An Economic Perspective on Regulated Utility Depreciation

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- What does economics tell us about depreciation for a regulated utility?
  - This can serve as an objective for how depreciation ought to work
  - In most (all?) jurisdictions there are probably regulatory or legal constraints that will cause a departure from the economic ideal

- What does the regulatory bargain say?
  - Regulators must provide the company with a reasonable opportunity to recover its investment and to earn a fair rate of return on its investment
  - The company in return has certain obligations, including providing service to customers under defined conditions and meeting quality standards, for example

- Investors own the company's assets and are paid a return on and of the assets in exchange for their use
- The company has an obligation to ask for economic depreciation rates so that it has a reasonable opportunity for the return of the investors' assets
- The regulator has an obligation to approve economic depreciation rates for the same reason

- The effect of the advent of competition must be taken into consideration when determining economic depreciation rates
  - Depreciation is no longer just a timing issue
- The electric utility industry will not have the telecommunications industry's advantage of rapidly falling costs and increasing revenues that permitted large write-offs due to inadequate depreciation

- Reward should follow risk
  - If investors own the assets, they bear the risk and should reap any gain or loss from the sale of an asset or from a useful life that is longer or shorter than anticipated
    - If an asset is no longer used and useful, it should be removed from the rate base
    - This is why it is so important to set economic depreciation rates
  - If, on the contrary, for example, losses on an asset sale are charged to ratepayers, then the gains should flow to ratepayers as well

- Symmetry is key