cannot serve, or what their requirements are. We let the marketplace develop by itself. During this debate in Texas and elsewhere there was one argument that said, ‘Let the market meet such build-out requirements’; but there was another argument that said, ‘If we don’t do that, we are only going to skim the cream’. High-value business customers would be served with very little benefit to the average customers, leaving the incumbent utility with the burden of serving the residential and the poor, among other things. So this certainly became a huge policy issue. In the Ohio State Commission, we decided not to impose a build-out requirement, while the commission in Texas did. Competitors came into Ohio, but they came slowly and there were a lot of political issues associated with why they are not serving out in the small villages and small towns. On the other hand, in Texas, no one came in the telecom industry because, in fact, such a requirement made it impossible. There was no economic business plan that made it easy to instantly

serve the residential customers concerned, and rebuild the infrastructure on top of the existing one.

The regulators were also called upon to deal with capital structure requirements as a precursor to permitting competition in the telecommunications industry. There was a major debate when competitors came on the scene in telecommunications and in electricity. Do we require them to have a certain capital structure? Do we allow these companies to be overly leveraged to be heavy in debt or not? One argument was that regulators should stay out of that, and not care about that particular issue, because, in fact, if they can survive, the market will take care of that, and we need not dictate and mandate a capital structure. But ironically, in hindsight, look where that has left us. That generally was the way we went, and many of us did not regulate the capital structure of the new entrant, probably with some good reasons. But the fall of Enron and the fall of WorldCom, in fact, left us in a situation where the capital structure that we were not looking at, particularly, turned out to be very important to the future survival of those companies. We have some very special instances, as well, where these issues affected the traditional utility function. Under the laws of the US, Enron was able to purchase one traditional utility free of any review of its capital structure. It purchased a traditional electric utility in Portland, Oregon. Interestingly, that has become one asset in the entire Enron portfolio that still has considerable value; but, in general, it is trapped now, and unable to move out and control its own destiny because of concerns that it will be bound up for years in litigation and the bankruptcy courts. The question is, what is the role of the regulator when in fact the major utility cannot get its own financing because it is tied up in bankruptcy through no fault of its own? It has caused us to rethink many issues associated with the move towards regulation or non-regulation of the capital structure of the new entrants in the United States.

Another issue that regulators have dealt with in this area is thinking about consumer protection requirements. Do we apply these to the new entrants? What are they? Are the new entrants required to serve the poor? Do they have a mandate to provide universal service? On the one hand, if you make them look like the incumbent, one could argue that we might as well never have moved towards competition. It is an interesting dichotomy. Again, this is a product affected with the public interest—that we want them to serve the poor as well as the wealthy. The intersection of universal service and a free market in telephony and electricity remains a vexing issue for US regulators.

Finally, in this area, a major view was that we do not need any price caps, and we do not need any regulation because the market will take care of it. California provides the best example. The concept was that

we would have everyone who can purchase electricity from a power exchange. There would be new entrants. If people did not like the price from their incumbent utility they could switch to another supplier. Let me contrast this view from California with the model undertaken in PJM, the operator of the market in a seven-state region in the mid-Atlantic region of the United States. Unlike in California, in PJM we always had price caps. We always have an absolute limit, even in a competitive market, on what is the reasonable price. In the PJM case, a thousand dollars per megawatt hour is the absolute highest price one can bid in the electricity market. Some people said, 'Why do we need this in a competitive market? Why should the regulator or the ISO (independent system operator) come in and say there ought to be a cap on those prices?' Our response has been that even in the most competitive models, you need circuit breakers. For example, the New York Stock Exchange has 'circuit breakers' at times when the market goes awry. And one thousand dollars per megawatt-hour is high enough not to discourage new entrants, but to provide some cap at some level to protect the customer. So, again, it is some sort of modification of our present requirements, as to what we would think to be appropriate for a purely competitive model.

We have talked about some of the issues that the regulator faces without any guidance from the courts, the legislature, or with executive branch on how to handle them. The regulators had to decide on their own. By the same token, there is a whole host of issues associated with the remaining level of regulation of the incumbent. For example, there is a major issue in telephony about interconnection of facilities. Interconnection of present facilities were built and paid for by the customers. But what about new facilities? Will an incumbent utility invest in a high-speed network if it has to turn around and make that network available at parity cost to its competitors? The local telephone company is arguing that this is going to stifle new innovation. On the other hand, if you do not allow this interconnection, do you have a situation where there is an unregulated monopoly in these new services? There is no answer. But such major debates are still raging. Will the entrepreneur, an incumbent utility, if it has its own dollars at risk, be able to build this network, and have to turn it over to its competitor? It is not an easy question to deal with. The flip side of that is: what are the rights of the customers in all these? My colleagues would say, 'wait a minute, the customers built and paid for that system, so they have a right to enjoy the profits from that system.' They built it, they paid for it, and therefore, they have basically a lien on the property, a sort of public lien on the property, an equitable lien with regard to the decisions on the pricing of that. Many arguments on this can be made. For example, do you have that right in any other product that you buy? If

I buy a pen, does that mean I have a right to the profits of the company in making this pen in the future since I was a loyal customer of that pen company? People would say no. You bought and you have received the product. You paid a price for services rendered. And there is no equitable lien of the customer towards that utility service. This is again one of those difficult issues where there has been very little guidance from the legislative body. It is a very difficult issue for the courts to get their hands on, because, at the end of the day, it is really a policy question. It is really an intellectual question tied in with what is good public policy.

Another interesting issue along these lines deals with what I call the ‘trust factor’. For example, PJM Interconnection, an independent system operator, operates the transmission grid, but does not own it. PJM does not control the switches. But it is an independent neutral operator of the grid. Now, one can ask, what do you need that for? If the regulator has required the incumbent to operate the grid in a non-discriminatory manner, what do you need a separate institution for? In fact, that was the traditional model. Well, we had this debate in the US for many years and what came out of the debate is this. Even if the utility has operated totally above board and actually administered the tariffs in such a way as not to favour its own service, or services of its competitor in providing access to the transmission grid, we still have what we have come to call the ‘trust factor’. The new entrants must have faith and trust that the utility will honour their request in a non-discriminatory manner. Of course, arguably, the new entrant always has a remedy—s/he can file a complaint with his/her federal regulator. But should a competitor have to stake one’s entire business model on a single regulatory proceeding? Their business model is contingent upon getting that instantaneous, fair, and open access to the grid and a business model that rests on rapid response from the regulator rests on a very thin reed.

At the end of the day, the regulators said, ‘We need to address this very amorphous thing called the trust factor’. For, it became obvious that the perception of neutrality and fairness is as important as is the reality of whether or not the entity has been fair and following the tariffs. Therefore, we ought to create institutions that are independent operators of the grid, even though the tariffs already required fair and open access.

We have to go one step further. Companies like PJM were formed as independent operators of the grid with their own independent boards with fiduciary obligations to ensure robust competitive markets. They are not the regulators, but a tool of the regulators to help create that ‘trust factor’ that we have found so important.

Moving on from here, now that we are talking about the incumbent, and now that we have decided that there is competition, the regulator

is then challenged to determine what are fair pricing policies for the incumbent. When is the incumbent, by lowering its price, engaged in a process of predatory pricing to drive out the competition, only to then subsequently raise its prices? There is a huge debate, again, with very little guidance from the courts or the legislature on what constitutes predatory pricing, or what constitutes factors for meeting competition which is fair. We had a statute in Ohio that said that you cannot reduce prices for the purpose of destroying competition; and the key words are ‘for the purpose of destroying competition’. When does the lowering of prices (which, after all, is what we want to see in a competitive market) constitute unlawful predatory pricing? What constitutes ‘market power’ and what defines the unlawful abuse of market power? These are very difficult issues. Recognizing the elements of destroying competition as opposed to meeting competition, is again, a very subjective area. This falls into the realm of economic theory, but at the end, it is very fact specific. Notably, one does not just look at the pricing policies of the two entities but also this much more amorphous concept known as intent. These are not easy cases for the regulator to address in this new paradigm.

Another issue along these lines is how universal service is maintained. We have this competitive environment, and we want people to be able to freely enter the market. We do not want barriers to entry. How do we ensure that we do not end up with the haves and have-nots? And, as in telecommunication, we have the same issue in electricity; again the statute says that you should promote universal service—but who pays for universal service? We have a situation where we have very costly skiing resorts coming up in the high parts of the Rocky Mountains in the US. The cost of providing telephone service is enormous. Should that be subsidized under the theory of universal service? Or should these residents, having chosen to locate their vacation homes in this location, be required to pay hundreds of dollars a month for telephone service, and not be subsidized? How far do we take the principle of cost causation and when does it conflict with good social policy?

These are very difficult issues. All these issues exist over and above those issues that pertain to the traditional regulatory functions. For eighty to a hundred years, we practised the principles of traditional regulation; we set tariffs governing rates, terms and conditions; we reviewed the service quality; and we casually looked at the capital structure. But we did not deal with these bigger issues until the past 10–15 years. And suddenly, the regulator, with no particular special expertise or background, is being called upon to address these legislative-type policy issues. I am not sure as to whether any person alone should make those decisions.



Where has this left us with in terms of judicial review? The regulators now suddenly find themselves taking up these huge policy issues, not easily made in the context of a specific case. In the area of judicial review, in the United States we have traditionally relied upon an established body of law. Post-1930s judicial review of administrative proceedings in the US has been very specific and narrow.

First, the court ensures the overall procedural fairness of the case. The courts have recognized that policy issues may need a different analysis than traditional issues of contested fact and have endorsed agency practices of responding to written comments rather than requiring a full hearing. However, the courts have still required that certain legislative-type facts be ascertained whether it be a determination that a given practice is unduly discriminatory or unjust and unreasonable.

While the courts in the US have recognized the right of a utility to present evidence to be heard on issues of contested fact, the courts have been less clear on whether the customers themselves have rights in this whole process. It is clear that the utility has due process rights, but does the customer have a similar due process right? Does s/he have that equitable lien on the proceeds of the company? Courts have been much more mixed on this latter question and generally have stated that if the statute provided for public hearing, that is sufficient. There is no extra judicial lien or constitutional right of the customer on the outcome of the proceedings.

On questions of law, the courts claim to have *de novo* review. We have heard that the courts are required to interpret the law. But how does one interpret the law when a statute says 'rates shall be 'just and reasonable''. How do you interpret what is the question of law when the issue is 'just and reasonable' or not? By the same token, what is the question of law when the issue is what constitutes 'undue' discrimination? It is very difficult for the courts, which have truly struggled on this issue. As a result, what they are looking for more and more is whether there is substantial evidence in the record to support the commission's decision or whether, more recently, the commission has properly explained its policy. If the regulator diverted from prior policy, has it provided an explanation that is clear and understood?

Today's judicial review in the US is characterized by a heavy degree of deference to the expertise of the administrative agency. As we get more into some of these difficult policy issues, we find that more and more the courts are willing to give due regard to the regulatory expertise. The courts in the US have adopted what has become known as the 'Chevron doctrine' that says that even on a question of law or interpretation of statute, which the administrative agency deals with every day, as long as their interpretation is within a zone of reasonableness, the court ought to give due regard to that decision, rather than merely

substitute the court's interpretation of a statute—such as what does 'just and reasonable', or 'undue discrimination' mean. Again, that is subject to a standard that the administrative agency cannot act in an arbitrary and capricious manner.

Let me now deal with some of the challenges and issues we are facing, with the hope that this may have some parallels in other countries. One of the challenges is establishment of markets. There is no clear guidebook or statute on how you establish a market. Someone once told me that there is no market for establishing markets. It requires a lot of hard work to set the rules right. What we found, again going back to the California experience, but even within the PJM system, is that an abuse of the rules can happen very quickly and millions of dollars can trade hands in a couple of hours. Prices can rise quickly. And, because there is a single market clearing price, every market participant actually obtains that price over an hour or over a day. It is very difficult to go back and figure out what the price would have been in a given hour in the absence of a market power abuse. And how do you quickly respond to market power abuses given the speed of the marketplace? How do you tell somebody in the next few hours not to abuse the market? The market is dynamic, and someone is going to have to put in bids for the next hour. The regulatory commission is not fast enough to analyse those issues to determine whether in fact there was an abuse of market power.

For that matter, regulatory commissions struggle on defining exactly what constitutes an abuse of market power. At what point do very high prices reflect a scarcity of resources rather than an abuse of market power? On a very hot day, prices can rise because resources are scarce. Dispatching the marginal unit to meet the last increment of demand may be at a very high price, because fuel costs are high or because that unit is expensive to run. When is there scarcity, and when an abuse of market power, is not clear. We further suffer from lack of a clear process to crack down on market power abuses. Electrons and telephone signals move at the speed of light. No regulatory commission can ever be fully up to the task of monitoring these markets for abuses and stopping them in real time. We rely on a mixture of the independent market monitors in the ISOs as well as the other market participants to police the system. It is unrealistic to put all of this burden on the regulatory commission alone. You have to find reasonable balance here, but as the markets for telephony and electricity move quicker and quicker, this becomes increasingly a challenge.

Commissions in the United States also face serious procedural issues and impediments that make the task quite difficult. For one, we have strict *ex-parte* rules; a commission is not allowed to speak to any single party except in an open proceeding with notice to all other

participants. On the one hand, this rule promotes transparency and trust in decision making. But, on the other hand, as a regulator, there were times when I just needed the answer to a certain question and it would have been very nice to be able to call someone up, and say ‘just give me the answer to that question’. As I was unable to do so, this significantly slowed down the decision-making process. So ‘*ex-parte* rule’ is good as it protects integrity. The US has also strict sunshine rules. We have five commissioners, and no more than two could be in a room together to discuss commission business at any given time. If more than two sit together, it is considered a public meeting. We could not have a discussion among ourselves, we had to have notice of the meeting and invite people to speak. What that led to, quite frankly, was gaming of the system. As chairman of the commission I would go to each of my commissioners one by one, and say I wanted to do this, and two others want to do that—let us see if we can craft a decision. It took five times as long to make a decision as a result. I mentioned the need for speed, something that regulatory commissions in the US are not particularly good at, and need to get much better at. The procedural rules – that they are forced to operate under – work against the rapid decision making that the market demands.

Finally, all of us face severe market disruptions caused by potential foundational challenges. The failure of Enron did not mean that there was a failure of regulation. The problem is that, in the public’s eye, it thinks that the Enron and WorldCom debacles mean just that. I think we are going to survive these challenges. It is probably the most difficult time in the utility industry in the US ever. We will need very wise commissions and extremely wise judicial bodies that have flexibility and nimbleness. But, together, the regulator and the judiciary can form a partnership to ensure that the customer receives true value in this movement towards the restructuring of these vital industries around the globe.

## Session summary

The session discussed various regulatory and judicial procedures prevalent in the US. In the US, one can challenge a federal regulatory decision in one of about 25 courts. They do not have a single court of appeal. In this regard, the expertise really does not lie at the judicial level; they really do not have people who are trained economists, who can sort through those issues. At the regulatory commission level, there is expert staff that presents evidence and formulates policy. In the US, the debate rages over what is the right policy. For example, in telecommunications, it has been said that interconnection shall be at an incremental cost to the company. That turns out to be the sunk cost or embedded cost. What the new entrant pays is the incremental cost of hooking up the new wires. Whether this is a policy issue, or not, is not yet settled.

Unlike in the US, legislation in the South Asian region, where the functions of a regulator are very narrowly and not very firmly specified, regulators do not have freedom to go beyond the boundaries. In the South Asian context, it is accepted that policy making is essentially the function of the government, and in all policy matters, the government is accountable to the legislature.

It was noted that in the United States, the regulator has to go before the legislature for getting his budget approved, and as part of that budget review process, the legislature is looking at the work that the regulator does, and can clearly adjust things through the budget process or through the appointment of commissioners, which requires a confirmation by the legislative body. And in the US, there has been no hesitancy on the part of the legislator to call the regulator in before hearings. It has been recognized that there is a need for communication between the regulator and the legislature. This is absolutely critical. The best laws are ones that outline a general purpose, and a general intent, but leave flexibility with the regulator. No legislature can anticipate all of these issues. Whenever the US has not done this, it has missed the mark. California is an example of a legislative solution that did not work in the marketplace. So, there is a need for legislation that is flexible.

The session noted different regulatory models in the US *vis-à-vis* South Asia. For example, the US has two different regulatory models for this. At the federal level, there are separate energy and telecom commissions. At the state level, in the US, the role of the commissions are combined, and covers sectors such as electricity, gas, and telephone, as well as transportation. In a state commission, staff is segmented on the basis of industry, energy, or telecommunications. The only integration is at the commissioner level. It was felt that this was not a good experience. Some felt that it is probably better to have a combined commission, particularly in new fields and in a new area. In such cases, one has to ensure that integration takes place throughout the organization. Thus, in a multifaceted regulatory commission, staff should be able to do different things, and not get into just one particular area.

The participants raised concerns by noting that the history of regulation is getting more and more complicated and confused as the industry is developing. In South Asia, it is at an early stage. The important issue that is raised for judicial intervention by the people affected by a regulatory order is that the regulator determines certain issues on which there are no data available. For example, an electricity utility does not have an assets register. Now, suppose the regulator takes a view in T&D (transmission and distribution) loss that is not accepted by the utility. So this issue goes before the court for judicial review. Now, is it a matter of fact, or matter of law? On what grounds will a judicial body take it up? Is it an appeal? These were some of the questions raised by participants. The US experience in this regard was discussed. It was noted that there was a time in the US when the judiciary did substitute its guesses for the opinions of the regulator. Then they moved away from that system. The session noted that one of the most difficult issues was when the regulator has to come up with a remedy because he does not like any of the proposals that are put forward. The company has come up with data, but it is clear that that data cannot be relied upon. The consumer group may have come up with other information. But, at the end of the day, the regulator has to take a decision. He has to come up with some solution. Suppose the regulator comes up with a number that is a compromise between two other numbers. In fact, there is no evidence in the records to support that. None testify to that particular number. What is the regulator to do? It is possible for the regulator to reject the company's application. But there may be some more consequences in doing that. So the issue is that then the regulator has little freedom to craft the remedy, when in fact the presentation by the utilities is incomplete.

The question where there may be too much flexibility for a regulator in this part of the world was discussed in detail. If there is too much

flexibility, it could defeat the purpose of attracting private sector investment. Secondly, the issue is: what incentive does a regulator have to promote competition? It was, however, felt that there needs to be a clear path that the regulator follows, which the industry and the financial community can rely on. In Ohio, various policy statements were put up, at the beginning. For instance, the chairman of the Ohio Regulatory Commission, once he joins, puts out a policy statement that outlines its goals. It is very important for the financial community to know these goals so that they should not guess at what the fundamental policy is. The commission comes up with policy statements that would not be appealable to the court, but they are the general goals. That is important for the financial community. As regards regulatory incentives to promote competition, it was said that a clear mandate from the legislative authority is needed, saying that it wants to embrace a movement towards market and competition. Once that is done, the regulator can move that forward.

On the various methods of financing and obtaining revenue to run regulatory authorities, the model in the US has withstood the test of time. The regulatory funding goes through a separate assessment of each company. The total budget of the commission is then assessed based on consumption among the various industries that the commission regulates. The commission's budget is outside the general budgetary processes. So, cutting the budget of the commission does not add to the government's ability to expend the money for anything else. It is money earmarked for the regulatory commission, and if it is not spent, it goes back to the utility. So that has been a good system that has limited the legislature's ability to pull the strings on the commissions or to divert funds from the commission to other sources. The industry actually provides the funding to an assessment, through surcharge.

The session further discussed three issues: first, can regulatory commissions participate in judicial proceedings to defend their decisions? If the regulator is defeated in the lower court, will the regulator go in for appeal to a higher court? Second, was there any special effort to sensitize the judiciary either in Ohio or in any other state after introduction of the new system involving regulatory mechanisms in various sectors? Third, has there been any federal initiative to introduce some uniformity in the approaches adopted by regulatory commissions and the judiciary in different states? On the first issue, a contrasting picture was noted across countries. In Canada, the regulatory commission never appears before the judicial body, while in the US, the named defendant is the regulatory commission. It is the regulatory commission which appears before the court and defends its decision. Some felt that the latter could be a much better process; many times in the US, the commission has been able to present the rationale of the decisions. As far

as the special effort to sensitize the judiciary is concerned, enough has not been done in the US because of very strict rules on separation in communication with the judiciary. In many cases, the judiciary is not necessarily aware of what is happening in these industries. However, it was felt that participation, such as from members of the judiciary, is incredibly valuable. Finally, on the issue of federal initiative to introduce uniformity on the part of regulatory commissions, it has proven to be a very difficult issue in the US, with 50 states; each of them considers itself to be sovereign over decision making. There are about 51 regulatory commissions, and it has been difficult to achieve uniformity on various issues.

## **Session VI**

### **Regulatory interface with judiciary: the Indian experience**

Chairperson's remarks

Justice A K Shah

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Regulatory interface with judiciary: the Indian experience

S Sundar, S K Sarkar, and Perna Kohli

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Session summary





# Chairperson's remarks

Justice A K Shah  
Bombay High Court, Mumbai, India

Legal aspects of regulation in South Asia 89-94

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Independent regulation in all countries in Asia is a recent phenomenon. In the Indian context, I will give you a brief background of the two important legislations. The first is the TRAI (Telecom Regulatory Authority of India) Act, which came into force on 25 January 1997. I will make a brief reference to some relevant provisions of the Act as they stood before the amendment and after the amendment. Section 11 of the Act provided functions of the Telecom Authority. Section 14 conferred powers on the Telecom Authority to adjudicate disputes. Section 18 provided an appeal to the High Court against the decision of the Telecom Authority. In October 1999, a division bench of the Delhi High Court delivered a judgement holding that the Authority has no jurisdiction to issue directions or regulations against the central government. In other words, the authority of the telecom body was only recommendatory. The bench said that the power to issue directions is restricted to service providers, and the central government which, while acting as a licensor, was not acting in the capacity of service provider. In January 2000, another bench of the Delhi High Court delivered a judgement holding that the Authority has no power to issue directions or regulations to change or vary rights of parties under the contract or licence. They said that the Authority has got only recommendatory power.

The result was that the entire object of the introduction of this Act was defeated. Finally, legislature intervened and extensive amendments were made to the TRAI Act in 2000. Now, Section 11 has amended that position vis-à-vis the central government. Clause B of Section 11 of the new Act confers specifically powers on the Telecom Authority to regulate contracts and licences. Section 14, which originally provided for adjudicatory powers of the Telecom Authority, has been replaced by a new Section 14, which constituted the appellate tribunal. Now this particular provision, I must say, is unique in itself. The appellate tribunal, as constituted by Section 14, exercises original as well as appellate jurisdiction. It exercises original jurisdiction as far as adjudication of disputes is concerned. Under the amended Act, the Telecom Authority has no jurisdiction to adjudicate on disputes between

the licensees or other parties. All disputes are required to be settled by the tribunal. It also possesses appellate jurisdiction against the decision of the Telecom Authority. The chairman of the appellate tribunal has to be a retired judge of the Supreme Court or a retired Chief Justice of a High Court. Now Section 18 was again amended. Under amended Section 18, appeal is provided to the Supreme Court. Under Section 18, the appeal will be a second appeal as far as appellate orders are concerned, because the first order would be that of the telecom authority, second order by the appellate tribunal, and the third order by the Supreme Court. So, the Supreme Court has been given jurisdiction on the question of law, and not on facts.

Coming then to the other Act, that is the ERC (Electricity Regulatory Commission) Act, this was brought into force on 2 April 1998. Under this Act, there is the Central Regulatory Commission. As far as the Central Regulatory Commission is concerned, Section 13(h) says that the commission has power to arbitrate or adjudicate on disputes. This is apart from the other functions of the regulatory authority like tariff fixation etc. Section 22 is concerned with the state commission. Clause (n) of sub-section 2 of Section 22 says that the state regulatory commission can adjudicate on the disputes and differences between the licensees and utilities, and refer the matter for arbitration. It says that you adjudicate, and refer to the arbitration. Now, in the Enron case, the main contention of Enron before us was that when there is an existing arbitration, the word 'and' should be read as 'and'. The commission must refer it to the arbitration. We said no, the word 'and' should be read as 'or'. And it has powers to arbitrate *or* adjudicate. There are two provisions which I would like to point out. Section 22 (d) says that one of the functions of the state regulatory commission is to promote competition, efficiency, and economy in the activities of electricity to achieve the objectives and purposes of this Act. This is also to allow avenues for participation of private sector in the electricity industry in the state and also to ensure a fair deal to the consumers. These provisions are quite relevant when we deal with the question of the extent of power of the courts to interfere with the regulatory commissions. The state of Andhra Pradesh in India has enacted an altogether different Act. That state's Act is similar to the ERC Act, but it is much wider. The Electricity Regulatory Commission in Andhra Pradesh has been given extensive powers, and the power of appeal lies with the High Court. In the Andhra Pradesh Act, the state electricity regulatory commission has no power to adjudicate. The Act says that the state commission will either arbitrate on the dispute or nominate an arbitrator to decide, to give his award. When the commission arbitrates, it gives its award. That award amounts to an order and it is appealable to the High Court. When an arbitrator nominated by the

commission gives his award, it goes back to the commission. Then, it passes an order in conformity with the award and that order is again appealable at the High Court. So this is the position as far as two Acts are concerned.

Now comes the question of accountability. I just want to make a few comments. It was suggested that the regulatory commission should be accountable to itself, and, at the most, there should be a judicial review. There should be complete freedom from the executive and Parliament. I respectfully disagree. This is not possible. The regulator will turn into a dictator, and will function without any control in such a case. At the same time, I feel that the control at the ministerial level should be discouraged; rather, it should be condemned. If any minister interferes with the order of the commission in India, surely the court will strike down his action.

The regulatory decision should be reviewed by the court in a limited way. When we come to the extent of review by the judicial authority, we must keep in mind two things. In the Indian scenario, there is no promptitude. There are hundreds and thousands of cases that are coming up before court. The court is not in a position to give any priority to the cases arising from regulatory Acts. Now there are four hundred High Court judges, and their assignments are changed from time to time. Are you going to sensitize all the four hundred judges? This is not possible.

Another regulatory statute was introduced in India that was to control the security markets, and protect investors. That was the SEBI (Securities and Exchange Board of India) Act. I want to read before you a judgement that was delivered. What happened was that SEBI suspended or debarred the president of the stock exchange from transacting on the stock exchange. The charge against the president was that he managed to get price-sensitive information with the intention of manipulating the market. And ultimately, he probably, according to SEBI, almost succeeded. Now this was an ex-parte interim suspension. So some questions were raised whether prior hearing was necessary, or whether post-decisional hearing was sufficient. The second question was whether this amounts to a final order and therefore, whether it is contrary to the law. The third question was the extent of power of the judiciary. The contention on the one side was that this information is not price-sensitive information. It is easily available to anybody. There was no evidence of manipulation. On the other hand, it was maintained that it is a price sensitive information, and that the share market was manipulated. This happened in March 2000. There was a central budget in March 2000, and the market crashed after two days. I do not know who was responsible for that. But, anyway, the courts are required to deal with this particular problem.

Now when this was argued, we declined the invitation to assess the material including an analysis of transcripts. It is not for the courts, especially while exercising powers under Article 226, to analyse the evidence in detail, and come to conclusion on the merits of the case. The operation of stock markets and the functioning of the brokers are not only highly technical, but very complex. The exercise to be carried out will invoke not merely the interpretation of the above circulars and the parameters of the authority of the president of the Bombay Stock Exchange but also the collection of the material relating to innumerable transactions, and the correlation of the same with various factors such as the time and rate at which they were entered into as well as the relationship between the conflicting entries. It is the SEBI and not the court that must carry out this exercise. And then, we said that the decision taken by the regulatory agency in exercise of its powers is entitled to the greatest weight, and the courts will be slow to interfere with such decisions against the orders of the regulatory agency. Now, we refer to a decision of the US Supreme Court, that is, in the American Power and Light Company (which is an old decision of the American Supreme Court) case. Only a few lines are important. What the American Supreme Court said was that the judgement of the Securities and Exchange Commission in dealing with the problem of adjusting holding company systems in accordance with the legislative standards prescribed by the Public Utility Holdings Act of 1935, is entitled to the greatest weight. Only if the remedy chosen is unwarranted in law or is without justification in fact, should a court attempt to intervene in the matter.

Then, it came to judicial review. What are the parameters? One of the arguments was the principle of proportionality. This was really expounded by Lord Denning in one of the judgements in the 1950s. The doctrine of proportionality argument was that the punishment awarded should be proportionate. You can restrict his transactions, but do not suspend his transactions altogether. This was on the basis of the principle of proportionality. Now this is what we said. To judge the validity of any decision or order passed by the SEBI, normally the *Wednesbury* test is to be applied to find out if the decision was illegal and suffered from procedural impropriety, or was one which no sensible decision-maker could, on the material placed before him, and within the framework of the law, have arrived at. The court would consider whether relevant matters had or had not been taken into account, and whether the action was not *bona fide*. The court would also consider whether the decision was absurd or perverse. The court would not, however, go into correctness of the choice made by the authority between the various alternatives open to him, nor could the court substitute its decision for that of the authority. The application of the

principle of proportionality is held to be applicable to legislative action, and an Act of Parliament can be challenged under the doctrine of principle. For instance, suppose for a simple offence of theft, Parliament prescribes punishment of life imprisonment. Surely the court will look into it and say whether it violates the principle of proportionality. So this is what the Supreme Court has said—that it is to this extent that this principle can be applied, not in the executive action.

There is another decision, which, according to me, is extremely relevant. That is the decision taken in the Andhra Pradesh Commission's case. Now that was a case where the Andhra Pradesh Electricity Commission fixed different tariffs for different types of consumers. The Supreme Court said: 'We also agree with the High Court that the judicial review in a matter with regard to fixation of tariff has not to be as that of an appellate authority in exercise of its jurisdiction under Article 226 of the Constitution. All that the High Court has to be satisfied with is that the commission has followed the proper procedure and unless it can be demonstrated that its decision on the fact of it is arbitrary or illegal or contrary to that, the court will not interfere. Fixing a tariff and providing for cross subsidy is essentially a matter of policy and normally a court would refrain from interfering with the policy decision unless the power exercised is arbitrary or capricious in law'. This, according to me, should govern the appellate power as well. One paragraph from the Calcutta High Court judgement is very important. What the Calcutta High Court said about this power, is 'that the constitutional power was always there, but this is an additional strength. We are the appellate court. In its overall appeal, we have all the powers which are concomitant or with the appellate power. We have powers of passing orders in substitutions, we have powers of passing orders in remand, we have powers to pass interim orders, and orders of stay'.

And finally, it is my feeling that there has to be an appellate tribunal, and one should not depend on the High Court. The High Court is not the proper forum. The appellate tribunal should be manned by (on the same lines as telecom) a retired judge of the Supreme Court or a retired Chief Justice, and one judicial person should be a retired judicial authority, and the other member should be from a different field. And then, the judicial review may lie with the higher court. Then, there are some inherent difficulties. A point was raised as to what happens if the court gives something more to the licensee than what is entitled normally. The answer is that it is very much there in the policy. Even in a judicial review, the court will say that you have disregarded these important policy principles which are laid down by the law. Therefore, the court has to interfere. Another thing is availability of data. Where is the data? It is half-baked decisions that are given. Now, suppose this matter is brought to the judicial authority, what are the courts going to

do with the same? They will be facing the same problem. So, I do not think there is much that can be done at the judicial level. The judiciary should be confined to these parameters, and the grounds of review should be limited.

# Regulatory interface with judiciary: the Indian experience

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Legal aspects of regulation in South Asia 95–112

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## Introduction

Until recently, natural monopolies, established and evolved in the belief that monopolies enjoy economies of scale in the delivery of services, were providing infrastructure services in most countries. Absence of competition gave monopoly suppliers the opportunity to set prices without providing commensurate value for money, and generally, the service providers conducted their business with little regard to quality or consumer interests. Further, in many cases, this led to operational inefficiencies, poor quality of services, and inefficient allocation of resources.

Governments in many countries including India found that they could no longer subsidize the inefficient operation of these services due to worsening fiscal constraints; the resources required for infrastructure improvements were limited and there were conflicting claims from other sectors. These, in addition to certain other non-ideological factors (Ministry of Finance 1996), compelled governments in many countries to look for commercialization and privatization of their infrastructure services. Technological advances also made it possible to unbundle infrastructure services, both horizontally and vertically. Thus, services that could be performed by several operators on a competitive basis could be separated from those that are best performed by a monopolistic service provider.

Governments also discovered that commercialization and privatization were not possible without independent regulation to balance the interests of various stakeholders, including consumers; ensure financial viability of the industry; provide comfort to the private sector considering that most of the incumbent operators were large government-owned monopolies; and finally, reduce transaction costs associated with privatization. Independent regulation in infrastructure sectors is new in the South Asia region, and, naturally, poses new challenges not only to the regulators but also to the various stakeholders, including the government. There are about 25 regulatory agencies in the region of which about 20 are in India.



## How do regulatory agencies differ from government and the judiciary?

Regulatory bodies, independent but accountable, have been created in most countries through specific legislation. They have been vested with functions and powers earlier enjoined on the governments or their agencies. For instance, these bodies are required to fix and regulate tariff for various infrastructure services, and regulate the quality of services. In the past, tariff-setting functions were in the domain of the government, and were performed without any effective consultation or transparency. Tariff setting was often a political decision influenced by electoral compulsions. In sharp contrast, the new regulatory process has been mandated to be consultative and transparent. The regulators are also required to be quick in their response to the needs of the stakeholders, and bring to bear expertise in decision making—expertise that governments often lacked. And all their decisions have to be well reasoned speaking orders, a compulsion that governments did not have. Above all, their orders can be appealed against—a risk that governments did not run, cloaked as their decisions were in the garb of policy. In short, although the regulators exercise the very powers that earlier were exercised by government, they are accountable to a much greater degree for their actions, and have much larger expectations to fulfil.

The regulators enjoy certain judicial powers; their proceedings are often quasi-judicial and they have the status of a civil court. But they are not the judiciary. The judicial bodies generally deal with bipolar centric interests, and in general, apply laws to facts. The regulatory bodies, on the other hand, are required to balance interests of multiple groups for the overall development of the sector. Naturally, the procedure and processes that these bodies are required to follow would have to be different, and accordingly, the legislations in different countries have addressed these issues differently.

The key aspects of ‘judicial process’ are the following. A passive judge rules on the basis of the record; the law of evidence governs what may and may not go into the record; parties adopt adversarial positions, and so on. The ‘conventional regulatory approach’ mimics this to some extent, with deviation being seen primarily with regard to the evidentiary rules. Now, the alternative process seeks to get away from the adversarial model and tries to build consensus and ‘buy-in’ from the start. The intention is to improve the quality of information coming into the decision-making process; recognize the multipolar nature of the disputes that come up before regulators; and keep down the levels of antagonisms that lead to endless appeals.

Further, in the normal judicial process, the issues are defined at the start, notices are given to the parties, all parties are heard, and impartial judges decide on the basis of the record. In fact, adversarial mode

does not always lead to a complete resolution of disputes, and is, thus, not appropriate for technical subjects that are not limited to ascertaining the facts. The process is also not efficacious in influencing long-term behavioural changes among various parties. Regulators, on the other hand, can use alternative regulatory instruments for rule making, such as workshops, advisory committees, public hearings, and negotiated rule making, and, for dispute resolution, mediation and arbitration.

Unlike the judiciary, the regulators have to work within the parameters of specified regulatory objectives, which are made clear in the legislation itself and are also bound by the stated policy of the government. For example, the TRAI (Amendment) Ordinance Act 2000 was enacted with the objectives 'of establishing TRAI (Telecom Regulatory Authority of India) and TDSAT (Telecom Dispute Settlement and Appellate Tribunal) to regulate the telecommunication services, adjudicate disputes, dispose of appeals, and to protect the interests of service providers and consumers of the telecom sector, to promote and ensure orderly growth of the telecom sector'. Accordingly, the functions of the regulatory bodies are laid out in the legislation: for instance, the TRAI is mandated (a) to ensure compliance terms and conditions of licence; (b) fix terms and conditions of interconnectivity between service providers; (c) regulate tariff; (d) lay down standards of quality of service; etc. TRAI is also bound by the National Telecom Policy of 1994 and 1999. In the judicial arena, no such functional responsibilities are specified. Also, even for the discharge of these functions, the legislation often lays down certain principles or guidelines. For example, Section 29 of the ERC Act 1998 says that the state electricity regulatory commission shall determine by regulation the terms and conditions for fixation of tariff and, while doing so, shall be guided by seven principles. One of them is that the commission shall consider factors that would encourage efficiency, economical use of resources, good performance, optimum investments, etc. This is in sharp contrast to judicial proceedings where application of rules to facts is the primary function. The judicial process is largely retroactive whereas the regulatory process charged with responsibility for efficiency, growth, and sector development has to be pro-active, and, where necessary, go beyond current data to look at the future.

### **Relationship issues among government, regulator, and judiciary**

In the earlier regime, the decisions on tariff were taken by the government or its agencies, and the same government could also review its own decisions. There was no provision for appeal against government's orders, as these were largely administrative orders or policy decisions;

these orders could at best be challenged in the writ jurisdiction of the High Courts. Now, the regulatory bodies have to be accountable for their actions. There is a provision for appeal against regulatory decisions. Appeals are either made in High Courts or in some cases before specialized bodies such as tribunals. In India's telecom sector, TDSAT has been set up as a specialized body to hear appeals against TRAI. This is in line with the practice in the UK and some other countries.

### Framework for judicial intervention

The superior courts can always intervene in regulatory decisions through their inherent power of judicial review. In addition, regulatory decisions are appealable in the High Court in most cases. The grounds for such appeal have been left vague in many a legislation, except in some state reforms Acts such as the OER (Orissa Electricity Reforms) Act, 1995, where there is an explicit stipulation on the nature of appeal. Section 39 of the Act says, 'any person aggrieved by any decisions or order of the commission passed under this Act may file an appeal to the High Court on any question of law arising of such order'. In contrast, the ERC (Electricity Regulatory Commission) Act 1998 says that any person aggrieved by any decisions or order of the commission (either central or state) passed under the Act may file an appeal in the High Court. In this case, the regulatory legislation does not categorically state as to whether an appeal against regulatory decisions lies only on issues relating to law, jurisdiction or procedure, or whether it can also be based on merits.

That the judiciary should have the right to review regulatory decisions is not in dispute; there is also no dispute about the need to provide for appeals against regulatory decisions. The issue for discussion is what should the courts or appellate tribunals be looking for when they review or entertain appeals against regulatory decisions. Should their concern only be

- 1 whether the regulator exceeded or abused its powers;
- 2 whether the regulator committed an error of law or a breach of the rules of natural justice; or
- 3 whether a regulator reached a decision which no reasonable tribunal would have reached.

Or, should they look into the merits of the case, into facts, and take decisions such as setting tariff or passing orders on interconnectivity, substituting themselves for the regulator?

## Review jurisdiction

There is a wealth of case law both in the UK and in India, where the courts have consistently taken the view that judicial review should only address questions of legality and reasonableness of tribunal decisions. In *R v Panel on Takeovers and Mergers ex p in Guinness plc*<sup>1</sup> Lord Donaldson referred to the judicial review jurisdiction as being supervisory or 'longstop' jurisdiction. Unless that restriction on the power of the court is observed, the court will, under the guise of preventing the abuse of power, be itself guilty of usurping power.

In *G B Mahajan vs Jalgaon Municipal Council*,<sup>2</sup> Justice Venkatachaliah, who later became the Chief Justice of India, discussed this issue in some detail and observed that powers must be exercised reasonably. He quoted Prof. Wade who says, 'the doctrine that powers must be exercised reasonably has to be reconciled with the no less important doctrine that the court must not usurp the discretion of the public authority which Parliament appointed to take the decision. Within the bounds of legal reasonableness is the area in which the deciding authority has genuinely free discretion. If it passed those bounds, it acts ultra vires. The court must, therefore, resist the temptation to draw the bounds too tightly, merely according to its own opinion. It must strive to apply an objective standard which leaves to the deciding authority the full range of choices which the legislature is presumed to have intended. Decisions which are extravagant or capricious cannot be legitimate. But if the decision is within the confines of reasonableness, it is no part of the court's function to look further into its merits. The court is not concerned with the question whether a particular policy is wise or foolish; it can only interfere if it is beyond the powers of the authority.' . . .

In *Tata Cellular vs Union of India*,<sup>3</sup> the Hon'ble Supreme Court reiterated these views, and laid down six principles on the basis of which administrative decisions should be reviewed. These are:

- 1 the modern trend points to judicial restraint in administrative action;
- 2 the court does not sit as a court of appeal but merely reviews the manner in which the decision was made;
- 3 the court does not have the expertise to correct the administrative decision. If a review of the administrative decision is permitted it will be substituting its own decision, without the necessary expertise, which itself may be futile;
- 4 the terms of the invitation to tender cannot be open to judicial scrutiny because the invitation to tender is in the realm of contract. Normally

<sup>1</sup> (1990) 1QB 146: (1989) 1 All ER 509

<sup>2</sup> GB Mahajan vs Jalgaon Municipal Council (1991 [3] SCC 91)

<sup>3</sup> Tata Cellular vs UoI (1994 [6] SCC 651)

speaking, the decision to accept the tender or award the contract is reached by process of negotiations through several tiers. More often than not, such decisions are made qualitatively by experts;

- 5 the government must have freedom of contract. In other words, a fair play in the joints is a necessary concomitant for an administrative body functioning in an administrative sphere or quasi-administrative sphere. However, the decision must not only be tested by the application of 'Wednesbury principle of reasonableness' (including other facts pointed out above) but must be free from arbitrariness not affected by bias or actuated by mala fide; and
- 6 quashing decisions may impose heavy burden on the administration and lead to increased and unbudgeted expenditure.

The cases discussed above mainly pertain to administrative decisions taken by governments or their agencies. But they are equally relevant to decisions taken by tribunals. And one can also argue that orders of regulatory commissions on matters such as tariff, quality etc. are, indeed, administrative decisions based on government policy, the interests of the stakeholders, the viability and the growth of the sector etc., and should be viewed accordingly. It is noteworthy that where orders of regulatory commissions have been challenged in High Courts in their writ jurisdiction, the courts have refrained from going beyond questions of legality. In *Bharat Kumar and others vs Government of Andhra Pradesh and others*,<sup>4</sup> a writ petition challenging the tariff orders of the Andhra Pradesh Electricity Regulatory Commission, the Andhra Pradesh High Court held: 'in exercise of judicial review function under Article 226 of the Constitution, it is not open to the Court to find fault with the conclusion reached by the commission on the ground that a more practical view is possible or a different approach is preferable. It is trite to say that the Constitutional Court exercising writ jurisdiction, does not place itself in the position of an appellate authority on the questions of law as well as fact and embark upon a fresh appraisal of the material placed before the commission and test the decision of an expert body from the standpoint of its own appraisal especially in matters of price fixation. As pointed out in *Cyanamide's case* (supra), the Court refrains from going into facts and figures in detail with a view to seeing whether there was some error in the price fixation. The Court under Article 226 cannot undertake investigatory role. The scope of judicial review in the matter of tariff fixation has been succinctly stated by a full bench of this Court speaking through *Sudershan Reddy, J in V B C Ferro Alloy's case* (supra) in the following

<sup>4</sup> WP 9388 of 2000

words. ‘...The tariff fixation can be declared unconstitutional only if it is patently arbitrary, irrational, discriminatory, or demonstrably irrelevant. The Court in exercise of its judicial review jurisdiction ought not to normally interfere so long as the exercise of the power to fix the tariff is within the zone of reasonableness. ... It is not permissible for the Courts to interfere with such tariff fixation when there is found to be a rational basis for the conclusions reached by the Board. Justice Cardozo in *Mississippi Valley Barge Line Company vs United States of America* (292 US 286-87; 78 L ed. 1260, 1265) observed: ‘The structure of a rate schedule calls in peculiar measure for the use of that enlightened judgement which the Commission by training and experience is qualified to form.... The judicial function is exhausted when there is found to be rational basis for the conclusions approved by the administrative body’. This Court has no expertise to go into the intricate and complicated mechanism of tariff fixation. It would not be possible for this Court to reweigh the relevant factors and substitute its notion of expediency and fairness for that of the statutory authority’.

Upholding the order of the A P High Court in the above writ petition, the Hon’ble Supreme Court observed<sup>5</sup>: ‘We also agree with the High Court that the judicial review in a matter with regard to fixation of tariff has not to be as that of an appellate authority in exercise of its jurisdiction under Article 226 of the Constitution. All that the High Court has to be satisfied is that the commission has followed the proper procedure and unless it can be demonstrated that its decision is on the face of it arbitrary or illegal or contrary to the Act, the Court will not interfere. Fixing a tariff and providing for cross-subsidy is essentially a matter of policy and normally a court would refrain from interfering with a policy decision unless the power exercised is arbitrary or *ex facie* bad in law’.

It is thus reasonably settled that in the review jurisdiction, the superior courts will only address the concerns listed by the Hon’ble Supreme Court in *Tata Cellular vs Union of India*, and not the merits or substance of the tribunal’s order.

## Appellate jurisdiction

But then what happens in the appellate jurisdiction of the superior courts? Courts have consistently drawn a distinction between ‘review’ and ‘appeals’. In *R v Panel on Takeover and Mergers, ex p Datafin plc*,<sup>6</sup> Sir John Donaldson, M R commented: ‘An application for judicial

<sup>5</sup> JT 2002 (2) SC 595. Association of Industrial Electricity Users Vs. State of Andhra Pradesh and Others  
<sup>6</sup> (1987) 1 All ER 564

review is not an appeal'. In *Lonrho plc vs Secretary of State for Trade and Industry*,<sup>7</sup> Lord Keith said: 'Judicial review is a protection and not a weapon'. It is thus different from an appeal. When hearing an appeal the court is concerned with the merits of the decision under appeal'. In *Amin, Re*,<sup>8</sup> Lord Fraser observed that: 'Judicial review is concerned not with the merits of a decision but with the manner in which the decision was made.... Judicial review is entirely different from an ordinary appeal. It is made effective by the court quashing the administrative decision without substituting its own decision, and is to be contrasted with an appeal where the appellate tribunal substitutes its own decision on the merits for that of the administrative officer'. The order of the A P High Court also makes this distinction, and implicitly says that the court as an appellate authority can interfere with the fixation of tariff.

Regulatory legislation in India provides for appeals against the orders of the regulatory commissions. Section 18 of the TRAI Act of 1997 provided for appeals against the order of TRAI to the High Court. The TRAI (Amendment) Act of 2000 has set up the Telecom Dispute Settlement and Appellate Tribunal to settle disputes between licensor and licensees, and between service providers, and to entertain appeals against the orders of TRAI. Section 27 of the CERC Act of 1998 similarly provides for appeals against the orders of the CERC to the High Court. Most Indian states have adopted similar provisions in their legislation relating to regulation in the electricity sector. And none of them, except Orissa, has addressed the question of whether appeals should only be on points of law or whether the appellate jurisdiction can extend to matters of fact and their interpretation as well.

In an appeal filed against the tariff order of the West Bengal Electricity Regulatory Commission by CESC (Calcutta Electric Supply Corporation), the service provider in Calcutta, the Hon'ble Calcutta High Court in a landmark judgement (2002)<sup>9</sup> held that it is 'not hearing any proceeding which is akin to a constitutional writ matter. No doubt the High Court remains the High Court and its constitutional powers are not taken away and cannot be taken away even if it is designated as an appellate forum in a particular Act. Our constitutional powers we continue to possess. The additional strength that those constitutional powers render to our judgement is always present. But in so far as we discharge the function of an appellate tariff fixation body, our

<sup>7</sup> (1989) 2 All ER 609

<sup>8</sup> *Amin v. Entry Clearance Officer*, (1983) 2 All ER 864

<sup>9</sup> *Calcutta Electric Supply Corporation Limited vs. West Bengal Electricity Regulatory Commission* (FMAT 2 of 2002)

scope of enquiry is not merely limited to law. It extends to facts, principles, and policies too. It is an overall appeal. We have all the powers that are concomitant with an appellate power. We have powers of passing orders, in substitution, in remand, and we have powers to pass interim orders and orders of stay. However, this appellate provision is new. It is so new that our judgement is probably the first one in this field all over the country. No applications for interim orders or stay order were made to us. We have thus proceeded to hear and determine the substance of the appeal itself'. A note on the judgement delivered by the Hon'ble Calcutta High Court is produced in Annexe I.

It would be seen from the note that the Hon'ble High Court has ruled that the licensee is free to fix the tariff following the principles set out in the Electricity Supply Act 1948 after providing for a reasonable return and that the commission is not to fix the tariff at the beginning of the year, for the year, but is only to ensure at the end of the year on the basis of audited accounts that the licensee has abided by the principles set out in the Supply Act. The High Court has also ruled that it is not for the commission to fix T&D (transmission and distribution) losses, that consumer representation should be restricted to those who have technical, financial, or legal expertise, and are authorized by the commission; and that in any appeal, none other than the commission has the locus to appear. The judgement is far reaching, and the learned lordships appear to have completely rewritten regulatory legislation.

But then, all this is not relevant to the discussion in this paper. What is relevant is the fact that the Hon'ble High Court's decision makes the High Court the ultimate authority for tariff fixation. And what is also relevant is that the High Court has looked into the capital base and accounts of the licensees, and fixed the tariff for the years 2000/01 and 2001/02. They are relevant because they establish the fact that a superior court in its appellate jurisdiction has the power not only to entertain questions of law but also act as a fact-finding body, and to enter in the domain of facts and policies, examine accounts and financial statements, and fix tariffs.

The issue for discussion is whether, even in their appellate jurisdiction, the superior courts should go into the merits and substance of regulatory decisions even though they have the power to do so, or confine themselves to questions of law, natural justice, and reasonableness. Jurisprudence on this is limited. As the Hon'ble Calcutta High Court observed, the appeal heard by it was the first of its kind. And it is a fact that while a number of writ petitions have been filed against regulatory decisions, appeals under Section 27 of the ERC Act have been few. Ultimately, as more appeals are filed, it would be for the superior courts to decide as to whether they would enter into the merits



of regulatory decisions or not. Hopefully, the courts would recognize that the very rationale for setting up regulatory commissions was that matters like tariff setting, quality of standards etc., called for expertise which governments did not possess, and that it may not be possible for a court to bring to bear the same amount of expertise on issues that a regulatory commission can.

As observed by the Hon'ble Supreme Court in the Tata Cellular case: 'two overriding considerations have combined to narrow the scope of review. The first is that of deference to the administrative expert. In Chief Justice Neely's words, "I have very few illusions about my own limitations, as a judge, and from those limitations I generalize to the inherent limitations of all appellate courts reviewing rate cases. It must be remembered that this court sees approximately 1262 cases a year with five judges. I am not an accountant, electrical engineer, financier, banker, stockbroker, or systems analyst. It is the height of folly to expect judges intelligently to review a 5000-page record addressing the intricacies of public utility operation".'

'It is not the function of a judge to act as a superboard, or, with the zeal of a pedantic schoolmaster, substituting its judgement for that of the administrator'.

The result is a theory of review that limits the extent to which the discretion of the expert may be scrutinized by the non-expert judge. The alternative is for the court to overrule the agency on technical matters where all the advantages of expertise lie with the agencies. If a court were to review fully the decision of a body such as state board of medical examiners, it would find itself wandering amid the maze of therapeutics or boggling at the mysteries of the pharmacopoeia. Such a situation as a state court expressed it many years ago is not a case of the blind leading the blind but of one who has always been deaf and blind insisting that he can see and hear better than one who has always had his eyesight and hearing and has always used them to the utmost advantage in ascertaining the truth in regard to the matter in question.

The second consideration leading to narrow review is that of calendar pressure. In practical terms, it may be the more important consideration. More than any theory of limited review, it is the pressure of the judicial calendar combined with the elephantine bulk of the record in so many review proceedings which leads to perfunctory affirmance of the vast majority of agency decisions.

## Conclusion

The two overriding considerations, namely, lack of expertise and time constraints apply equally to appeals, and present a case for restricting the courts' intervention. Clearly, if the tariff set for a year by a regulator is

altered well after the year by a superior court there could be undue hardship to the consumer or the service provider. The judiciary will also, hopefully, appreciate that unlike in government, the decision-making process in the regulatory commissions is transparent, and that all stakeholders are given an opportunity to be heard and, therefore, there are fewer chances of facts not being brought on record. And finally, the judiciary must recognize that regulators are mandated to encourage efficiencies, protect consumer interests, promote the growth of the sector, etc., and these responsibilities call for allowing the regulators some 'play in the joints'.

Regulatory jurisprudence is yet to evolve in the subcontinent. In fact, our regulatory experience is rather recent and limited. Regulatory agencies should be allowed time to establish and grow. This would, perhaps, be facilitated if the superior courts decide, even in their appellate jurisdiction, not to look into the merits of regulatory decisions or where they find a regulator's orders erroneous in substance, remand the matter back to the regulator for revisiting its decision. But if courts were to start ruling on every aspect of regulatory decisions, the regulators would find it difficult to discharge their rather difficult mandate. Alternatively, Parliament could consider bringing Section 14(A) (2) of the TRAI (Amendment) Ordinance and Section 27 of the ERC Act on the lines of Section 39 of the Orissa Reforms Act 1995 to restrict appeals against regulatory decisions to points of law. Regulatory risk should be mitigated but not replaced by judicial risk.

## Reference

Ministry of Finance. 1996

**The India infrastructure report: policy imperatives for growth and welfare**

New Delhi: Ministry of Finance, Government of India.

## Annexe I

### Brief on the judgement delivered by the Hon'ble High Court of the State of West Bengal at Kolkata

#### In the matter of

Calcutta Electric Supply Corporation Ltd                      Appellants

vs

West Bengal Electricity Regulatory Commission      Respondents

#### *The parties*

- The appellant enjoys a licence to supply electricity in the city of Calcutta.
- The respondent is a commission formed under Section 17 of the Electricity Regulatory Commission Act, 1998 (hereafter Commission Act).
- Matters pertaining to electricity are covered under the Indian Electricity Act, 1910 (hereafter the Act of 1910) and the Electricity (Supply) Act, 1948 (hereafter the Supply Act).
- Section 3 of the Act of 1910 provides for the issuance of licences.
- Section 57 of the Supply Act provides that the provisions of the Sixth Schedule shall govern the charges/tariff charged by the licensee from consumers.
- The Sixth Schedule – which set out the methodology for the calculation of the tariff – stated that :

‘... the licensee shall so adjust his charges for the sale of electricity whether by enhancing or reducing them that his clear profit in any year of account shall not, as far as possible, exceed the amount of reasonable return.’

‘Provided that such charges shall not be enhanced more than once in any year of account.’

#### *The Electricity Regulatory Commission Act of 1998*

- Was an Act enacted by Parliament and came into force on the 25th day of April, 1998. Further, the Act provides for the establishment

of a Central Electricity Regulatory Commission and state electricity commission, rationalization of electricity tariff, transparent policies regarding subsidies, promotion of efficient and environmentally benign policies and for matters connected therewith or incidental thereto.

- Section 3(1) provides that the central government shall, within three months from the date of the commencement of this Act by notification in the Official Gazette, establish a body to be known as the Central Electricity Regulatory Commission to exercise the powers conferred on, and the functions assigned to it under the Act.
- Section 17 provides that the state government may, if it deems fit, by notification in the Official Gazette, establish, for purposes of this Act, a Commission for the state to be known as the (name of the state) Electricity Regulatory Commission.
- Section 22 provides for the functions of the state commission. One of the functions is to determine the tariff for electricity—wholesale, bulk, grid, or retail.
- Section 27 provides for an appeal against an order of the commission before the High Court.
- Section 29 provides for the parameters – by which the state commission is to be guided – for determining the tariff.
- Section 29 reads as under:
  - 1 Notwithstanding anything contained in any other law, the tariff for intra-state transmission of electricity and the tariff for supply of electricity, grid, wholesale, bulk, or retail, as the case may be, in a state (hereinafter referred to as the ‘tariff’), shall be subject to the provisions of this Act and the tariff shall be determined by the state commission of that state in accordance with the provisions of this Act.
  - 2 The state commission shall determine by regulations the terms and conditions for the fixation of tariff, and in doing so, shall be guided by the following.
    - a) the principles and their applications provided in Sections 46, 57, and 57A of the Electricity (Supply) Act, 1948 and the Sixth Schedule thereto;
    - b) in the case of the board or its successor entities, the principles under Section 59 of the Electricity (Supply) Act, 1948;
    - c) that the tariff progressively reflects the cost of supply of electricity at an adequate and improving level of efficiency;
    - d) the factors which would encourage efficiency, economical use of the resources, good performance, optimum investments, and other matters which the state commission considers appropriate for the purposes of this Act;

- e) the interests of consumers are safeguarded and at the same time, the consumers pay for the use of electricity in a reasonable manner based on the average cost of supply of energy;
  - f) the electricity generation, transmission, distribution, and supply are conducted on commercial principles;
  - g) national power plans formulated by the central government.
- 3 The state commission, while determining the tariff under this Act, shall not show undue preference to any consumer of electricity, but may differentiate according to the consumer's load factor, power factor, total consumption of energy during any specified period or the time at which the supply is required or the geographical position of any area, the nature of supply, and the purpose for which the supply is required.
  - 4 The holder of each licence and other persons including the board or its successor body authorized to transmit, sell, distribute, or supply electricity wholesale, bulk, or retail, in the state shall observe the methodologies and procedures specified by the state commission from time to time in calculating the expected revenue for charges which he is permitted to recover and in determining tariffs to collect those revenues.
  - 5 If the state government requires the grant of subsidy to any consumer or class of consumers in the tariff determined by the state commission under this section, the state government shall pay the amount to compensate the person affected by the grant of subsidy in the manner the state commission may direct, as a condition for the licence or any other person concerned to implement the subsidy provided for by the state government.
  - 6 Notwithstanding anything contained in Sections 57A and 57B of the Electricity (Supply) Act, 1948 no rating committee shall be constituted after the date of commencement of this Act and the commission shall secure that the licensees comply with provisions of their licence regarding the charges for the sale of electricity both wholesale and retail and for connections and use of their assets or systems in accordance with the provisions of this Act.
    - Section 30 provides that where a commission departs from factors specified in clauses (a) to (d) of Section 28 and clauses (a) to (f) of sub-section (2) of Section 29, it shall record the reasons for such departure in writing.

### *The facts*

- The appellant filed two tariff petitions before the respondent for the years 2000/01 and 2001/02 for fixation of tariff.

- A third petition for the year 2002/03 was filed with the request for extension of the time limit for filing the tariff petition.
- Against the claim of the appellant the tariff fixed by the commission was as under:

Year	<i>Claim by Appellant (paise per kilowatt hour)</i>	<i>Granted by Commission (paise per kilowatt hour)</i>
2000/01	426 (28% increase)	339 (1.9% increase)
2001/02	446 (4.5% increase)	337 (-0.5%)
2002/03	Extension of time	Rejected

- The appellant filed Appeals before the Hon'ble High Court under Section 27 of the Commission Act.

### *Issues before the court*

#### **Jurisdiction**

- Proceedings are not akin to a constitutional writ petition.
- Present proceedings are under an appeal provision. In appellate jurisdiction, the court has the power to not only entertain questions of law but also act as a fact-finding body. As such, the court is empowered to enter in the domain of facts and policies.

#### *How should the tariff be fixed?*

- 1 Whether the parameters set out under Section 57 read with the Sixth Schedule of the Supply Act are binding on the commission or not?
- 2 Whether the permission given by the Supply Act to the licensee to earn reasonable return has been cut down in any manner?

#### *Decision of the High Court*

- To hold that the commission has the power to determine whether the provisions of Section 57 read with the Sixth Schedule of the Supply Act would apply to a particular case or not, would amount to holding that Parliament has delegated its power of amendment and repeal and also its power of re-enactment and cancellation of repeal. This is impermissible besides being unconstitutional.
- The permission to earn reasonable return has been maintained in the Commission Act and, therefore, the provisions of Section 57 read with the Sixth Schedule of the Supply Act have to be given full weightage and are the guiding principles by which the tariff has to be determined.

### *When will tariff be fixed?*

- Section 22 lists the fixation of tariff as one of the functions of the commission.
- However, no time line has been prescribed for such fixation. Whether it will be at the beginning of the year, during the year, or the end of the year is the question to be considered.

### *Questions posed*

- 1 Whether the licensee has to submit tariff petitions at all to the commission?
- 2 When does the commission fix the tariff?
- 3 What is the nature of the order fixing such tariff?

### *Decision of the High Court*

- The licensee need not submit the tariff petitions before the commission at all. The licensee is only required to follow the principles set out under Section 57 read with the Sixth Schedule of the Supply Act and maintain a reasonable return.
- The time line for the commission (and in turn the High Court) to fix tariff is flexible. There is a difference between projection and fixation. The commission is not to project the tariff at the beginning of the year but is to secure – and that too at the end of the year after finalization of accounts – that the licensee has abided by the principles set out under Section 57 read with the Sixth Schedule of the Supply Act during the year.
- Once the commission fixes the tariff, it is a supervening decision and the licensee must obey the tariff decision. The Commission Act provides for punishments also in the circumstance of failure to comply with such decision on fixation of tariff.

### *Consumer representation*

- Section 29(2)(e) of the Commission Act clearly spells out that the interest of the consumer is to be protected/safeguarded.
- Section 31(4) of the Commission Act sets out the persons who can file objections and association permitted by the commission to participate in the proceedings.
- In terms of regulation 25, when tariffs are fixed the commission issues notices in the newspapers inviting objections or comments.
- Section 26 of the Commission Act authorizes the commission to authorize any person it deems fit to represent the cause of the consumers.
- Section 37 of the Commission Act mandates the commission to ensure transparency.

*Decision of the High Court*

- 1 Transparency does not mean an open or public hearing.
- 2 To argue that 17 lakh consumers are entitled to be heard individually is merely a theoretical objection and not a practical one. The law does not provide for indiscriminate participation in these proceedings.
- 3 Prior to 1998, there did not exist or vest in the consumers any such right.
- 4 Merely because the commission or the High Court heard some parties or allowed certain consumers to participate does not mean that the person is authorized in terms of Section 26 of the Commission Act.
- 5 Any person authorized by the commission in this regard would have to be an expert in technical, financial, or perhaps even in legal matters.

*Transmission and distribution losses*

- Energy to the tune of about 22% generated and purchased by the appellants from its generating stations gets lost and is never billed for.
- The appellants had generated and purchased more than 6000 mega units in the year 2000/01 but billed for only 5165 mega units. The rest got lost in T&D (transmission and distribution).
- The commission had fixed about 16% of the total generation and purchase as the permissible T&D loss for this year. Further, they wanted the appellants to minimize the loss every year by 0.7% until they reach the figure of 14%. This was based on the departmental letter of government of the year 1993.
- Half of the total loss of 22% was technical loss and the other half was lost due to theft of electricity, i.e., large scale consumption without paying for it. The consumers and the commission wanted the appellants to shoulder a large part of the loss caused by theft.
- In this situation the High Court wanted to know, on a matter of principle, whether actuals should be disallowed to the appellants or not?

*Decision of the High Court*

- 1 The voltage of supply is an ordinary 220 volts or 440 volts at some places and about 6000 volts in industrial undertakings. Large voltages need special type of gears and transformers and those are no items for ordinary households.
- 2 It is not disputed that a lot of energy gets dissipated in transmission. It is also accepted that the large expenditure incurred by the appellant to counteract this loss is proper and within the terms of the Sixth Schedule.



None of the appearing parties had any problem with the 11% technical losses.

- 3 The issue regarding theft is a contentious issue. What is relevant is that no fraud in the accounts of the appellant is either imputed or proved by any party or authority. Also, no mala fide has been imputed to the appellant.
- 4 The appellant has not conspired to have its own electricity stolen. The appellant in this case does not cause or voluntarily allow theft of electricity but is as much a victim of it as a paying consumer. There are no good or cogent grounds to hold that the appellant is liable for the theft of its energy.
- 5 The commission's reason for disallowing the actuals of theft is based on a government letter without really assessing whether it is actually realisable or not. The commission has merely set a standard, without any basis.
- 6 The reading of the 16% as T&D losses is not permissible since a pre-set percentage cannot be a substitute for fresh and judicial assessment. In each case, a controversy is raised about the propriety of actuals.
- 7 The comparison between the appellant and BSES, Mumbai, is also not correct. The same BSES has much higher losses in Orissa. Further, the business of generation and supply of electricity is so huge that the comparison of two licensees is bound to mislead. It is, therefore, better to scrutinize the particular licensees' own records and dealings.
- 8 The final conclusion is that on account of T&D losses the accounts of the licensee does not need any rectification.

### *Locus*

In appeal only the commission has locus to oppose the appeal of the licensee and none other has any locus.

Finally, against the claim of the appellant and the tariff fixed by the commission, the decision of the High Court was as under:

Year	<i>Claim by Appellant</i> (paise per kilowatt hour)	<i>Granted by Commission</i> (paise per kilowatt hour)	<i>High Court</i> (paise per kilowatt hour)
2000/01	426 (28% increase)	339 (1.9% increase)	396
2001/02	446 (4.5% increase)	337 (-0.5%)	400
2002/03	Extension of time	Rejected	400

## Session summary

The session noted that the judicial machinery is slow. If it is expedited, it would benefit the infrastructure sector. If it is slow, it leads to a lot of uncertainty among investors. Everybody is in a hurry to implement reforms in this region. So it is better that the judicial process is speeded up.

The session recalled the evolution of India's regulatory commission in the electricity sector. In the pre-1991 stage in India, the public sector had been operating the entire infrastructure in all areas, such as telecom, power, roads, and ports. The public sector was dominant, and the Government of India and the state governments used to fix the tariff and do other things. Government deliberately gave up that power. It was thought that the regulators can harmonize the interests of all the stakeholders, government being one of the stakeholders. By implication, the regulatory job, some felt, is not to maximize anybody's interest, or maximize anybody's benefit. Their job is to harmonize everybody's benefits, and optimize the benefits so that the sector as a whole prospers. Earlier, the central public sector undertakings or the state public sector in India would have benefited by an order. The intention was to maximize the benefit of a particular authority or a particular stakeholder. But, today, regulators are trying to harmonize and optimize the benefits for everybody. The need for regulatory transparency was impressed upon. It was felt that the regulator should be fair, like the courts.

There was in-depth discussion as to whether appeal will lie on a 'matter of law' or a 'matter of fact'. In India's CERC (Central Electricity Regulatory Commission) case, they have had several appeals against some of CERC orders, where the question was not only on matters of law. Initially, some persons who were aggrieved went to the court, and immediately got a stay. After a stay, in some cases, CERC was asked to give affidavits. Now, after some hearing, the stay was removed, but the main case is still going on. It is not clear in these cases whether the matter will be heard both on matters of law and fact. Second, should the regulator be present before the courts during hearing? Some thought that the regulator should be given an opportunity to be present in the court and present his facts. Others find that, in reality, this is yet to happen. In the entire judicial process, there is no uniform

policy, and different courts in India are working on the issues from different viewpoints.

During discussion, Sri Lanka's judicial procedure was also discussed. In Sri Lanka, the telecommunication regulatory commission's decision was subject to appeal. However, not all its decisions were subject to appeal. There were two particular actions under two particular sections for which there can be an appeal; these include decisions from public hearings, and the decisions with regard to licence condition violations. The appeals were on questions of law. So the rest of the regulatory actions was subject to only judicial review. In one case, Sri Lanka had a particular decision, which went on appeal both under writ jurisdiction and also under judicial review. The case relates to the operator's not implementing a decision, and therefore, was in violation of its licence. Then operators appealed under Section 15 of the TRC Act 1991, Sri Lanka, under the appellate jurisdiction. In the proposed regulatory legislation in Sri Lanka, in a whole range of industries, excluding telecommunications, only the public hearing process would be subject to appeal on questions of law. The rest of the decisions under the proposed public utilities commission would be subject to judicial review. This law is yet to be enacted.

## Session VII

### Regulatory decision making: some thoughts

Chairperson's remarks

Themiyā Hurulle

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Regulatory decision making:  
some thoughts – the Bangladesh experience

K M A Bakar

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Session summary



# Chairperson's remarks

Themiya Hurulle

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In normal life situations when a person is called upon to take decisions, that person quickly seeks some view, assesses the facts presented, uses his or her instincts, and takes the decision. This can be applied in a more formalized manner in the running of companies and public organizations as well. However, in the case of regulators, things are not that easy—things are more complicated than that. The regulator is guided by a set of specific rules and laws, which must be generally conformed and adhered to. The regulator has to interact with the stakeholders who have a thorough knowledge of the facts and the situation. Therefore, the regulator has to balance the interests of all the stakeholders, be it the operators, the consumers, and so on. This is a very difficult exercise since the regulator in some instances may be subjected to external pressures, which he or she must not yield to. But good suggestions should be considered. However, the regulator generally has nearly Hobson's choice or, to say simply, has very little choice! The functions of the regulator nowadays are subject to close scrutiny. The regulator in his decision-making processes cannot take arbitrary decisions. There are various interest groups which are watching him, so to speak. Modern means of communication like television or the Internet may result in incorrect decisions reaching far and wide. Therefore, the decisions of the regulator not only have to be fair, but should *appear* to be fair in the eyes of all. Then, in the regulator decision-making endeavours, the regulator should be afforded freedom in his actions. That does not mean that the regulator can act with impunity. He must act with caution and restraint. I would add that now we are dealing with matters that travel at the speed of light or even faster. Therefore, fast-changing situations all over the world call for reactions from the regulator with promptness and expeditiousness.

# Regulatory decision making: some thoughts – the Bangladesh experience

K M A Bakar

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In the face of ever-increasing demand for essential services there is a need to expand facilities proportionately. In most countries, providing essential services such as telecommunications, electricity, gas, water supply, etc., had been the responsibility of the State, which used to provide these essential services through State-owned agencies. The State-owned agencies, being financially handicapped and having other limitations, were failing to adequately meet the increasing volume of demand, which eventually led to the opening up of these sectors of public utility services to private sector participation. The private investors came to play a very significant role in expanding the horizon of the market and providing best services to the consumers/users through healthy competition. The State responsibilities in these areas became more and more that of regulators than of service providers. In the recent past, regulatory functions increased tremendously, which necessitated the introduction of alternative regulatory practice through independent regulators, largely relieving the burden of government functionaries. This ushered in an era of infrastructural development. To secure a level playing field for fair and healthy competition, and to safeguard the interest of investors, services providers, and consumers, legislation has been enacted in many countries for sustainable growth under the new concept of alternative regulatory practice.

The concept of alternative regulatory practice in this region is new. Sri Lanka was the first country to establish a telecommunication regulatory commission under the Act of 1991. In 1997 India set up the Telecommunication Regulatory Authority of India and in the following year, i.e., in 1998, established the Central Electricity Regulatory Commission. Pakistan set up a telecommunication regulatory authority in 1997. Nepal set up the Telecommunication Regulatory Authority under the Nepal Telecommunication Act, 1997. Very recently, Bangladesh established the Bangladesh Telecommunication Regulatory Commission in January 2002 under the Bangladesh Telecommunications Act, 2001 and steps are underway to establish another regulatory commission in the power sector.

Unsatisfactory procedure of taking decisions, very often tainted with an element of bias and arbitrariness, and delay in dispute resolution occasioning frequently taking the dispute to court, seriously retarded infrastructure development and discouraged private investor participation in these essential sectors. The changing lifestyles of people, particularly in economic activities and enjoyment of modern amenities, led the ministries and government departments to allow independent regulators to pursue and develop, under well-designed procedures, an alternative regulatory practice. This was done to facilitate infrastructural development through private investors, operators, and service providers, and participation in an environment of healthy competition.

Decision making usually involves a process of dealing with matters or a dispute by the authority concerned in a transparent manner and in accordance with the relevant provisions of law. This may be an administrative decision, quasi-judicial decision, or a judicial decision having different practice and procedures. In many cases the administrative decision, in the absence of procedural law, is found to have no legal basis and is struck down by courts. In 1945 the United States enacted the Administrative Procedure Act, which proves that a particular procedure for taking a decision by administrative authorities lays the foundation of the doctrine 'due process of law'. In this regard, the doctrine of 'natural justice' has come to play its role in sustainability and acceptability of such decisions in the eye of law. Legal decisions in some cases also set some basis and guidelines.

Judicial decisions are given by courts or tribunals through court proceedings that are used to the adversarial system in an adjudicatory process. Judicial proceedings in our country involve generally complicated and lengthy procedures in many cases, frustrating the purpose of justice. Under the traditional legal system almost all courts have a substantial volume of pending cases. This congestion could not be reduced in spite of increase in the number of courts. Apart from the congestion, the incidental proceedings, and appeal and revision arising out of the proceedings of trial court also takes years to reach a final decision. Alternative dispute resolution practices save time and money and harmonize social rift. They also help commercial activities to go ahead without being tangled in lengthy court proceedings. The Shalish Ain 2001 (newly enacted Arbitration Act 2001) has further widened the area of dispute resolution, particularly in commercial matters through arbitration.

Bangladesh, with an area of 144 000 km<sup>2</sup> and more than 130 million population, has the lowest teledensity in the South Asian region. The BTTB (Bangladesh Telegraph and Telephone Board), as the sole State-owned department had hitherto been providing telephone services to the



subscribers. In 1988 mobile telephone services in the private sector were opened. Currently, there are four private mobile phone companies providing mobile phone services to the subscribers. BTTB has not as yet introduced mobile phone services. Private operators are providing Internet services. Telecommunication services are also being provided through VSATs (very small aperture terminals) by private operators. Voice trafficking through Internet has not yet been permitted in Bangladesh. It is being examined if VOIPs (voice on Internet protocols) can be opened and recognized as a matter of policy and practice. The process of introducing telecommunications through satellite in Bangladesh is underway, which, hopefully, may be opened soon through private sector operation. BTTB is now providing overseas services through four satellite earth stations. Some private operators are already in the process of introducing fixed telephone services. The demand for telephone services is still high and the sector is an emerging area with enormous possibilities of a good market among the private operators through fair and healthy competition. In the backdrop of this state of affairs, the Bangladesh Telecommunication Regulatory Commission has been established.

### **Salient aspects of the Bangladesh Telecommunication Act, 2001**

The Bangladesh Telecommunication Act, 2001 aims at ensuring an efficient and well-regulated telecommunication system in Bangladesh through open competition among the private operators and also through proper regulation of the sector by establishing an independent regulatory commission. The intention of the legislation has been manifested in its will to establish an independent regulatory commission with the transfer of all the regulatory powers from the MoPT (Ministry of Post and Telecommunications) to the BTRC. Under this Act of 2001, BTRC has been vested with the exclusive power of granting licences to the operators, approving fixed standards of equipment, resolving disputes between the operators and operators and subscribers, and monitoring and undertaking a scheme for raising the standard of telecommunication services in Bangladesh. BTRC is empowered to inspect and seize illegal installations and equipment, start cases against violators and conduct investigation of the cases, impose administrative fines, and also issue enforcement orders and injunctions. As compared to many regulatory bodies of other countries, BTRC has been vested with enormous powers, on its functional side, for regulating the telecom sector in Bangladesh. Decisions taken by the BTRC are final, with no provision of appeal or revision thereof by any other authority. The government or the MoPT has the power to formulate policy, which may from time to time advise the BTRC to undertake

certain steps towards improvement and expansion of the telecom sector. In case of any contract with foreign organizations, BTRC has to take prior approval of the government. At the end of each financial year, BTRC shall submit an annual report on its activities of the previous year to the minister of post and telecommunications for placement of the same in Parliament. The BTRC is accountable for its activities to Parliament through the minister, whom the BTRC is required under law to keep apprised of the activities of the BTRC. The constraints of the BTRC in relation to the government are that it cannot create posts for its support staff without the sanction of the government. Budget allocation has to be approved by the government and the terms and conditions of the service of the members of the BTRC and its staff are determined by the government.

The BTRC is a collegial type of commission consisting of five commissioners, of whom one is a chairperson and another is a vice-chairperson. Unless delegated by the commission, all decisions have to be taken by the commission in its meeting as a whole, since the commission is a single entity. In case of disagreement, the decision of the commission shall be the decision taken by the majority of members, the forum whereof shall consist of minimum three of its members present in the meeting.

Having regard to the scheme of the law, to get the regulatory decision with minimal scope of being tangled in lengthy court proceedings and to ensure transparency in decision making, the members of the BTRC are drawn from different areas such as legal, technical, commercial, and administrative. They should have sufficient experience and expertise—not less than 15 years in their respective fields. The commissioner from the legal side shall be a person qualified to be a judge of a High Court. There is a provision for taking advice from experts by the commission while taking decisions, if necessary. BTRC can conduct public hearings and decide issues of public interest. It has the power to entertain complaints and resolve disputes between the consumers and operators, compel witnesses to appear, and give evidence, produce documents, hear the parties through the advocates, and record evidence. It can exercise the powers of a civil court in so doing under the Code of Civil Procedure, 1908. This shows that the BTRC has been vested with powers of a judicial nature. Broadly speaking, the whole function of the BTRC involves technical, commercial, and legal issues and, as such, the members of the commission have been drawn from all these areas with the intention that the decision of the BTRC shall bear in it the reflections of the wisdom and expertise of all the related areas. Because of the composition of the commission, with experts from all the relevant fields, the legislators consciously kept the decision of the BTRC out of the scope of appeal

or revision of its decision by any other authority, thereby securing the unique position and independence of the commission. Unless there be any other consideration of what the law perceives to be the legislative intent, the commission shall do its best to take a decision which in all fairness should not be subjected to any further scrutiny by any other authority. Further, the decision of the commission has been kept immune from being called in question in any court. The commission is empowered to issue injunctions, impose administrative fine up to 300 000 Taka for violation of certain provisions of law and its directives. Apart from these, the commission has also been given the power of contempt of court. The dispute resolution procedure and passing of enforcement order all show that the BTRC is a quasi-judicial body with all the trappings of adjudicatory powers with adequate powers as an effective alternative dispute resolution mechanism in the telecom sector.

There is no denying the fact that absolute power sometimes tends to despotism, arbitrariness, and corruption. This may happen in the case of decision making by an individual authority. When the decision has to be collectively taken by a commission of several members, there will be less chance of arbitrariness and corruption. Sometimes there may be a situation of incoherence and lack of consensus, which may stand as an impediment in the way of efficient and healthy functioning of a commission of this type. However, every system has to be developed through trial and error, which may eventually result in suitable functional practice and procedure.

In case of arbitrariness and actions done not in accordance with law, occasioning failure of justice, there is a remedy under Article 102 of the Constitution of Bangladesh, which is the extraordinary jurisdiction of a High Court to scrutinise the propriety of any order of any government functionary or statutory body. The decision of the BTRC is open to judicial review by a High Court under Article 102 of the Constitution.

With regard to judicial review of the decision of the BTRC, this aspect may be examined further from some realistic standpoint. BTRC has the expertise of highly experienced technical, commercial, and legal experts to give its decision where the issues may be equally and adequately dealt with. The High Court division does not have special expertise of technical and commercial nature. In such a situation, the technical and commercial aspects of the dispute may be more appropriately dealt with by the BTRC. The purpose of adoption of alternative regulatory practice is to get disputes resolved quickly by conciliatory practice. The decision of the BTRC combines in itself judicial, administrative, commercial, conciliatory, and facilitatory attributes, which stands unique and quite unrelated to any other category of judicial and administrative decision. Taking all these

aspects into consideration, and having regard to the exigencies of commercial and development strategies, the decision-making status of the BTRC may be recognized as co-equal with that of the High Court division to prevent miscarriage and/or providing judicial remedy against illegality or arbitrariness, if any. This will provide for quick and speedy resolution of disputes in the areas where regulatory bodies of the nature and status of BTRC are entrusted with that responsibility. This will allow most disputes to be resolved speedily and the decision will be reached with finality, eventually helping the commercially oriented areas of essential services through the private investor's participation in an atmosphere of healthy competition.

The socio-economic conditions of the people of the South Asian region are more or less similar and we have inherited the same legal system which is the legacy of the British colonial rule in India. Although alternative regulatory practice and the alternative dispute resolution mechanism have been in use in most of the European countries and the US during the last few decades, yielding most encouraging results, these ideas are new in this region. This has to be properly shaped in the legislative process and firmly routed alongside the traditional justice delivery system as an auxiliary forum to ease and reduce the congestion in the courts. This has to be done to provide for alternative dispute resolution mechanisms for speedy disposal of disputes in the development of the essential services sector and commerce-related matters. The need for an alternative dispute resolution mechanism has been recognized in recent years by the highest authorities in the judiciary and also by the Government of Bangladesh. The Ministry of Law, Justice and Parliamentary Affairs has been running a project with USAID (United States Agency for International Development) on the alternative dispute resolution mechanism in Bangladesh. The former Chief Justice, Justice Mustafa Kamal, has been closely associated with the project. The present Chief Justice, Justice Mainur Reza Chowdhury and the outgoing Chief Justice, Justice Mahmudul Amin Chowdhury, in their speeches in the felicitation and farewell, laid much emphasis on alternative dispute resolution practices, which in the present day context can only help reduce the mounting congestion in the courts. Alternative dispute resolution presupposes the exclusion of that particular dispute from the jurisdiction of the common law courts and for reasons of their being done in conciliatory spirit, to be kept out of judicial scrutiny through lengthy procedures again and again. In order to keep the decision of regulatory bodies immune from judicial review, the orders concerned must reflect reasonableness and the legal aspects. In this view of the matter, the composition and status of the regulatory bodies should be commensurate with the nature of the job, so that they can best serve the purpose.

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The session noted various issues as regards the regulatory decision-making process in the telecom sector in Bangladesh. As regards the procedure, the BTRC (Bangladesh Telecommunication Regulatory Commission) has been given the power under the law to formulate regulations. And by regulation, they have to develop the procedure. They do not have to seek any guidelines from the government saying what should be the rate, or what should be the tariff, or the procedure. There is a tariff statute, which contains some principles only, but it differs from area to area. BTRC is also taking help from the experience of other states, other countries and other systems. It has full independence in rate setting. There is a small proviso regarding the BTTB (Bangladesh Telegraph and Telephone Board). They have been given a moratorium when they can act as they did in the past. That will expire and, after that, the BTRC has all powers regarding tariff setting in the telecom sector.

There was a query on subsection (q) of Section 30 (2), which says that the duty of BTRC will be to ‘arrange publicity of and public hearings on matters of public interest’. In this context, who is going to decide what are matters of public interest? It was felt that public interest litigation is a concept already in practice in the judicial system in Bangladesh. Any member of society feeling aggrieved can come to the particular forum for redressal. If anybody or any consumer is affected by this decision, they can come to the BTRC for redressal. There is a procedure for a public hearing. BTRC can also go in for *suo motu* if it feels that there is a need for intervention to decide the matter, and give its decision.

The emergency provisions in the recent Telecom Act in Bangladesh was also discussed. There is a provision which says that in the interest of some urgent issues facing the government – and if national issues are involved – the government can suspend services. During the suspension period, persons affected can be given compensation under the law. This is not a thing that curtails the independence of the BTRC, because the law is there for national interest. There is a need to draw a line at some point about various national emergencies, where there may be occasions, and the government may be required to act or may

be required to invoke the emergency provisions of the Constitution. It was pointed out that on such future occasions, BTRC shall take a closer look at the law, and bear in mind the interest of the public.

Unlike in other countries, the Bangladesh Telecom Act provides for adequate police power to the commission. It was felt that in day-to-day regulatory practice, the BTRC may not have much resources and time allocated for using these police powers. It was felt that the commission may like to make least use of police power, as it is not equipped with the capacity to police or patrol the vast domains that have been placed at their disposal. Within the BTRC, there was a thinking of even outsourcing this policing function, thereby delegating the authority to the people with the competence and ability to discharge it. It was suggested that the BTRC, although armed with enormous powers, was created to encourage pluralistic tendencies, and to encourage innovative initiatives by the private sector and others. Thus, it was felt that commissioners should exercise their powers cautiously.

## Session VIII

### Analytical case studies of select judicial interventions: the Sri Lanka experience

Chairperson's remarks

Justice S I Imam

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Analytical case studies of select judicial interventions:  
the Sri Lanka experience

Rohan Samarajiva

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Session summary





# Chairperson's remarks

Justice S I Imam  
Sri Lanka High Court, Colombo, Sri Lanka

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In Sri Lanka, the TRC (Telecommunication Regulatory Commission) was set up in 1991 and it was held by every one in Sri Lanka to be the pioneer in this field. India too has progressed quite far with much experience in this particular field.

In a particular court case in Sri Lanka, Sri Lanka Telecom Ltd, the incumbent and the successor to Sri Lanka Telecom, filed action in the court of appeal against the TRC, and the director-general, who was made the second respondent. Apparently, the appellant, namely, Sri Lanka Telecom Ltd, was aggrieved by an action, as initially they had the sole monopoly in the field of telecommunications in Sri Lanka. Subsequently, as a result of these private companies, namely, Suntel and Lanka Bell coming in, it was pointed out on their behalf that it was detrimental to them financially. Subsequently, the appellant company demanded from the WLL (wireless in local loop) operators certain benefits. They said that the appellant company was of the view that, as a result of these private companies being established, they were deprived of certain revenue, which they should have got. For example, the subsidy demanded by the WLL operators and the appellant company could not be determined, as there was no consensus.

Subsequently, this matter was referred to the then director-general of the TRC of Sri Lanka, and he made an award. He passed an order which covered almost all aspects of their grievances and this matter was referred to, for mediation. Now under Section 12 of the licence, the parties had to initially comply with the conditions in the mediation award. But then, the appellant company, namely Sri Lanka Telecom, did not even take part in the mediation process. Although the second respondent notified them to appear and make representations, they did not do so. What they initially wanted was a writ of certiorari and a stay order preventing the second respondent, namely, the director-general of the TRC of Sri Lanka, from carrying out the award. Subsequently, when this matter was referred to the court of appeal, it was contended on behalf of the respondents that the procedure laid down in Section 12 of the licence, was not complied with by the appellants. When this was brought to the notice of the appellants, they withdrew the appeal. Subsequently, the appeal itself was dismissed and no costs were ordered.

# Analytical case studies of select judicial interventions: the Sri Lanka experience

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I now describe a story: it has drama—good guys, bad guys, mistakes, and lessons learnt. We are looking at a particular period in telecommunications and a specific problem—interconnection. I think it is very pertinent to Bangladesh, because, unfortunately, everywhere in the world, whenever I give lectures on interconnection, I usually mention that Bangladesh does not even have interconnection for a significant proportion of telecom users. Now I hope that you will give all the people who are on your network the ability to talk to other people, so that I can stop using your country as a bad illustration in my lectures. Particularly in Bangladesh, you would know that interconnection is a very difficult problem—one that has not been fully solved in most countries. In Sri Lanka, we have had great difficulty in solving it. So it is not that anyone is immune to these problems.

In regulation, we are looking for situations where there is mutual gain, where both sides can win. In my view, there is no obvious win from the incumbents' perspective with regard to interconnection, that is, from the earlier, historical companies' perspective. This can be illustrated in the following way. Assume that the incumbent has got one thousand customers, and also assume that the new entrant has given telephones to his friends and relatives or whoever and has got ten people on his network. Now you buy a telephone not for the purpose of having it on your table as an ornament but for making telephone calls. So, as far as the incumbent's network is concerned, you can think what you get out of the telephone service is something called 'calling opportunities'. There are 999 calling opportunities for anybody on that the incumbent's network. On the other network, the calling opportunities are only nine. So if there is no interconnection, you can see the situation—that it is much more beneficial to be on the large network than to be on the small network. If you think of countries like Bangladesh, Sri Lanka, and so on, all the powerful people, the hospitals, the police stations, all these people are on the old incumbent's network. So as a result, if you are having a heart attack, and you are on the new network, and there is no interconnection, then your fate is that you are supposed to die there without being able to call the hospital for help.

The primary responsibility of a telecommunication regulator is to make sure that there is interconnection. If there is interconnection, the calling opportunities are equalized. So, in the case of people on the old or large network, now they can call 1009 people. They can now call ten more people than they could before. And on the small network their situation has radically improved; they have gone from nine to 1009 calling opportunities. Now you can see that, for the people who are trying to market the new network, it is a much easier marketing job now than to say, 'Well, why don't you buy my service' when there is interconnection. They can now say, 'You can call the same number of people as there are people on that other network, which is my competitor'. So you can see this is an enormous win, an enormous benefit, for the new entrant. But for the incumbent, while there is income from interconnection and there actually is a benefit to his customers as well, he has got all these emotional and psychological problems that I mentioned before. The benefits are not in proportion to the perceived loss in competitive advantage, and they are very unhappy about the situation. So this is a problem that is found everywhere in the world. Interconnection, even in the United States, has not been a painless activity because of these reasons. Even in the United States or Canada, there have been great difficulties with regard to interconnection. If we go back to 1971, there was a moment when MCI (the challenger in the long-distance market) got completely cut off, technically disconnected by AT&T taking a court order and getting them disconnected so that MCI customers couldn't make any phone calls. I used to think that these things happened only in developing countries, but, going back into the history of telecommunications regulation, I found that these things also happened in the United States. So it is a tough question that we are dealing with.

Now, the underlying problem was worse in Sri Lanka. We had given the incumbent an ambiguous exclusivity for five years as part of privatization. The language that was given in the privatization documents and in the licence modifications was that no other licence shall be issued for international telephone service. This was interpreted by the incumbent phone company as a monopoly, and it was interpreted by many others as not a monopoly, because there were several other operators who were offering international services or who had licences that allowed them to offer international services prior to that. That is why I say it was ambiguous, because it was not clear that there were different interpretations of its meaning. The incumbent was very much dependent on international revenues. At that point, over 60% of its revenues came from international origination and termination. At the end of 2000, because of rate rebalancing, this had changed, but still 42% of the incumbent's revenues came from international, and 27% of

the total came from termination—that is, from calls coming into the country. So this was the really valuable part of the operation. So, you can see that, given such a situation, they would be very defensive about their international revenues.

Now the general context was that we had periodically licensed mobile operators; we had four national mobile operators, and they had interconnection but on quite unfair commercial terms. At that point, we had two national fixed access operators. There were disputes from the very beginning for these companies, and, as an interim solution, the then director-general came up with a solution known as ‘sender keeps all’, saying that there would be no financial transfers between the two parties and a 35 per cent discount on outgoing international calls originating in the competitors’ networks. One side would keep their revenues and the other side would keep their revenues with some provisions that were very controversial even at that point. This had given rise to very high levels of animosity. These people were basically unable to stay in one room at one point. They were being abusive towards each other, and it was quite surprising to know that professionals at the level of CEOs can behave in this manner. But this is the kind of situation we had to deal with.

So I came to Sri Lanka and started work in January 1998. I gave a commitment that we would address the problem by the second anniversary of the interim decisions—which was November 1998. Going through all kinds of procurement procedures, we managed to mobilize Canadian consultants by about May 1998. I told them from the beginning that they must go in for ADR (alternative dispute resolution) and mediation. So what the consultants and the staff did was come up with a process document that was mutually agreed upon by the parties. We actually brought in even the mobile operators at one stage in the beginning, and then we decided to do it in two phases.

We have had three parties in the first phase, that is, the incumbent and the two fixed operators. They agreed with the process document that said that there will be ADR or mediation, and, where shielded by confidentiality agreements, they would try to arrive at a mutually acceptable interconnection agreement. If that worked, that document would be given to the regulatory commission, which would consider it and accept it. If it did not work, we had another set of procedures, which I did not believe would work, because for mediation to be successful you have to have the possibility of a win-win solution. But I really also believed that mediation would bring down the animosity levels, which it did. So we had a curious situation, that was touch and go, because, continuously, the incumbent was making various kinds of demands and threats, saying that they would pull out from this and so on.

For mediation, it is rather important to recognize some of the environmental conditions that you have to create. It is not simply putting people in a room, and getting them to talk to each other. It consists of creating the right environment where they get away from their official and adversarial positions, and create an environment in which they will talk to each other with mutual respect. In Ohio, you put these people into some secluded environment, preferably a pleasant one, and you even get them to take off their jackets and ties if you can, and try to get them to engage in a sort of civilized discussion. So we did all that; but in the end the mediation failed. The mediators' report came to the TRC (Telecom Regulatory Commission) in the beginning of September, and we followed a detailed procedure that was set out in the document that everybody had agreed to and signed. If you have already agreed to the procedure, it is a little difficult to challenge it later. And all the parties had agreed to the procedure. So, by November 1998, we issued the determination regarding the interconnection. The primary difference that we made at the level of the TRC was that we changed the way international termination was dealt with.

Then began the legal phase. Up until that point, there had been no court cases involving regulation in Sri Lanka, as far as I know. Up until that point there was nothing, although regulation had existed for eight years. Now the first case came and it had nothing to do with us. The incumbent went to the district court and obtained an ex-parte injunction against one of the data operators who can be described as an enhanced voice operator. That particular licence, issued in 1991, had provisions to supply enhanced voice services. The incumbent got an ex-parte injunction against this operator who had to shut down shop. So they had to shut down all the operations until the injunction was lifted. I heard about this court case and was desperately running around trying to find out what the court order was about, because I was expecting it to be against the regulatory commission. I found out that it was not against the regulatory commission but against one of the operators. During this time, we were in correspondence with the incumbent operator who was obviously unhappy with the decision. He asked for reconsideration, wanting to know on what basis we had made the decision and so on. So we gave him a response telling him why we had come up with the decision. We had incomplete information at this point. We had to evaluate cost-based interconnection as the objective. However, the company had not provided the cost data. So the entire decision was based on benchmarks. They wanted to know what kinds of benchmarks we had used, and we gave them that information.

In the meantime, we had a very aggressive engineers' union, which was making all kinds of demands and representations, including threatening to shut down the network. So I was at one point drafting

emergency regulations, in case they actually tried it. But we had opened up the lines of communication with the unions before that. I asked around and actually figured out that the engineers were not actually capable of shutting down the network because, in our country, engineers sit behind desks and do managerial tasks. It was only the technicians who were capable of shutting down the network. This was a very straightforward, honest, professional union, and I had explained to them what we were doing. The interconnection decision was one of the most controversial decisions we issued. It was preceded by unions putting up posters in the streets of Colombo, against me and against the commission. I went straight from the news conference announcing the interconnection determination to a meeting with 13 unions where I explained to them what the decision was. So we kept the lines of communication open, and we did not actually get the so-called technical response that was threatened by the unions. There was a time when calls were mysteriously misdirected to various places. But we managed to contain that problem.

In January 1999, the ex-parte injunction that was issued against the enhanced voice operators was lifted. This had nothing not to do with us: it was between two operators. The newspaper headline that Wednesday, I distinctly remember, was: 'Bell tolls for SLT monopoly'. Now this particular headline did more damage to the incumbent than anything else that anyone could have ever thought of, because at this point all kinds of characters came out of the woodwork saying, 'Okay, the monopoly is over and we are going to get into this very lucrative termination business right away'. That was not the commission's fault. That was the fate that the incumbent brought upon itself by going to court without a strong case.

In February 1999, evidence was presented to us that the incumbent was not fully implementing the determination. There was a *de facto* implementation going on because the other parties were settling their accounts on the basis of our decision. The other fixed operators were getting threatening letters from the incumbents saying that they were not paying the proper amount. They said that they were following the regulatory commission's orders and were settling the accounts on this basis. So we had *de facto* implementation on most of the key parts. We were, in the meantime, building up a record leading to a licence condition violation. We have provisions in our law that if a company violates its licence conditions, we have to go through a specified legal procedure. We have to consider the issues, and have a draft licence condition violation order that is served on the party, and we publicized it. We ran the draft order in the newspapers of the country, and we gave them 28 days' time to respond. We were going through the legal procedures of finding an operator guilty of a licence condition violation, which was

something that had never been done before, particularly not against the incumbent.

In March 2000, the incumbent sought 'judicial review' by way of writ jurisdiction against the regulatory commission, where I was the second respondent. The first respondent was the commission, because all decisions in Sri Lankan telecom regulation are taken by the commission. I, as director-general, had no powers whatsoever, though parties blamed me for everything that was going on. The third and fourth respondents were the other two fixed-access operators. So they sought judicial review, and I spent a good part of March–April 2000 preparing a very detailed response to this, which was a fifty-plus page single-spaced affidavit, and two volumes of supporting documentation. We actually carried these into the courtroom with a flourish. I did not have any firm evidence but I sensed they were going to ask for an injunction on that day in May against the regulatory commission, and against enforcement of the interconnection order. In Sri Lanka, we have an independent judicial system. So I was determined that we would not be stymied in this manner and, in fact, as far as regulation was concerned, the very fact that a stay order was neither requested nor granted meant that we had de facto implementation. The company could not go back to the old settlement regimen. They had to work with the new one. While this writ process was going on, they asked for a long date. The TRC licence condition violation procedure was going on in parallel. We were putting notices in the newspapers asking them to make representations, and so on, and as we completed it, they now invoked the appeal powers that exist in the Act, which was allowable against a licence condition violation order. So when they formally appealed, we collected all the documentation that we had given to the court under the writ process. We also reorganized it and sent it to the court of appeals. We did this because, in this case, we could not make representations, and could not put up that in an affidavit. The record had to speak for itself.

In June, the court of appeals ordered consolidation of the two proceedings. After that, as far as I know, nobody told me that the matter had come up for a proper hearing. It went on being postponed, and was withdrawn subsequently. Later on, the fixed operators agreed on a MoU (memorandum of understanding). If the incumbent had accepted our determination, they would have had to make substantially larger payments. They would have to pay Rs 9.50 per minute to their competitors for the international calls that were terminated on the network. If there were more minutes terminated on their networks, they would have to pay more. It was pegged to the number of minutes that were terminated. So they fought against this. While they were fighting this, they were engaging in technical disruptions and various

other things. The competitors decided to give interconnection to various kinds of data operators. So the international traffic started flowing not across the incumbent's gateway but from various other places, and flowing into the domestic networks, and they started flowing into Sri Lanka Telecom's or the incumbent's network as domestic calls. So, in 2000, Sri Lanka Telecom noticed a very significant decrease in its international revenues, because the number of minutes that was coming through their gateway was decreasing very fast because it was coming in through multiple other gateways. At that point, they finally decided that their original course of action was not very productive, and arrived at an MoU with the other two operators. The arrangement was roughly as follows: I would say that if the incumbent had 13 million minutes coming into their gateway, they would pay a certain amount to their competitors. If they had 15 million minutes coming in, they would pay an additional amount. If they had 19 million, they would pay yet another additional amount and so on. This was to incentivise these operators to prevent other people from interconnecting and to take the traffic from Sri Lanka Telecom. So, the result was that when they fought the regulatory commission for a determination, they paid what it required them to pay the competitors—Sri Lanka Rs 9.50 a minute, and this is the decision they fought. But they ended up paying Sri Lanka Rs 17.50 per minute, almost double the first amount, under the MoU that they themselves arrived at later. So the end result of all this was that there was a lot of pain and suffering. People's lives were also affected.

A lot of bad things happened in 2000/2001. The entire level of regulatory risk in the telecom sector went up and investment went down. The image of the regulatory agency was also tarnished because the regulatory agency then tried to participate in enforcing the ambiguous exclusivity. We had a situation where operators were bringing in equipment, and they were being held up at customs and in the ports for long periods for no reason other than the fact that it was harassment of operators, who were suspected to be terminating international traffic. The operators' energies were misdirected to legal infighting. There were court cases – about 14 court cases during this period – and they were all withdrawn in 2001. As far as I know, there is only one court case that is still pending. That is against somebody on a personal capacity for having exceeded the legal authority of his office.

I can remember in the early period when we were talking to lawyers, there was not much knowledge about telecommunications and interconnection issues. One of the good things that happened in the 1999–2001 period was that there was a tremendous learning that occurred in our legal profession about telecommunications, interconnection, and regulatory issues. It is difficult to regulate telecommunications



through the courts, the worst example being that of New Zealand, where there was an attempt to resolve interconnection matters through courts. And the dispute went right up to the privy council and came back. For 10 years, they kept kicking this thing back and forth, and finally, they gave up on the idea that the courts could do telecommunications regulation, and they even created a regulatory agency in the only country that tried telecom reform without a regulator. So I think Sri Lanka also demonstrates that it is very difficult to do complex technical infrastructure regulation through the courts.

So what are the lessons? The lesson that I would point out is that regulators should do their best to try to avoid going to court. My belief is: they should try to build up consensus, try to get 'buy in', and try to prevent people from going to court. And I think now in 2002, everybody has learnt their lessons, and one of the most gratifying moments of my return to Sri Lanka was to have the incumbent, some of the most aggressive officials from the incumbent, telling me in public that they regretted having fought against the regulator. They did not have to say that in public, but they said that they regretted having fought the regulator. So I thought that was some kind of affirmation for the kind of approach based on mediation and win-win solutions that we attempted.

It is very important to conduct the proceedings properly and to build up and manage the record. The key element in the American regulatory system is the dossier. It means not one file but shelves of books, shelves full of documents related to a particular case. So, one of the most important things was to try to maintain the integrity of the documentation, and to keep all the papers together. In many cases, we cannot defend ourselves because we have not documented ourselves enough. It is my belief that we must have people or somebody like a secretary-general who has responsibility for documentation in a regulatory agency so that all this information is properly collected and organized. We have to make sure that it is under control, that it is not tampered with, and that it is available in case of an appeal.

In Sri Lanka, we were not used to giving up all this information, or to give all our reasons. My commission's staff were of the opinion that we should follow the British example, and the British example in the case of the first interconnection determination done by Sir Brian Casper Carsberg was pretty much a one-line decision, and where no reasons were given. It was criticized very intensely later. But it was basically a one-line decision. My staff suggested that we should not give all the reasons because that would lay us open for appeal. The commission, which was made up of very eminent people, after considering this argument as well as my position that we should give reasons, said that we should not give too much information, and we adopted

what I call the 'iceberg strategy'—that is, we gave a small amount of information, but we had the rest of it ready; nine-tenths of it was not made public, but compiled and kept ready. So that is what the company got when it took us to court. We submitted the nine-tenths of the documentation, which we did not give in the first instance.

I would still argue for giving more reasons than we did. But if you cannot do that for whatever cultural or legal circumstances you are in, at least go for the iceberg strategy, where you may keep the documentation ready if somebody wants to look at it. Again, if the case does come up, try to argue it as much as possible in the judicial review process. I think it would be a much better situation where you can explain the process to the courts yourself. In the appeal process, if your record is properly built up, the record will speak for itself. If the record is not properly built up, then there are possibilities of misinterpretation. And then the question may come up as to how much to include in the decision. I tend to prefer the idea of doing draft decisions, and allowing comment on them. But that is something that is very controversial.

## Session summary

Sri Lanka's mediation efforts were discussed in depth. It was felt that it can be very effective between two competing parties. But, sometimes, mediation can lead to a least-common-denominator approach that does not really address the policy issues that the commission needs to provide some guidance on. There might be opportunities or situations where the commission just needs to speak on a particular issue and give guidance to the industry, as opposed to just settling disputes between two parties. For example, in 1997, Sri Lanka was a party to the General Agreement on Trade in Services, and the commission had made a commitment to the regulatory reference paper. It was found that one third of that document is about interconnection. It deals with competitive issues, non-discriminatory interconnection, and things of that nature. So the Sri Lankan regulator made it very clear from the beginning that whatever solutions were to be achieved through the mediation process, it had to take into account stated government policy, cost-oriented tariffs, cost-oriented interconnection, compliance with the WTO (World Trade Organization) regulatory reference paper and things of that nature. It was also made very clear that that was not negotiable. The incumbent's CEO, in the early part of 1998, was of the opinion that the only document that had any legal authority over him were the privatization documents. So the regulator had to gently convince him that the laws of the land will also apply to him, which they after some time accepted. But when the WTO issue was raised, they pleaded ignorance. Later on, they were convinced that it was also a relevant document. Interestingly, they said that the Telecom Regulatory Commission was in violation of the WTO Regulatory Reference Paper. In their appeal, they accused the regulator of having violated the WTO guidelines. In sum, the regulator in Sri Lanka did not allow the options, and the mediation was not completely unconstrained. The mediation, it was felt, had several boundaries that were drawn around it very clearly. These were non-negotiable boundaries. The regulator drew those boundaries very strictly. Thus, mediation has to be constrained in certain cases.

## **Session IX**

### **Roles and responsibilities of judiciary vs regulators**

Chairperson's remarks

T L Sankar

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Session summary



# Chairperson's remarks

T L Sankar

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## Roles and responsibilities of judiciary vs regulators

A regulatory system should be independent, but it should also be accountable. How to reconcile independence and accountability was a matter for further discussion. The basic objective of a regulatory mechanism is to free the industry, which, by its very characteristics, is a natural monopoly. So there is a need to introduce competition as much as possible. Introducing competitive conditions, and, at the same time, balancing the interests of the different stakeholders is the primary responsibility of the regulator. It is not an easy function, because there are very many actors in this game whose relative strengths are very uneven. The asymmetric information available to the incumbent versus the newcomer, the size of the incumbent versus the newcomer, the kind of advantages that a person who is already in as against new people who are coming in, has, and the fact that these industries are government owned, make the above exercise complicated. Public sector undertakings have certain characteristics that are somewhat indifferent to commercial interests. A regulatory system tends to be somewhat long drawn and messy in most South Asian countries, because of lack of data and understanding. Also, there was the lack of acquaintance of the people who present the case or who oppose the case, be they lawyers, regulatory staff, and even the regulators themselves. It is not the function of a regulator to behave like a judge, but to bring about a consensus, to move pro-actively towards a solution of the issues raised. Thus, it would be more appropriate to look at alternative ways of dispute resolution. But the methods of alternative dispute resolution are not easy either. If you had to function properly in any market, if those players are well informed and acquainted, it can easily be settled.

It is clear that a regulatory decision has to be subjected to review. A regulatory order is not likely to give satisfaction to all the stakeholders. Therefore, there would be scope and need for this issue to be reviewed. That is where the judiciary comes in. If the judiciary is to look into the orders passed by the regulatory commissions, what would be the scope of the review? It is not easy to decide this. One must leave it to the judiciary to decide what could be looked at, and what could not be—

to have a simple definition that you try out. There is a distinction to be sought between ‘review’ and ‘appeal’. A ‘review’ may look at the issues of law, whether, legally, the order was passed in proper form and the procedures were followed. But in an ‘appeal’ it could go into the substance of the thing. There was always a very enlightened view that, whatever it is, one has to give deference to the fact that a regulatory order has gone through a process of open discussion, and has been subjected to mediation or whatever interaction of the judicial viewpoint, the technical viewpoint, or the financial viewpoint. It is rather difficult, following normal procedures, to look into that. The issue as to what would be the view that the regulator should take was not clear.

A number of criteria should be looked into, when a regulator is trying to build competition. He has to ensure that it is in keeping with the policies. He has to see that there is equitable availability of the services to all. Therefore, it raises a number of questions as to what really is possible. Would the regulator be right in saying that the poor households should be given services at almost free or very low rates, whereas for the rich householder’s domestic connections, they should be high? This is accepted universally. But if one looks at the cost of service, it will be going against these principles. Historically, when the government was managing, infrastructure provision was taken as a service that has to be provided by the government. It was a service, and therefore, the poor would be charged less, the rich would be charged more. Though, to begin with, in many countries, the cost of service was not so clear, they were concerned about the direction towards cost of service. Then, over that came certain policy objectives relating to socially relevant uses of electricity. The same question can be asked about telecom also. Is it necessary to bring about connectivity to all our remote villages? Government does build roads to remote villages. One could say, ‘Why let them sell to their own remote areas?’ Should interconnection of newcomers be given only at incremental cost? One has built the pipelines at great cost, and now, here comes a newcomer who says that he will pay just the incremental costs, and get on to this. So should he pay proportionately? This is an issue even in developed countries. One has got the sunk cost—it has been spent, and it has to be recovered.

Very often, one would find that a great deal of these costs have been recovered. Now what does one do in this kind of situation? Some of these issues did not find a satisfactory answer. The real point is universal service. It is like ‘the polluter pays principle’. Ultimately, the responsibility has to be fixed, as to who is going to undertake this task of providing the service, which cannot come about in a very competitive way. Network services have this problem wherein you have to build on the network. It is not like building a factory for producing cement or fertilizer. It is difficult to provide service in industry on a stand-alone basis.

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The session mostly dealt with universal service obligation in network industries. It was recognized that it is much more costly to serve distant rural areas. So, given the policy decision, if one wants to connect these people, one has to subsidize them somehow. The real question is what is the best way to subsidize them. If one has to subsidize them, then the taxpayer will have to pay. Typically, subsidies are provided for inputs to a sector. The best example is in education. Historically, most donors provide funds for building schools, but the service delivered is actually education. So one may have examples of fabulous school buildings, but no service being provided. Now there is a shift in the mentality of most donors that subsidy should be provided not for building inputs. Once the output is delivered, the subsidy is to be provided; for example, provide the subsidy when education is delivered and students are educated.

It was recognized that the subsidy system designed especially in the South Asian situation is not transparent. There is a lot of confusion, and there are a lot of misgivings about who ultimately benefits from the subsidy. And, therefore, a simple coupon system was suggested. The idea is to get an entitlement. For example, for each farmer who is cultivating two acres of land or one hectare, one would like to, in the Karnataka (India) situation, allow about three thousand units of power per year. So one gives to each one of the farmers three thousand coupons. As far as the industry is concerned, it will be paid in these coupons, and these may be immediately negotiable in any bank, like a cheque. It is a very good idea, but difficulty may arise if a coupon is not honoured by anyone. The industries have to be hanging around district officers to get that money collected from these coupons.

In Sri Lanka, the subsidy issue is being tackled differently. Basically, instead of just giving money to the incumbent or to a particular company for installing the networks, the basic aim of 'output-based aid' is that they would identify a particular area, say, a particular remote part of Sri Lanka. This was attempted in Chile and Columbia in the telecom sector. In eastern Nepal, too, they identified a certain area, and said this is very high cost, and the government needs to get the network rolled out. Then, this can be put up for bidding, on the basis



of a least-cost subsidy. So, one may specify the various requirements that one wants to achieve. For example, if one wants X number of working telephones per village, or wants a pay phone, one can give all these specifications. And then, these people will have to make bids on their business plan and indicate how much subsidy they want. The problem arises if the company does not deliver. In Sri Lanka, in order to avoid such a problem, a new step has been devised. The companies were not given the right at the beginning. Once they do certain kinds of actions, money is given to them. In Sri Lanka, this is being planned in rural areas. It will be made possible for any of the operators in Sri Lanka, including those that have mobile licences only or fixed licences only, or data licences, to bid for it. For the purpose of these activities, their licence limitations will not apply. In Sri Lanka, rural telephony operators are not getting enough revenue from these people. There is a cross-subsidy problem. If one works out rural telephony through cross subsidy, the operators see these people as loss makers, rather than as real customers. One of the reasons why they see them as loss makers is because in an integrated system they do not get to see the termination revenues. They see only the origination revenues. So one may have asymmetric interconnection rates, where one pays more to terminate a call in a rural area, because the networks are more costly. This has been done in Chile, and they have done it in the ratio of one to twenty. To terminate a call in the capital cities, if it is one US cent, in the high end, it is 20 cents. So one gets a very big revenue stream coming in from the calls that come from the urban areas into the rural areas. So now they have got that capital cost problem solved through least cost subsidy. They have got a second revenue stream, which comes from calls coming in, and the original revenue stream, which is from people making calls out. So then the business case is much better. In South Africa, the concept is being attempted.

Citing again the Sri Lanka experience, it was pointed out that in Sri Lanka, there is no telecom area that has any roll-out obligations. The incumbent operator is expressly excluded from universal service obligations. Mobile operators have no roll-out obligations. It has been noted that, despite this, from 1994 till date, Sri Lanka has quadrupled the size of the network, and has had the fastest growth rate in the whole area, short of China. This has been done through competition, by allowing the tariffs to go up. Telecom tariffs in Sri Lanka have gone up by more than 100% over the last four to five years. Because one has unnaturally low prices, the market signals do not work properly, and the industry does not get the proper kind of investment. Simply keeping the tariffs low for the existing consumers would prevent adequate kinds of investments, and provide less connectivity to those who are currently not connected. In Sri Lanka, there was a ten-year waiting list

for quite some time. The connection fees used to be over 200 dollars a month; but, in fact, it was 600 dollars because one has to pay about 400 dollars in bribes in addition. By creating competition, a situation was created where that 400 dollars was no longer to be given. It is still a very high connection charge. But, still, Sri Lanka now has more people on the waiting list. When Sri Lanka started the process, they were aware that the costs have not actually come down. It was suggested that they allow the market to work to the extent that the market can work, and then try to go in for subsidies and universal service actions. It has been noted that in many countries, incumbents are not at all interested in rural areas. There is a need to get some clarity about the basic economic principles before one starts talking about the benefits to individual consumers.

In India's port sector, a small element of social obligation has been accepted, but there is a cap on that, say 1.5%–2% of revenue generated. Some felt that unrestricted cross subsidization, loaded on to tariffs and compulsorily required to be borne by the service provider, should not be allowed. That should be borne by the government.

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## Concluding session

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Ahsanul Haque Molla

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Vote of thanks

F Q M Farooq



# Rapporteur's summary

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Senior Fellow, TERI, New Delhi, India

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There is no uniformity in the South Asian region on various regulatory issues such as the regulator's role, the government's relationship with regulators, the regulatory process, and most importantly, appellate bodies, as well as the interface with the judiciary. It varies according to market development in a particular country. More than that, the regulatory role is different even across sectors within a country. So, depending on the requirements and the needs of the sectors, we find that the regulatory role varies. Interestingly, more or less, there is consensus that the role of the regulator is to implement government policy. The formulation of policy is the exclusive province of the government. While we have seen that most of the regulators in this region have concentrated on tariff issues, there is a general feeling that the regulator has to go beyond tariff determination. There is less agreement as to how far the regulator can take a pro-active role in market development or sector development. But it has been felt that, particularly in developing countries, there is a need for regulators to address various concerns, particularly concerns of affordability and accessibility of services. But here it was recognized that the broad framework on this issue has to be formulated by the government. But, given the framework, a methodology has to be worked out by regulators in consultation with stakeholders.

It was agreed that a regulatory body should be independent, and should act as a referee. Regulatory accountability was discussed in depth. There was considerable debate on what accountability means in the context of regulatory governance. Can the regulator be accountable only to itself? If it is accountable to itself, how do you fence that accountability? In most regulatory legislation, it is found that the regulator is made accountable to Parliament. For example, the annual reports containing its annual activities have to be placed before Parliament for scrutiny. But another question raised relates to the fact as to whether it would be possible to have some kind of Parliamentary oversight, through a standing, select, or hearing committee. This can be a mechanism for the committees to know, to understand, and to get educated as regards regulatory development in the country at regular intervals. A very vexed issue that came up during discussion was the

relationship of the regulatory bodies with the minister. It is true that in most regulatory legislation, the areas of responsibility or the role definition have been given in the statute. Nevertheless, beyond this statute, there is a need for consultation with the minister on certain important developments on the subject. The UK model of consultation process was discussed. There was, however, no unanimity on the issue, and it was felt that further research is required on the subject.

The regulatory process and, particularly, alternative regulatory instruments, were discussed in detail. The advantages of workshops, advisory committees, public hearing, etc., which most of the regulatory commissions are seized of, was felt to be complex under various circumstances. The difficulties in adopting these processes in various countries were noted, but it was felt that these could be the areas of intensive understanding and adoption in the future. Also, mediation and arbitration were discussed fully. For example, in a situation where there are incumbents with uneven strength *vis-à-vis* the new entrants, how could the arbitration proceedings yield results? Of course, here the experiences differ from country to country. While Sri Lanka has a positive experience, India's telecom sector has a mixed experience.

The other important issues, discussed and debated at length, relate to what could be the appeal and review mechanism in regulatory governance. Different sectors, industries, and countries have adopted different methodologies as regards the appeal mechanism. We have seen regional variation in the appeal and review mechanism in the infrastructure sectors. But, in general, it was felt that the principle of natural justice should prevail during the process, and the interest of different groups should be balanced. And, importantly, it was felt that there is a need to codify and share experiences of regulatory and judicial decisions, and case laws. While discussing the advantages of the high courts and the expert appellate tribunal on the appeal issue, it was felt that perhaps the advantages lie with the appellate tribunal.

Finally, country experiences especially those of the US, India, Sri Lanka, and Bangladesh were discussed. While discussing the US experiences, it was seen how the judicial review evolved over a period, and how they reviewed the procedural fairness, and examined the question of law. Regulators in the US normally defend their decisions in court. This is quite different from the procedure adopted in Canada, where the regulator does not appear before court. In the South Asian experience, a different picture emerges. First, in South Asian countries whether the regulators should defend their own decisions before the appellate court is an issue on which there was no unanimity. This is an issue to be considered for in-depth research in the future. Second, while it is true that regulatory accountability requires some kind of appellate mechanism, the issue is what could be the nature of that

appeal. There are many views on the subject, but one emerging view is that the appeal can be only on a point of law. Many legislations in this part of the world are not very clear on the issues except one or two statutes. The grounds of appeal have been left open to the interpretation of courts. Another suggestion is that the scope of appeal, perhaps, could exclude the merits of the case, and if required, the existing regulatory legislation can be amended. The universal service obligation issues were discussed in depth. What could be the role of the regulators *vis-à-vis* the role of the government during the process of fulfilling universal service obligations, and how one can reconcile the various objectives of regulation keeping in mind the efficiency criteria, were discussed, but without agreement.

# Introductory remarks

S Sundar

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Regulatory experience in South Asia is very limited. In fact, we have had regulators only for the last five years, while Sri Lanka has had it maybe for the last 10 years. India's experience has been limited to some six years. Bangladesh has experienced this very recently. There is not enough experience in the various aspects of regulation in this part of the world. Regulatory jurisprudence has not grown in any significant manner. The regulatory mechanism itself is yet to be understood in this part of the world by the various stakeholders, especially the governments of the countries concerned. Also, regulators are yet to establish themselves and earn credibility. All this, hopefully, will happen given time and more opportunities to exchange experiences between the countries. In this workshop, the best part of the time was spent discussing issues of accountability to government, Parliament and the judiciary, and to discuss and define the extent of the interface between the judiciary and the regulator. All this cannot be settled overnight. Over a period, hopefully, the stakeholders (especially the government and the judiciary) will begin to understand, recognize the need for independent regulation, and learn to respect the regulators and their expertise. Hopefully, over a period, the regulators will establish their credibility and earn, in our civil societies and our polities, the kind of respect that the judiciary in our countries has acquired over a period. That would be the test of success of the regulatory mechanism.

SAFIR has been a very useful instrument for bringing regulators and the regulated entities involved in South Asia together, both by means of workshops such as this, and annual training programmes. What is lacking in all our countries is groups or agencies within our countries who would advocate the cause of independent regulation, and who would educate civil society, the government, and various players in our countries about the need for independent regulation and the manner in which independent regulation should be encouraged to grow and earn respect. I hope that between our countries, with the help of SAFIR, we are able to craft such a mechanism or encourage such an agency to come up that will carry the message of independent regulation to our governments and civil society.



# Concluding remarks

Ahsanul Haque Molla

Minister of State for Post and Telecommunications, Dhaka, Bangladesh

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I feel greatly honoured to be present among such distinguished personalities in this closing session of the workshop. I understand that at the end of the two-day workshop you all are tired and exhausted. I will not tax your patience much.

I believe that the rich deliberations made in the two-day workshop leading to the formulation of important recommendations will greatly help the concept of alternative regulatory practice to get firmly established in this part of the world, maximizing the benefits to the consumers in a healthy culture of participation and competition.

The Government of Bangladesh is fully committed to the policy of privatization of the utility service sectors, to be regulated by an independent regulatory body. In the industrial sector, the Bangladesh Privatization Commission is working towards augmenting the process of privatization of the state-owned industries. The privatization of power and energy sector is already underway through appropriate legislation.

The BTRC (Bangladesh Telecommunication Regulatory Commission) is the first regulatory commission in Bangladesh. Under the Bangladesh Telecommunication Act, 2001, the BTRC has been vested with full powers to regulate the telecommunication sector, including its development through efficient regulation and as an independent body composed of highly experienced persons from different branches of knowledge. The government retains only the power of policy making, international relations, foreign contract, training, etc.

In the interest of unfettered growth and development of the national economy through commercial competition, the need for speedy disposal of disputes assumed momentum, which led to adoption of the alternative dispute resolution mechanism. If commercial disputes are taken to court, there is no denying the fact that the commercial activities in many cases come to a halt and ultimately die down due to lapse of time, say, years and decades, which results in a discouraging situation. Again, on the other hand, absence of judicial scrutiny could result in arbitrariness and miscarriage of justice. Taking into consideration all this, the concept of alternative dispute resolution through regulatory bodies needs to be synchronized in such a manner that there may be minimal scope left for court interference. To develop sound and

healthy workable practice and procedures, the judges, lawyers, and regulators need to be sensitized in the proper sense of the term. This workshop has made valuable contributions to this end. Legislations and judicial precedents, combined, can help the regulatory practice in this region.

I can assure you that the Government of Bangladesh will consider the recommendations of the workshop and do its best to create an environment for the successful working of alternative regulatory practice by sharing your experience.

## Vote of thanks

F Q M Farooq

Vice-Chairman, Bangladesh Telecommunication Regulatory Commission, Dhaka, Bangladesh

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We have come to the last leg of the workshop, which was spread over two days. We had the opportunity to hear and share the experiences of various representatives of regulators as well as luminaries from the judiciary and judicial departments, and legal experts. I would like to take this opportunity to express our deepest thanks to our honourable guest today the Minister of State for Post and Telecommunications, Mr Ahsanul Haque Molla, who could take out some time for us, be with us, and give us advice. We know that he has a very busy schedule and he was busy with his state affairs. Still, he could spare some time for us and we are grateful to him for that. I would also like to take this opportunity to express our deepest thanks and gratitude to the contributors for their deliberations. We had the opportunity to share their experiences, especially for Bangladesh Telecommunication Regulatory Commission, which is only six months old. We have really benefited very much from the experiences of other regulators. And, last but not the least, I thank the organizers – TERI, SAFIR, PPIAF and BTRC – who have worked very hard in organizing and conducting this workshop very successfully.

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