the result of the Order No. 442 overall growth rate analysis.

WCG claims that the 1.13 industry average market-to-book ratio used in Order No. 442 does not justify a positive estimate of "sv" because this average reflects high (above one) market-to-book ratios of utilities that are not issuing common stock. Utilities that are issuing or are projected to be issuing common stock in the future, WCG claims, generally have market-to-book ratios lower than one. Therefore, WCG claims the Commission's estimated "sv" calculation is biased upwards. As a remedy, WCG claims that the market-to-book ratios of only those utilities expected to be issuing new common stock should be considered in measuring any "equity accretion" and that such considerations would show a negative "sv," or dilution rather than accretion.

In Order No. 442, an industry average "s" (measure of new stock issuance growth rate) was multiplied by an industry average "v" (measure of market price relative to book value). Since most utilities' stocks were selling above book value, the resulting estimated "sv" had a positive value.

The Commission agrees that accretion (or dilution) occurs only upon issuance of new stock. As WCG points out, if most utilities are not issuing stock, most utilities do not experience accretion (or dilution).[6] If "s" and "v" were individually estimated only for those utilities that expect to issue stock, and if those utilities that are issuing common stock are likely to have market-to-book ratios below unity, then the product of "s" and "v" based upon such data might well have a slightly negative value rather than the positive .155% indicated by the analysis in Order No. 442.

WCG did not, however, support its claim that only those utilities issuing common stock have market-to-book ratios below one. Verification of such an assumption would require separate computations of the "s" and "v" factors for each company in the sample. The purpose of the generic approach is to estimate the industry average cost of equity, not the cost of common equity for each electric utility. To estimate "s" and "v" for individual companies, rather than on an industry average basis, would be counterproductive and inconsistent with this purpose.[7]

[6] WCG Request for Rehearing at p. 2.

[7] "v" could be readily calculated individually for each company as it is merely a function of the price-to-book ratio. Estimating "s" individually for up to 100 utilities would appear to be a prohibitive task.

WCG's suggestion to use only data for those companies issuing common stock in the base period would also lead to an inaccurate estimate of the industry average growth rate, which was the objective of the analysis. To the extent that the utilities that were expected to issue common stock in the base period were the utilities whose stock was selling below book value, as WCG alleges, they would not have been generally representative of the industry, since the industry average market-to-book ratio was slightly above unity during the base year.[8]

WCG's suggested implementation methodology would have the Commission use a non-representative sample of utilities (i.e., only those issuing stock) on which to base the industry average cost of common equity. The industry average should also reflect the fact that most utilities now publicly issue common stock, on average, less frequently than annually. To base the "sv" growth component solely on data for those utilities that issue common stock in a particular year would wrongly ignore the utilities that did not expect to issue stock in that year.

In any event, the growth rate ultimately used to determine the benchmark was not the 4.7% resulting from the "br+sv" analysis, but rather 4.5%, which also reflected the Commission's analysis of historical growth rates and analysts' projections. The 4.5% growth rate used in Order No. 442 is therefore based upon analysis independent of the outcome of the "br+sv" analysis. Concerning WCG's argument that the full flotation cost percentage should be deducted in computing the "sv" component, the Commission is not persuaded as to the validity of this argument at this time. Since the Commission's choice of the growth component of 4.5 percent is based upon the results of analyses independent of the "br+sv" growth analysis, the Commission need not address this point further. WCG's request for rehearing on this issue will therefore be denied.

*D. Ratemaking Rate of Return*

1. Summary

Petitioners raise numerous arguments with regard to the Commission's ratemaking rate of return concept. This topic in Order No. 442 has promoted the most opposition.

EEI, the Southern Company, and BEC argue, on various bases, that parties were given inadequate notice of the issue, and that it is not fair for the

[8] Order No. 442, 51 FR 343 at 357 (1986).

Commission to adopt this concept in the final rule when it was not proposed in the NOPR or raised by any party in the comment process. They also object to the extent and nature of the support upon which the Commission relied to justify its final decision.

BEC and NEP argue that the Commission has not supported the basic predicate for the ratemaking rate of return concept, insofar as it has not adequately demonstrated the need for consistency in the definitions and estimates of the allowed rate of return and the rate base. They argue that there is no need for the Commission to base the rate of return determination on its method for computing rate base; the determinations are said to be independent of one another.

BEC, the Southern Company, EEI, and NEP also argue that the Commission has not adequately demonstrated that there is an inconsistency that needs a remedy. Petitioners argue that the hypothetical example used in Order No. 442 to explain the ratemaking rate of return concept was flawed in its assumptions, did not adequately reflect the real world, and therefore did not prove an inconsistency exists. For example, they state that the assumption of a forward-looking test period does not adequately reflect the effects of regulatory lag. Alternatively, EEI, BEC, and NEP argue that stock market prices reflect the way rate base is defined and estimated. They claim that any inconsistency between the way rate base is computed and the allowed rate of return is already adjusted for the cost of capital estimate of the Commission.

EEI and BEC contend that even if there is an inconsistency between the rate of return and the rate base, there are probably many other aspects of the cost of service that could likewise be evaluated for consistency which might offset the adjustment being made to the rate of return.

The Southern Company, EEI, and NEP further assert that, if an adjustment is to be made, the formula adopted by the Commission is not the right one with which to make the adjustment. They argue that the formula is based on erroneous assumptions about the way rate base is defined and estimated. For example, they challenge the assumption that the average test year rate base incorporates monthly compounding.

Finally, applicants raise two additional arguments. First, BEC argues that application of the ratemaking rate of return concept to a company with a growing rate base would require that it make an annual rate increase filing in order to update its allowed rate of