

A Final Word

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In his response, Ergas makes three points; I will briefly address the first and last.

I cannot be quite so categorical that firms should always be allowed to recover the costs of prudent investments. The Coasean bargain between the firm and its customers may well involve a promise by the regulated firm that it will bear the risks of speculative investments (as would occur in a competitive market). Where there is such a promise it seems unwise to later change the terms of the regulatory contract to raise prices to consumers to cover the costs of unprofitable investments. Doing so undermines the incentives for customers to invest in reliance on the monopoly service. In some cases, preventing firms from recovering prudent investments does protect the interests of consumers.

Ergas is correct to emphasise that a regulator is not exactly like a court. However, I emphasised that a public utility regulator can be and should be thought of as a kind of arbitrator. Like other arbitrators, regulators must develop rules of procedure which, while more flexible than those of the courts, still ensure fair and wise outcomes. Viewed as a form of dispute resolution, I suggest that Johnny is not doomed to fail. Johnny can assist in the ongoing elaboration of the regulatory contract through the resolution of disputes with wisdom and fairness. Like a judge, Johnny may occasionally disappoint and may err. But, like a judge, the dispute-resolution service role remains a valuable part of the long-term regulatory contract.

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