

Incentives for Efficiency through Regulation

By ENVER MASUD

Regulatory incentives for efficiency should be viewed as a comprehensive process, rather than solely a simple mechanistic procedure. In the following article, the author reports that the Iowa State Commerce Commission has developed such a process. It has also adopted a simple mechanistic procedure which could serve as a powerful incentive by itself. In its pursuit of regulatory incentives for efficiency the commission's staff has been surprised to find that electric power brokering schemes may not be as effective as their proponents claim, and that a goal of power production efficiency should be fewer control centers.

THE 1981 session of the Iowa legislature required the Iowa State Commerce Commission to "adopt not later than July 1, 1983, rules and policies to implement a program for the continuous review of operations of rate-regulated public utilities with respect to all matters that affect rates or charges for utility service." The 1983 session passed an act, known as House File 312, relating to public utilities and providing civil penalties. This act, among other things, requires the commission to adopt rules for analyzing a utility's management efficiency, for assessing rewards and penalties, for disallowing return on excess generating capacity, and for encouraging energy and capacity sharing.

The principal staff responsibility for implementing these legislative requirements for electric, telephone, gas, and water utilities was assigned to the new Operations Review Division which began functioning in the fall of 1982, and is now staffed at about 80 per cent of its authorized ceilings. The primary goal of our division is to control utility costs. Being a new division we were able to take a comprehensive look at the issue of regulatory incentives for efficiency, and structured the organization

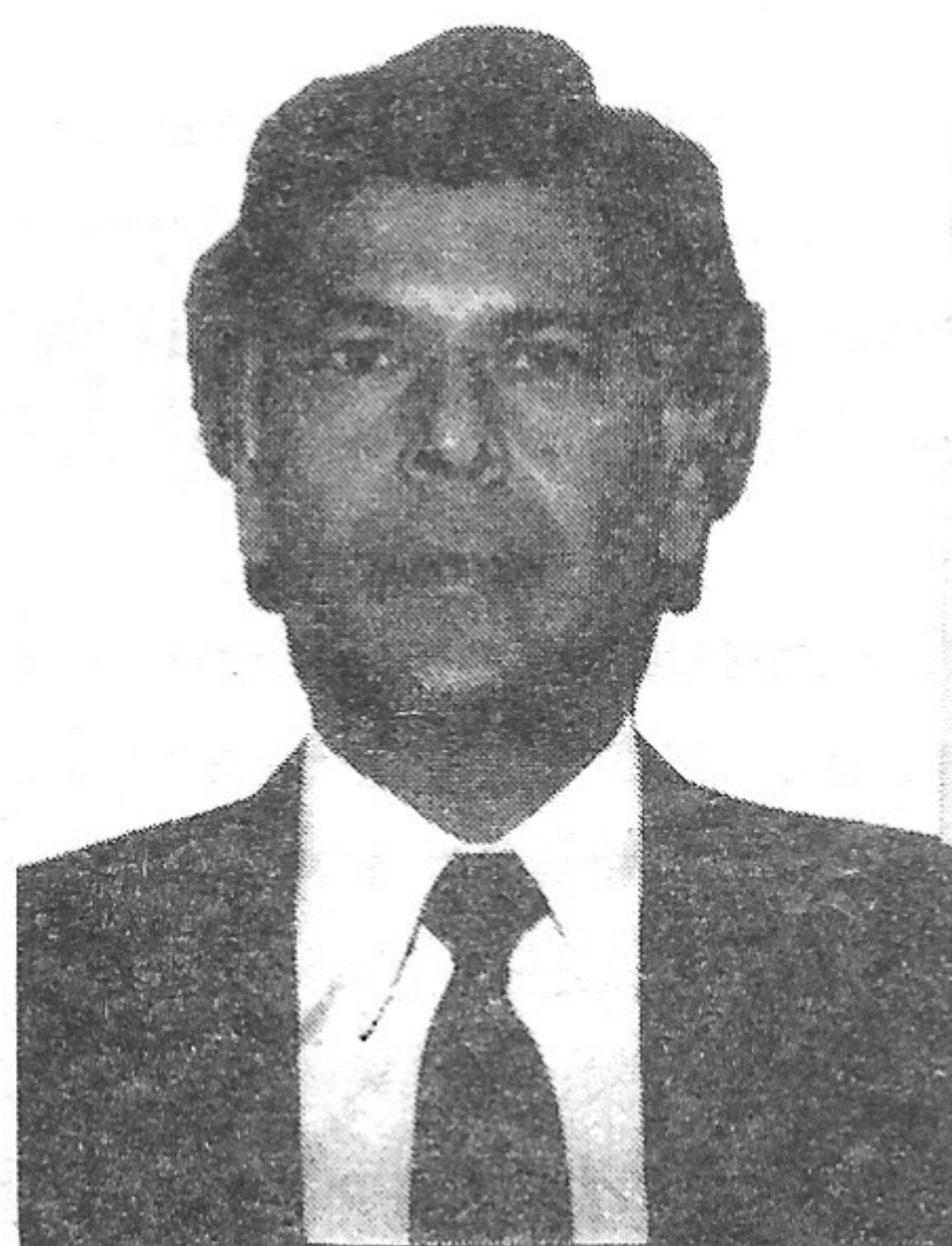
accordingly. We see regulatory incentives for efficiency as a comprehensive process, not just a mechanical system of incentives. This article describes this comprehensive process, our organization, and our priorities. It also provides an overview of our four top priority projects: our annual report, project lambda, incentives, and service attitudes survey. We believe each of these has unique features which should be of interest to utilities and regulators.

The Operations Review Process

The Operations Review Division attempts to control costs and service quality by a four-step process:

- 1) Identify opportunities for improvement.
- 2) Investigate improvement opportunities identified.
- 3) Persuade utilities to set objectives to realize opportunities defined.
- 4) Recommend incentives, when necessary, to realize opportunities.

The first step, identification of opportunities, consists of statistical analysis, modeling, research, and audits. Company income statements and operating statistics are evaluated, trends plotted, and significant deviations from a company's past performance or the performance of other companies (or both) observed. Models are utilized to evaluate proposed capital investments, operating costs, and revenue requirements. Research is conducted to identify opportunities for innovation. Company records are audited to assure compliance with the uniform system of accounts, and identify potentially unreasonable costs. This process yields many potential opportunities which are prioritized on the basis of expected benefits to the consumer versus expected costs of investigating these opportunities.



Enver Masud is currently director of the Operations Review Division at the Iowa State Commerce Commission. He has had six years of experience in systems engineering, research, and policy formulation with the federal government, where he managed the National Power Grid Study, the National Electric Reliability Study, and the Strategic and Emergency Planning Branch of the U. S. Department of Energy. **Mr. Masud** is a registered professional engineer, holder of three degrees, and a senior member of the Institute of Electrical and Electronics Engineers.