

Paul Joskow and Richard Schmalensee : “*The US model transformations*”

***Abstract***

*We discuss US regulators’ use of “cost of service” (COSR) or “rate of return” (ROR) regulation to set allowed revenues of investor-owned utilities and the prices paid by their customers for distribution services. We begin by outlining the structure of the US electric power industry and the basic operations of state regulatory commissions. We provide an overview of the determination of an investor-owned utility’s allowed revenues as the sum of allowable operating expenses and capital related costs, defined as the utility’s rate base times its allowed rate of return. Retail prices are then set for various classes of customers to enable the utility to earn its allowed revenues. We conclude with discussions of regulatory lag and the performance of cost-of service regulation in practice and of recent developments of performance-based (or incentive) regulation intended to improve performance.*