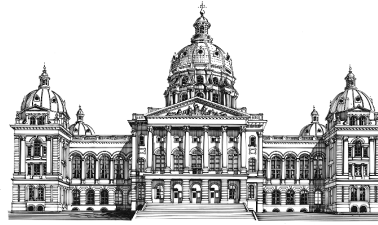

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Incentive Regulation

ISSUE

A description and review of incentive regulation of telephone utilities.

AFFECTED AGENCIES

Utilities Division, Department of Commerce

Office of the Consumer Advocate, Department of Justice

CODE AUTHORITY

Chapter 476, Code of Iowa

BACKGROUND

Incentive regulation is a modified form of rate-of-return regulation. Regulators authorize a base rate-of-return, and earnings above the authorized rate are shared between the ratepayers and the shareholders. Incentive regulation is perceived by some as a method to encourage utilities to streamline operations, control costs, and offer the most advanced and efficient technology. Updating technology is necessary for some telephone utilities to enable customers to connect to the Iowa Communications Network (ICN).

The Regulation of Telephone Utilities Study Committee met during the 1992 Interim to review Iowa's current laws and rules regulating telephone utilities to determine if any changes were necessary to allow for greater efficiency by utilities while guaranteeing quality service and reasonable rates for consumers. The Study Committee reviewed several written materials and heard oral testimony. A major report entitled "Study of the Role of the Telecommunications Industry in Iowa's Economic Development" prepared by Arthur D. Little, Inc. that was commissioned by the Iowa Utilities Board and the Department of Economic Development was also reviewed by the Committee.

The A.D. Little Study indicated that the telecommunications marketplace is changing rapidly due to technological innovations (digital switches, fiber, cellular, satellite, etc.) and by the introduction of competition at the federal and intrastate level. The A.D. Little Study recommended passage of incentive regulation because it would allow the marketplace to keep pace with technology, without total deregulation, and would allow customers an opportunity to share in the profits.

The Study Committee did not recommend or oppose incentive regulation because there was no clear general consensus among the telephone utility industry, the Iowa Utilities Board, or the Consumer Advocate of the impact such a change in regulation might have. The Study

Committee submitted a list of provisions that should be included if incentive regulation is adopted to help address the concerns of all parties involved. These include:

- An initial review of a participating utility's rates within 12 months prior to participating.
- Development of a mechanism that provides sharing any increased earnings with customers.
- Minimum participation period of 2 years, unless the Consumer Advocate or the utility asks for termination due to exceptional or unforeseen circumstances.
- Periodic reporting on implementation as determined by the Iowa Utilities Board.
- A maximum time period for the authority of the Board to establish and maintain a plan of incentive regulation of 4 to 5 years.
- A study of the effectiveness of the plan of incentive regulation be submitted to the General Assembly.
- The local exchange utility be required to submit a detailed plan for investment of revenues in the utility's network and facilities as well as the disposition of any additional revenues.
- The Board and the Consumer Advocate have a strong role in assuring the quality of services provided.

CURRENT SITUATION

The General Assembly did not approve incentive regulation during the 1993 Session. This was due in part to the fact that telephone deregulation received serious consideration during the latter part of the Session. Telephone deregulation was also not approved.

ALTERNATIVES

The Fiscal Committee may want to review the Study Committee findings and recommend that the Legislative Council reauthorize the Study Committee and require them to research deregulation as opposed to incentive regulation.

BUDGET IMPACT

No impact to the General Fund. Any additional regulatory costs incurred by the Utilities Division or the Consumer Advocate would be billed to regulated utility companies. The impact to utility companies and consumers cannot be estimated.

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