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An expository note on depreciation and profitability under rate-of-return regulation

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Abstract

This note provides a simple, general proof that if a regulated firm is allowed to earn its actual (nominal) one-period cost of capital on the depreciated original cost of its investments, and if actual earnings equal allowed earnings, then the net present value of all investments is zero for any method of computing depreciation. Some implications and extensions of this Invariance Proposition are discussed.

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