

Implementing incentive compatible menus of contracts to regulate electricity distribution investments

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Abstract— Investment regulation constitutes one of the major difficulties in regulating monopolistic activities such as electricity distribution. Information asymmetries and uncertainties over technology and demand especially hamper the evaluation of the efficiency of network investments. In this context, ex-ante regulatory schemes with ex-post corrections such as profit sharing contracts can be particularly useful. Moreover, menu regulation could encourage distribution firms to provide regulators with more accurate information. However, such a mechanism is rarely applied in electricity distribution. In order to facilitate its diffusion, this paper provides clear guidelines to construct incentive compatible menus of profit-sharing contracts and discusses its possible implementation in Spain.

Index Terms— Investment regulation; Menu of contracts; Profit-sharing; Electricity distribution

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