document involves an amendment that only extends the compliance time without compromising air safety and does not impose any additional regulatory or economic burden on any person. During the interim, public comment is invited. This amendment is, therefore, not major under Executive Order 12291 (46 FR 13193; February 19, 1981) and not significant under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979). Because its anticipated impact is so minimal, it does not warrant preparation of a regulatory evaluation. For these reasons and because few, if any, Boeing Model 727 airplanes are operated by small entities, I certify that it will not have significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Issued in Seattle, Washington on July 13, 1984.

Wayne J. Barlow,

Acting Director, Northwest Mountain Region.

[FR Doc. 84-19557 Filed 7-24-84; 8:45 am]

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DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 37

[Docket No. RM80-36-000; Order No. 389]

Generic Determination of Rate of Return on Common Equity for Electric Utilities

Issued: July 18, 1984.

AGENCY: Federal Energy Regulatory Commission.

ACTION: Final rule.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is amending its regulations by adding a new Part 37 to establish procedures for determining benchmark rates of return on common equity for jurisdictional electric utilities and for applying them in individual cases. The rule provides that the Commission will have annual proceedings to determine the average cost of common equity to electric utilities and a method for updating this cost estimate quarterly until the next proceeding.

The findings made in the annual proceeding will be used to establish benchmark rates of return to assist the Commission in making determinations of the allowed rate of return on common equity in individual rate cases. The benchmark rates of return from the first two annual proceedings will be considered advisory only. Beginning with the third annual proceeding, the applicable benchmark rates of return will have the status of a rebuttable presumption. They will be presumed binding unless the parties settle on a different rate of return, or the Commission finds the subject utility to be significantly more or less risky than average, or the Commission determines that a finding of undue discrimination requires that a different rate of return be allowed.

The rule is intended to achieve three purposes: to produce more accurate and consistent rate of return decisions, to involve the Commission more directly and currently in a consideration of the financial and operating circumstances of the electric utility industry, and ultimately to reduce some of the burdens that rate filings impose on applicants, intervenors, and the Commission.

EFFECTIVE DATE: The final rule is effective August 24, 1984.

FOR FURTHER INFORMATION CONTACT: Arnold H. Meltz, Federal Energy Regulatory Commission, 825 North Capitol Street NE., Washington, DC 20426, (202) 357-8153.

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Before Commissioners: Raymond J. O'Connor, Chairman; Georgiana Sheldon, A. G. Sousa and Oliver G. Richard III.

SUPPLEMENTARY INFORMATION:

I. Introduction

The Federal Energy Regulatory Commission (Commission) is amending its regulations by adding a new Part 37 to establish procedures for determining benchmark rates of return on common equity for jurisdictional electric utilities and for applying them in individual rate cases.[1] The change in procedures has three purposes: to produce more accurate and consistent rate of return decisions, to involve the Commission more directly and currently in a consideration of the financial and operating circumstances of the electric utility industry, and ultimately to reduce some of the burdens that rate filings impose on applicants, intervenors, and the Commission.

Under the new rule, the Commission annually will determine an estimate of the average cost of common equity for the jurisdictional operations of electric utilities and an indexing procedure to update this estimate quarterly between proceedings. After the close of each calendar quarter, the Commission will publish a benchmark rate of return based on the estimated cost of common equity for that quarter. The benchmark rates of return resulting from the first two annual proceedings will be advisory only.

Beginning with the third annual proceeding, the rule provides that the allowed rate of return will presumptively be set at the benchmark rate of return in effect at the time a company files either an initial rate schedule or a change in an existing rate schedule. It will not be biding in an individual case, however, if there is a settlement based on a different rate of return, or the Commission determines that the risk of the operations under the rate schedule is significantly different from average, or the Commission determines that a finding of undue discrimination requires that a different rate of return be allowed.

In accordance with the rule adopted here, a Notice of Proposed Rulemaking, Docket No. RM84-15-000, is being issued concurrently with this order to institute the first annual proceeding to determine: (1) An estimate of the average cost of common equity for the jurisdictional operations of public utilities for the year ending June 30, 1984 and (2) an indexing procedure to establish quarterly benchmark rates of return for application in individual rate cases.

II. Background

A. Historical

In theory, the allowed rate of return on common equity establishes the level of profits a regulated utility will be allowed to earn. In practice, a company may earn above or below the allowed rate of return.[2] The determination of this

[1] Unless otherwise indicated, the term "rate of return" refers to the rate of return on common equity.

[2] While electric utilities have generally earned below their allowed rates of return over the last decade, these aggregate company results may not

Continued

allowed rate of return in regulatory proceedings has been the subject of discussion and debate for many years.[3] Moreover, the rate of return is frequently mentioned when the subject turns to ways of improving regulatory procedures by relying more on generic rulemakings to decide commonly occurring issues. In this regard, a Commission Staff Study in 1980 specifically recommended the use of a generic approach for the equity rate of return issue. That approach, the study concluded, "provides the Commission with a better means for addressing the substantive aspects of the rate of return issue, while, at the same time, offering a procedural mechanism that is far more efficient and less expensive."[4] It was against this background that the Commission decided to initiate this rulemaking to propose a generic procedure for determining allowed rates of return in wholesale electric rate cases.

B. Notice

As stated in the Notice of Proposed Rulemaking (Notice), the purpose of this rulemaking is to establish procedures for generically determining rates of return on common equity for electric utilities subject to the Commission's jurisdiction and for applying such rates of return in individual rate cases.[5] The Notice contemplated dividing the electric utility industry into three risk classes and then determining a rate of return for each risk class. Alternatively, the Notice suggested that the use of a single risk class might be appropriate, thereby allowing an industry average rate of return to be applied to all jurisdictional electric utilities. It was proposed that these procedures be done biennially and that during the two year interim the base year results be updated quarterly by indexing them to interest rates on U.S. Treasury bonds.

The allowed rate of return in an individual case would have been determined by averaging the quarterly rates of return for the appropriate risk class in a specified manner. This generically determined return would have had no effect if the parties to the case reached a settlement on the rate of return issue. Otherwise, the generic return would in general have been binding; waivers could have been granted in unusual cases, but it was anticipated that this would happen only rarely.

C. Comments

In November 1982, the advisory staff, after notice, held an informal public conference with interested persons to discuss the proposed rule.[6] This was followed by the formal submittal of comments in early 1983.[7] The public comments raised a number of concerns with the proposed rule. In summary, the commenters believed that the risk classification scheme was unduly burdensome, as well as technically unworkable in a generic context. Most also felt that the electric utility industry is not sufficiently risk-homogeneous to make the alternative industry average approach equitable. Finally, concern was expressed regarding the proposed indexing mechanism because of the volatility in interest rates over the last few years and the belief that these interest rate changes were not adequately tracking changes in the cost of common equity.

Despite the concerns raised in the comments, there was widespread support for the concept of a generic determination of rates of return, and several commenters offered alternatives which were designed to address the proposed rule's perceived deficiencies. These alternatives tended to focus on procedures which would produce an industry average rate of return that either would be advisory only or have the effect of a rebuttable presumption. Such procedures, in effect, represent more flexible versions of the industry average approach proposed in the Notice.

D. Final Rule

Based on an evaluation of the comments and the general policy objectives discussed in the Notice, the Commission has decided to adopt a non-binding industry average approach. Under the rule adopted, an estimate of the average cost of common equity for the jurisdictional operations of public utilities and an indexing procedure to update this estimate quarterly will be determined annually through informal rulemaking proceedings. After the close of each calendar quarter, the Commission will determine a benchmark rate of return by updating the annual estimate of the cost of common equity in accordance with the indexing procedure found most useful. The benchmark rates of return resulting from the first two annual proceedings will be advisory only. They are intended to provide guidance to parties and serve as a point of departure for the Commission in setting allowed rates of return. Appropriate evidentiary weight will be given to these rates of return based on the record in each case.

The benchmark rates of return resulting from the third annual proceeding will have the status of a rebuttable presumption. It will be presumed that the allowed rate of return in an individual rate case is the benchmark rate of return in effect at the time a rate schedule is filed. To rebut the presumption, there must be a showing that the risk of the operations under the rate schedule is significantly different from average, that a different rate is required to remedy a situation of undue discrimination such as price squeeze, or that there is a settlement based on a different rate of return. The burden of going forward with evidence rebutting the presumption will be on any participant contesting the use of the applicable benchmark rate of return in an individual rate case.

III. Basis for the Rule

A. The Cost of Common Equity

The cost-based nature of ratemaking has resulted in the cost of common equity becoming the standard for rate of return determinations. It has been difficult to apply this standard, however, primarily for two reasons: It is not a directly observable cost and so must be estimated, and it can also change

necessarily depict the earnings experience of electric utilities on the wholesale portion of their businesses.

[3] *See Establishing the Rate of Return on Equity for Wholesale Electric Sales: Potential Regulatory Reforms* (December 15, 1980) (hereinafter "Commission Staff Study"), a discussion paper by a Federal Energy Regulatory Commission Staff Study Group; C. Curtis, *Decisional Delay in Wholesale Electric Rate Increase Cases: Causes, Consequences and Possible Remedies* (January 23, 1980), a report submitted to the Congress under section 207(b) of the Public Utility Regulatory Policies Act; Federal Energy Regulatory Commission Advisory Committee on Revision of Rules of Practice and Procedure, *Report of the Subcommittee on the Review of the Decisional Process* (July 26, 1979); Notice of Proposed Statement of Policy, Just and Reasonable Rate of Return on Equity for Natural Gas Pipeline Companies and Public Utilities, Docket No. RM77-1, issued October 15, 1976, 41 FR 46618 (October 22, 1976).

[4] Commission Staff Study, *supra*, at 5. After notice, 46 FR 3909 (January 16, 1981), Commission staff held an informal public conference to hear and discuss views from interested persons on the proposals made in the staff discussion paper. *See* Transcript of Informal Public Conference, Docket No. RM80-36-000, January 30, 1981.

[5] Notice of Proposed Rulemaking, Generic Determination of Rate of Return on Common Equity for Electric Utilities, Docket No. RM80-36-000, issued August 26, 1982, 47 FR 38,332 (August 31, 1982).

[6] Notice of Informal Public Conference, 47 FR 50298 (November 5, 1982).

[7] Initial comments were due by January 15, 1983 and reply comments by February 22, 1983.

significantly as capital market conditions change.

In terms of relative significance, the cost of common equity is a large but not usually the largest element of a utility's cost of service. Including associated income taxes, it may account for 15 to 20 percent of total costs.[8] It normally is more than a utility's cost of debt and less than a utility's fuel costs.[9]

The practical regulatory importance of the cost of equity is, however, substantially greater than its relative contribution to the total cost of service. The cost of equity can account for the largest part of the disputed dollar amount in a rate case. Utilities and intervenors may differ by four percentage points or more in their estimates of the required rate of return on common equity, which can lead to a similar difference in the total proposed rate; in relation to the proposed rate increase, the importance of the disputed equity return is of course much greater.[10]

There is little doubt as to the applicable legal principle: A utility should be allowed a return on its common equity commensurate to that which investors can expect on investments in unregulated companies of comparable risk.[11] A utility should, in other words, be allowed a rate of return equal to its opportunity cost of capital. The problem is to determine what that cost is.

This question is easy enough to answer in a formal sense: A utility's cost of equity is the return that investors require when they buy the utility's common stock.[12] This return is comprised of a risk-free real return reflecting the time value of money, compensation for expected inflation, and compensation for risk. In competitive capital markets, this return must also be equal to the returns which investors require on other investments of comparable risk. The formal answer does little to resolve the issue in a practical sense, however.

Investors purchase common stock in the expectation of receiving dividends, or in the expectation of reselling it at a higher price to someone who will buy it in the expectation of receiving dividends. The cost of equity is thus the dividends that investors must expect when they buy common stock. The same might be said of the cost of debt: Its cost generally is the interest payments that investors expect when purchasing a debt instrument. But in the case of debt that expectation rests on well-defined contract rights. For common stockholders the only practically important economic right is the right to share in such dividends as the corporation may declare out of whatever profits it may earn.

That is the nub of the problem. The determination of the cost of equity capital is typically based on investor expectations, but those expectations are not in turn based on anything as definite as the terms of a bond trust indenture. Investor expectations can only be measured indirectly. In one commonly used form of discounted cash flow analysis (DCF), for example, it is assumed that investors expect a return equal to current dividends plus some growth in those dividends over the forseeable future. By addressing the investor's expected rate of return in this way, one can also obtain an estimate of the investor's required rate of return, since under conditions of market equilibrium the two rates of return will be the same.

Indirect measurement is better than no measurement at all. The cost of equity in dynamic capital markets cannot be determined through precedent, nor is the intuitive judgment of the Commission and staff likely to be a reliably accurate guide. The difficulties inevitably involved in the measurement go far, however, to explain why the range of dispute can be so wide on this issue.

B. Current Procedures

The problem of measuring the cost of equity is now dealt with through adjudication in each case. The utility, staff, and intervenors all typically sponsor witnesses for the purpose of estimating the utility's cost of equity. Much of this evidence is repetitious from one case to another. A small number of analytical techniques, such as DCF or risk premium methods,[13] is used in each case and applied to utilities that resemble each other an must raise their capital in the same market. Furthermore, there is reason to doubt that the commitment of substantial litigation resources to this repetitious task in fact produces satisfactory results when measured by the correspondence of allowed rates of return to utilities' actual costs of equity.

Not all of the responsibility for the divergence of allowed returns from actual costs of equity, however, can be placed on the procedures used to determine the cost of equity capital. Measuring the cost of equity is a difficult task and likely to be imperfectly done under any conceivable procedure. Moreover, any single estimate, no matter how precisely made, is unlikely to correspond to the cost of equity over the entire rate effective period; only some form of automatic adjustment mechanism analogous to the fuel adjustment clause could maintain a close correspondence between an allowed return and actual costs over changing market conditions, and we do not propose to adopt such a mechanism in this rulemaking.[14]

It appears, however, that current procedures contribute to the problem. In fact, it is questionable whether the adjudicatory process is the best means of resolving an issue like rate of return. Since past Commission decisions may not provide much guidance on what the appropriate rate of return should be in an individual case, particularly during a period of rapidly changing economic conditions, there needs to be a *de novo* evaluation of the rate of return issue in case after case. Furthermore, although the aggregate resources committed to the rate of return issue by applicants, intervenors, and the Commission may be substantial, the resources available in an individual case, of course, are limited. A natural consequence of this process is that the rate of return evidence in any given case may be of uneven quality, and may also focus on different time periods. Not only can these several factors affect the accuracy of a cost of equity determination in an individual case, but they can also

[8] Earnings available to common stockholders (used here as a proxy for the cost of equity) and income taxes (including an investment tax credit adjustment) accounted for 17.7 percent of electric operating revenues in 1982, based on an earnings allocation factor of 95.0 percent reflecting the ratio of electric utility operating income to total utility operating income. *See* Energy Information Administration, Department of Energy, *Financial Statistics of Selected Electric Utilities—1982*, February 1984, at 8–12.

[9] Net interest charges (including a credit to Allowance for Borrowed Funds Used During Construction) accounted for 8.4 percent of electric operating revenues in 1982, based on the same allocation factor used for earnings, *supra*. Fuel costs (including nuclear fuel costs and purchased power) accounted for 42.7 percent of electric operating revenues in 1982. *See Financial Statistics, supra*.

[10] *See* Commission Staff Study, *supra*, at 25–28.

[11] FPC v. Hope Natural Gas Company, 320 U.S. 591,603 (1944).

[12] To be more precise, one needs to include flotation costs in the definition of the cost of common equity. These are the costs incurred in selling common stock which, though relatively small, are not accounted for elsewhere in a company's cost of service.

[13] These techniques are discussed in more detail in the Notice, *supra* note 5.

[14] The quarterly indexing procedure included in the rule adopted here is intended to ensure that rates reflect recent capital market conditions at the time that the rates go into effect. Subsequent adjustments under the rule, as under current procedures, must be made through a new rate case.

influence the extent to which rate of return decisions are consistent across companies and over time.

The current case-by-case approach also suffers from another and, perhaps, less obvious shortcoming. Consideration of the cost of equity issue potentially offers the Commission an opportunity to assess the financial and operating condition of the electric utility industry, but that potential is now realized to only a very limited degree. Electric rate cases may not reach the Commission until two years or more after the period from which the financial data submitted in them are drawn. When they are considered, time and resources limit consideration of the broader issues. But even if the evidence were more current and sufficient time and resources available, data relating to a single electric utility do not offer the best or most useful perspective for evaluating the industry as a whole.[15]

These shortcomings in the current approach suggest three purposes for a rule establishing generic procedures for determining the cost of equity capital. One is to reduce the commitment of staff and outside resources by reducing some of the duplication involved in the case-by-case approach. A second is to make more accurate determinations of the cost of equity, principally by concentrating staff and outside resources on a single generic proceeding, rather than dividing them among numerous cases. This purpose is also served by improving the consistency of cost of equity determinations across companies and over time through procedures which better ensure that similar companies are treated similarly. Finally, the Commission can make the cost of equity determination a more useful vehicle for evaluating the current status of the electric utility industry.

In the Notice, significant emphasis was placed on the wasteful duplication of effort involved in the case-by-case approach. It was hoped that a generic procedure would allow a substantial saving of resources for both the Commission and parties. This purpose was reflected in the form of the proposed rule, which sought to achieve an almost complete elimination of case-by-case adjudication of the rate of return issue. The comments filed in this rulemaking have convinced us that it is not now possible to rely solely on a generic procedure to determine the cost of equity. The rule adopted here therefore involves a phase-in from current procedures to a presumptively controlling industry average approach.

C. Potential Benefits of the Rule

We believe that even with these modifications, over the long term the rule can reduce the resources used in litigating electric rate cases. It can do so directly by changing the factual question considered in the individual proceeding from the general one of cost of equity to the narrower one of relative risk. It can also do so indirectly by encouraging settlements. Litigation, whether in a judicial forum or an administrative one, is in large part a product of uncertainty, which allows opposing parties each to hope that the final results will justify the continued proceedings. The generic procedure adopted here should reduce uncertainty, since the advisory and later the presumptive rate of return will be known to all parties by the time each proceeding begins.[16]

The potential importance of a generically determined rate of return in reducing uncertainty is suggested by recent experience after the Commission's explanation of its suspension policy in the *West Texas* case.[17] As explained in that order, proposed electric rate increases that are found to be potentially unjust and unreasonable are suspended for only one day if the proposed increase, based on preliminary review, does not appear to be more than ten percent excessive. The *West Texas* order encouraged utilities to draw from both company specific and industry-wide Commission precedent in developing rates that can be expected to be found substantially cost justified. Utilities thus have an incentive to file rates that conform to Commission guidelines, and to a considerable extent they have been successful in meeting the *West Texas* standard. The availability of a benchmark rate of return under the rule adopted here should reduce uncertainty further by providing guidance on the rate of return that the Commission will use as a point of departure.[18]

The saving of resources in individual cases must of course be balanced against those used in the generic proceeding itself. The net effect cannot be predicted with certainty; it depends too much on the way in which parties respond to the rule. We think it likely, however, that on balance the rule ultimately will save resources both for the Commission and for parties.

The second benefit that the rule can be expected to produce is more accurate and consistent rate of return decisions. The rule will allow the Commission to concentrate more resources on a careful consideration of the current cost of common equity to electric utilities as a group. Additional resources, however, do not guarantee more accurate results. There are, as discussed earlier, inherent problems in determining the cost of equity capital that no amount of analysis can wholly solve. But the rule will direct and focus those resources in a way which should improve the decisionmaking process in this area.

At the informal public conference, the proposed rule in the Notice was discussed as presenting a tradeoff: More time and resources could be devoted to a generic proceeding than to individual cases, but at the same time, individual company differences would be less visible in the industry average used in such a proceeding.[19] The rule that we adopt here does not present any such tradeoff. Differences in required rates of return between one company and another stem from differences in risk, and under the final rule, the risk issue is left to case-by-case adjudication, where warranted. The industry average used in the generic determination therefore is not intended to be an estimate of the cost of common equity for any particular electric utility. Rather, it is intended to apply to companies whose risks are not significantly different from the industry average risk. For companies with more divergent risks, the industry average is intended to serve as a useful benchmark for evaluating individual company costs of equity.

Used in this way, the industry average offers its customary statistical

[15] It has been noted that the case-by-case approach, "focusing as it does on the 'trees' of individual utilities, makes it difficult for the Commission to perceive the 'forest' of the industry being regulated." *See* Commission Staff Study, *supra*, at 4.

[16] In this respect, the rule adopted here differs from the one originally proposed. In the proposed rule, the allowed return would have been based on the cost of capital for quarters subsequent to the filing of the rates. In the informal public conference, however, it was suggested that parties might be reluctant to settle under the proposed rule for fear that they could later be shown to have settled at a return less favorable than would have been allowed. That concern is not as relevant to the final rule. On the other hand, more certainty was a source of concern to some who thought it was the uncertainty about the rate of return which enabled parties to negotiate settlement agreements.

[17] West Texas Utilities Company, 18 FERC ¶ 61,189 (1982).

[18] *See* Commission staff study, *supra*, at 27, where the data in Table I indicate that a change in the rate of return of only one percentage point can amount to almost 8 percent of the proposed rate increase. It should be noted that this finding was based on average data for 51 rate cases in 1980. The impact of a one percentage point change in the rate of return may vary considerably from one case to another.

[19] *See* Transcript of Informal Public Conference, Docket No. RM80-36-000, November 18, 1982, at 133-134.

advantage. The data used in cost of capital analyses of individual companies may vary for reasons having nothing to do with those companies' cost of equity capital. In the industry average, these spurious variations tend to cancel each other out. As a result, the benchmark offered by the industry average cost of equity is likely to be more accurate than individual utility costs of equity determined from data relating solely to the subject companies. Moreover, the rule adopted here unbundles the relative risk issue from the cost of equity determination and allows full attention to be given to whether the risk of an individual company differs significantly from that of the industry average.

The third benefit that the Commission expects from the rule is a more current and direct understanding of the financial and operating circumstances of the electric utility industry. It seems reasonable to anticipate that the annual proceeding will focus the Commission's attention on the electric utility industry, as opposed to an individual company, in a way not possible under current procedures. By doing so, the annual proceeding can expose the Commission to industry trends which highlight aspects of its regulatory responsibilities not directly related to the rate of return. In addition, whenever the Commission has to decide the relative risk issue in an individual case, the required decisionmaking process itself should further enhance the Commission's understanding of the industry.

IV. Comment Analysis

A. Introduction

This section reviews the comments submitted in this proceeding that concern the substantive aspects of the final rule adopted here. The comments have shown how difficult it is to assess the relative risk of a company. Since that difficulty seems to be compounded in a generic context, the Commission believes it prudent to leave the resolution of that issue to the case-by-case approach. Since the final rule has the Commission determine, in each annual proceeding, the industry-average cost of common equity (including flotation costs) and the method of indexing between proceedings, initial findings on these issues are deferred to the first such proceeding.

B. Alternative Proposals

Commenters were, in general, critical of the risk classification approach of the Notice. They argued that no single risk measure is reliable enough to use in distinguishing companies by risk class. Nor did anyone propose a reasonable method of combining several risk measures into a composite measure. As commenters observed, relative risk established by one risk measure is not consistently replicated by other equally reasonable measures. Further, anomalies in statistical measures obtained by using reported data can lead to erroneous or inequitable results. Commenters also raised the concern that attempts to periodically classify utilities into risk classes would probably consume more time and resources than the current case-by-case approach.

With regard to the alternative industry average approach of the Notice, commenters were also critical. Many disagreed with the premise of risk homogeneity in the industry and believed that it would be inequitable to give the same return to all.

Several commenters recommended periodic proceedings whereby the Commission would review the state of the industry and publish findings on the average and/or the range of common equity costs. It was proposed that these cost estimates serve essentially advisory roles in individual rate proceedings. In general, these commenters stated that parties to proceedings should be free to disagree with these findings and introduce evidence in support of their views.

These commenters differed primarily on the frequency of generic proceedings and the manner and extent to which the findings would be binding in individual proceedings. Staff suggested a "benchmark alternative" with quarterly determination and publication of the industry average cost of common equity and various risk measures.[20] These data would automatically be made part of the record in all proceedings but would be advisory only. The Edison Electric Institute (EEI) proposed annual proceedings where the Commission would determine and publish an average and a range of rates of return which would serve as "points of departure" in individual proceedings.[21] EEI also recommended that the burden of proof in individual rate cases be placed on the party or parties that recommend an allowed rate outside of the range. Public Systems recommended a similar approach with annual or biennial proceedings after which the Commission would affirm an administrative law judge's decision if it was within the generically determined range and supported by ample data and logic.[22] The New England Power Company (NEP) proposed another variant where the industry average cost estimate would be "presumptively controlling" in individual rate cases.[23] The administrative law judge would be authorized to depart from it only if the individual utility was significantly above or below average risk or if investor expectations of dividend growth rates had changed since the last generic proceeding. NEP recommended further that its proposed procedure should be administered so that most companies would receive the generic rate.[24]

Other commenters suggested substantively different approaches. Some recommended that the Commission set allowed rates of return for each utility based on the rate of return most recently allowed by its predominant state regulatory commission. Alternatively, a few commenters recommended that state-determined rates of return might be used in those cases where the Commission-regulated wholesale revenues constituted a small percentage of a company's total electric revenues. One commenter suggested that the allowed rate of return determined at the state level be viewed as a rebuttable presumption.

One other alternative suggested by commenters warrants discussion. The focus of this rulemaking has been on the determination of the allowed rate of return on common equity. Some commenters, however, stated that the Commission should instead establish an allowed overall rate of return for the industry based on a weighted average cost of all capital—debt and equity. Commenters claimed that this approach would provide incentives for the lowest overall capital costs over time. One commenter contended that if the overall cost of capital were established on a pre-tax basis there would be an incentive to minimize income tax expenses by maximizing the use of debt capital. Some asserted that if an overall pre-tax rate of return for the industry were made applicable to all companies, they would attempt to reduce their

[20] Staff Comments, dated December 24, 1982, at 4.

[21] Initial Comments of EEI at 42.

[22] Initial Comments of Public Systems at 4 and 87.

[23] Initial Comments of NEP at 5 and 13.

[24] Other commenters who supported, in their Initial Comments, one or another of these approaches include Baltimore Gas and Electric Co. at 2, Boston Edison Co., *et al.* at 6 and 19, Carolina Power and Light Co. at 7, Cleveland Electric Illuminating Co. at 2, Duke Power Co. at 4, Florida Power and Light Co. at 26, Gulf States Utilities Co. at 4, Illinois Power Co. at 2, Niagara Mohawk Power Corp. at 3, Ohio Edison Co. at 2, Public Service Company of Indiana at 1, Arizona Electric Power Cooperative, Inc., *et al.* at 27, and Morgan Stanley and Company Inc. at 5.

overall cost of capital and income taxes below the average in order to maximize their own returns on equity.

The Commission agrees, in general, with the concerns expressed by commenters regarding the risk classification proposal. As for the single rate of return approach, the Commission recognizes that the assumption of risk homogeneity among all jurisdictional utilities is not adequately substantiated.[25]

The Commission, however, sees substantial support from commenters for a compromise alternative that falls somewhat between these alternatives. The final rule is based essentially on the suggestions offered by staff, Public Systems, EEI, and NEP. The Commission agrees with the commenters that the generic rates of return should not be binding. The Commission notes, however, that Public Systems, EEI, and NEP each recommended some manner by which greater evidentiary weight might be given to the generic rate of return in individual rate cases. This, of course, makes the rule more effective in reducing litigation and otherwise conserving resources.

The rule adopted here incorporates a rebuttable presumption standard similar to that proposed by NEP. Under the rule, parties will be able to rebut the benchmark rate of return on only three bases: a showing of a settlement based on a different rate of return, a situation of undue discrimination, such as price squeeze, which requires a remedy, or a significant risk difference.

The Commission's decision to adopt a "significant risk difference" standard is based on three considerations. First is the consideration that differences in risk are synonymous with differences in the cost of capital. Second, since evaluating risk or cost of capital differences involves difficult technical issues on which there is much controversy, the Commission believes that the evidence should be sufficient to demonstrate that a measurable difference in fact exists. Since the benchmark rate of return will be determined using an industry average cost of equity estimate, on which more confidence can generally be placed, the Commission believes that a strict standard should govern attempts to rebut it in individual cases. Third, there is some merit to not recognizing risk differences that are based on efficiency differences. In this way, companies are given an incentive to improve their efficiency. A relatively efficient company may be allowed a rate of return somewhat above its cost of capital while a relatively inefficient company may get a rate somewhat below its costs.

The Commission, however, believes it appropriate to phase in the "presumptively controlling" aspect of the final rule by having the benchmark rates of return resulting from the first two annual proceedings be advisory only. In this way, the Commission hopes to gain useful experience in implementing the rule. By operation of the rule, the benchmark rates of return resulting from the third annual proceeding will have the status of a rebuttable presumption in individual rate cases.

The "follow the states" proposals have obvious appeal as far as they reduce resources used in rate cases. However, since state commissions may have substantively different ratemaking policies, the state-determined rates of return may not be appropriate for wholesale rates. Further, a state-determined rate of return may relate to a different time period than the wholesale rate case to which it would apply and thus be incompatible with the Commission's objective of allowing rates of return reflective of capital market conditions at the time rates go into effect. Finally, the Commission is responsible for making its own independent evaluation of utility costs.

While there appears to be some merit to the incentive aspects of the "overall rate of return" proposals, the Commission believes that it would be inappropriate to impose this regulatory scheme on a mature industry comprised of companies with significant differences in both capital structure ratios and embedded costs of debt and preferred stock. Such an approach would likely yield excessive rates of return on common equity for some companies and inadequate ones for other companies.

C. Frequency of Generic Proceedings and Indexing

Virtually, all commenters who focused on the frequency of generic proceedings recommended that they be held more often than biennially. No commenter argued for less frequent proceedings. Most considered a two-year period too long between Commission reviews and determinations. Many commenters pointed to the extreme volatility in financial markets over the last few years as a reason why more frequent Commission examinations are needed.

Most commenters were favorably disposed towards indexing between proceedings although they had reservations about the manner in which it would be done. Some lauded the Commission for wanting to keep allowed rates of return current. However, there was a general desire for some stability in these rates. Many expressed a fear that the indexing may cause excessive volatility in allowed rates of return. For some this fear related to the potential for indexed rates to diverge from actual costs, especially when based on interest rates that do not bear a one-to-one relationship with common equity costs. One customer group expressed a concern that utilities may game-play the timing of their rate requests based on expectations of changes in generic rates if they were allowed to fluctuate too much. These commenters suggested various ways to deal with the excessive volatility, including indexing less frequently than quarterly, putting a limit on the quarter-to-quarter change, allowing a large change to trigger a new proceeding, and, generally, having more frequent proceedings.

The Commission agrees with the commenter who said that, without the risk classification scheme, annual proceedings will be manageable and more helpful. Although annual proceedings may result in the use of greater resources initially, the Commission believes that, over time as the proceeding becomes more routine, there will be a significant decline in the resources used. The more frequent review will result in greater accuracy in accounting for year-to-year changes in financial markets. Through annual proceedings, the Commission will be more attuned to the changes occurring in the market for utility securities and be able to respond more quickly to the changes.

The Commission believes that a quarterly indexing mechanism is necessary between the generic proceedings even if they are held on an annual basis. Since each generic proceeding will necessarily focus on the cost of common equity for the preceding year, there is a need to somehow update these numbers to the time period to which they will apply. And since capital costs can change significantly over short periods, there is a need to have some way of keeping the benchmark rates current until another generic proceeding can be concluded. Otherwise the benchmark rates of return will lag behind the cost of capital. The Commission also believes, however, that there should be some stability in allowed rates of return. Since indexing methods can be designed to achieve any

[25] In this regard, the Commission is aware that recent events relating to nuclear power may have increased the disparity in risks of individual companies in the industry. *See, e.g.*, Salomon Brothers Inc., "Electric Utility Monthly", May 3, 1984.

desired tradeoff between stability and the currency of allowed rates of return, the Commission believes that the specific features of the indexing mechanism should be dealt with in the annual proceedings.

D. Time Period for Application of Benchmark Rates of Return

The Commission, in its Notice, raised the issue as to whether allowed rates of return on common equity should be based on estimates of capital costs during the test period or during the period of the rate's effectiveness. Implicit in the discussion of that issue was the Commission's use of the most current information at the time of its decision even if that information reflected changes in market conditions beyond the close of the hearing record.

The few comments that addressed this issue are divided. One utility and one customer group recommended that rate of return be treated the same as other costs.[26] The customer group raised the special concern that the Commission should not treat the rate of return as a "moving target" and employ extra-record evidence in setting allowed returns.

Three utilities and one customer group took the opposite position and recommended that the Commission continue to treat rate of return different from other costs.[27] They generally argued that the rate of return be based on estimates of the cost of capital during the period of the rate's effectiveness made at the time of the Commission's decision.

The final rule diverges from the proposed rule in the Notice and sets the presumptive rate of return for any rate filing equal to the benchmark rate of return in effect on the date of the filing. The considerations behind this aspect of the rule are six. First, capital costs do not appear to be significantly different from other costs. The rule attempts to treat rate of return as much as possible like other costs of service. In this respect, the rule does not entail having the Commission take a retrospective view of the cost of equity at the time of its decision. Second, the rule will provide some certainty at the time of filing as to what the Commission is likely to allow. Third, the specification of a standard time period for determinations of capital costs in all rate filings should encourage parties to focus any disagreements on consistent time periods. Fourth, while there may be a lag in the benchmark rate compared to actual capital costs during the period of a rate's effectiveness, there is no *a priori* bias one way or another. Fifth, basing the applicable benchmark on an estimate at the time of filing should provide greater incentives for risk and cost reductions than if the company believes that the Commission will reflect any changes that occur after the filing date in its final decision. Finally, there is administrative efficiency in having a rule that does not require different cost of common equity evaluations in locked-in and open-ended cases.

E. Efficiency Incentives

As pointed out in the Notice, the present mode of cost-plus regulation provides very few incentives for managerial efficiency.[28] In the Notice, the Commission therefore asked for comments on the possibility of adjusting the rate of return to take explicit account of differences in relative efficiency among electric utilities.[29] The reaction to this proposal was generally negative. Most commenters suggested that consideration of this issue be deferred or dealt with in a separate rulemaking.

The Commission has decided that it will not in this proceeding establish a separate mechanism for systematically adjusting allowed rates of return based on relative efficiency assessments. There are three reasons for this decision. First, judgments of relative efficiency necessarily require statistical techniques that control for significant differences in operating and service territory characteristics that affect production costs. At present, the Commission is not persuaded as to the reliability of such techniques.[30] Second, any attempt to assess relative managerial efficiency would also have to control for forces external to the utility's management. That is not an easy task, especially when some of these factors are essentially regulatory in nature.[31] Finally, explicit adjustments to the rate of return may not be the best mechanism for inducing improved performance.[32]

Even though the Commission has decided against establishing a mechanism for systematically adjusting the allowed rate of return for managerial efficiency, the rule adopted here does not preclude making adjustments to the allowed rate of return when a significant risk difference is found, if there is compelling evidence of managerial efficiency or inefficiency. This option is available now under current procedures and will continue to be available after this rule goes into effect.

Finally, it should be noted that the final rule does have two implicit efficiency incentives built into it. First, for the many companies which warrant the benchmark rate of return there is an incentive to improve their efficiency to the extent that it can also reduce their cost of capital. By doing so, a relatively efficient utility can obtain a rate of return somewhat above its cost of capital, while a relatively inefficient utility can perhaps avoid getting a rate of return below its cost of capital. Second, as mentioned before, by tying the allowed rate of return to the time of filing, companies have a greater incentive to improve their efficiency and reduce their costs than they would if the Commission in its final decision makes adjustments for cost of capital changes that occur after the filing date.

F. Waivers

Most commenters that addressed the issue of waivers to the rule recommended that they be granted liberally, at least during the initial years of the rule's effectiveness. While a few commenters suggested some restrictions on the granting of waivers, these related to the risk classification and average rate of return approaches of the Notice.[33]

[26] Initial Comments of Detroit Edison Co. at 1 and Public Systems at 24.

[27] Oral Presentations, November 7, 1982, of Carolina Power and Light Co. at 5, Southern California Edison Co. at 6, and Cities at 11. Initial Comments of Florida Power and Light Co. at 23.

[28] It is noteworthy that the courts have stressed that the Commission's principal goal is to bring about the production of electricity "at the lowest possible cost to the consumers in the long run in the economist's terms, to insure the efficient performance of an industry." *See* NAACP v. FPC, 520 F.2d 432, 440 (D.C. Cir. 1975), *aff'd*, 425 U.S. 662 (1976).

[29] Because of the Commission's ongoing concern with electric utility efficiency it commissioned a study to examine the feasibility of incorporating one or more incentive mechanisms into the regulatory process. The results of that study appeared in a report issued last year. See Federal Energy Regulatory Commission, *Incentive Regulation in the Electric Utility Industry* (hereinafter "Incentive Regulation"), *Volumes I and II*, September 1983. The Commission also recently approved a two-year experiment designed to improve exchange efficiency for a group of six Southwestern electric utilities. *See* Public Service Company of New Mexico *et al.*, 25 FERC ¶ 61,469 (1983).

[30] *See* Incentive Regulation, Volume I at 4.20–4.21 and the Comments of the National Economic Research Associates, Appendix A of Volume II.

[31] *See*, for example, "Power Play: N.J. Plant Switches 4 Times As U.S. Changes Its Mind," *Washington Post*, July 14, 1980, p. A4 for a history of how federal policy has affected the use of fuels at Atlantic City Electric's Deepwater generating station.

[32] It has been suggested, for example, that an incentive program tied to management compensation may be more effective and less expensive to ratepayers than one that affects a utility's earnings. *See* Incentive Regulation, Volume I at 4.10.

[33] Initial Comments of Union Electric at 5, Utah Power and Light at 3, and General Services Administration at 8.

The Commission believes that the final rule responds to the concerns of the commenters by making the benchmark rates of return advisory only for the first two years and then giving them the status of a rebuttable presumption. It thus virtually eliminates the need for any waiver requests. In unusual circumstances, of course, the Commission, in response to a petition or upon its own motion, can waive application of the rule.

G. Procedural Issues

Shortly after the public conference held on November 18, 1982, EEI filed a petition requesting that a new notice of proposed rulemaking be issued.[34] EEI claimed that the Notice issued on August 26, 1982 should not be considered a notice of proposed rulemaking but should be treated as an advance notice of proposed rulemaking or a notice of inquiry because it appeared that the Commission was "soliciting broad based information to help determine exactly how to proceed in establishing a generic rule." EEI therefore requested that, after the Commission had reviewed the comments and data submitted to its Notice, it publish a new notice of proposed rulemaking which sets forth the precise procedure, methodology, and generic rate of return that the Commission proposes to adopt.

A number of commenters endorsed the EEI petition to the extent that it requested that the Commission issue a new notice before establishing any particular rate of return on equity. Numerous commenters distinguished between the procedures adopted by the Commission for establishing a rate of return and actually establishing a specific numerical rate of return. Many commenters argued that the Commission's Notice was sufficient only to establish the generic procedures but was not adequate for determing the actual rate of return to be used in individual rate proceedings.

Other commenters argued that the so-called benchmark alternative offered by staff was outside the scope of the Commission's Notice. These commenters noted that in staff's comments submitted to the rulemaking file, staff indicated that it would make two changes in the proposed rule. First, it would eliminate the tripartite risk classification and establish one risk classification, and second, that the rule would establish only an advisory rate of return, rather than a binding one. These changes were outside the scope of the Commission's Notice, commenters argued, and necessitated an additional opportunity to comment on any changes in the original proposal.

The Commission agrees with several of these commenters but disagrees with others. The Commission agrees with those commenters arguing that the Commission should establish only the procedures to be used in developing the generic rate of return, but that it should not use the Notice to establish the actual rate of return. Accordingly, the Commission is establishing in this final rule only the procedures for determining benchmark rates of return and for applying them in individual rate proceedings. The Commission is initiating a new proceeding to implement this final rule. That proceeding will determine the actual rate of return and the updating procedures. Interested persons will have a full opportunity to comment further in that proceeding.

The Commission does not agree with the arguments made by EEI regarding inadequacies in the Notice. The Administrative Procedure Act (APA) requries that the Commission state "either the terms or substance of the proposed rule or a description of the subject and issues involved." 5 U.S.C. 553(b)(3) (1982). The legislative history of the APA indicates that the notice of proposed rulemaking "must be sufficient to fairly apprise interested parties of the issues involved, so that they may present responsive data or arguments."[35]

The Commission has fully complied with the APA. The Commission gave notice of both the "terms and substance" of the proposed rule, in addition to "a description of the subject and issues" involved in establishing a generic rated of return. The Commission posed other alternatives that it was considering and sought comment on several questions. EEI and others criticize this approach as being too uncertain to constitute a proposed rule. We disagree. The recent trend under the APA and various regulatory reform provisions is to encourage agencies to consider "significant alternatives" to those presented in the proposed rule.[36] We believe that the proposed rule met every legal test of sufficiency and, in addition, was suffiently concrete that, as a policy matter, it was fair to expect interested persons to make responsive comments to this proposal.

The Commission similarly does not agree with those commenters who argued that the benchmark rate of return is outside the scope of the Commission's Notice. The proposed rule specifically requested comment on whether a single risk classification was more feasible than the tripartite classification. Additionally, as noted earlier, the changes in the rule are a result of the commenters' discussion of the difficulties inherent in the tripartite risk classification and a binding generic rate of return. Accordingly, we believe that the changes made in the final rule are within the scope of the proposed rule and that an additional opportunity to comment is not warranted.

V. Implementation of the Rule

Unlike the proposals published in the Notice, the rule adopted here only establishes procedures for determining benchmark rates of return and for applying them in individual rate cases. The first annual implementation of the procedures under the rule in Part 37 will be conducted in a separate proceeding. A Notice of Proposed Rulemaking, Docket No. RM84–15–000, is being issued concurrently with this order, and interested persons will be given an opportunity to submit comments. Based on a review of these comments, the Commission will issue an order in early 1985 setting forth its findings.

A. Annual Proceeding

The scope of the annual proceeding under § 37.4 will be confined essentially to a determination of an estimate of the average cost of common equity for the jurisdictional operations of public utilities during the preceding year and an indexing procedure to update this estimate quarterly.

Benchmark rate of return is defined in § 37.3 as the rate of return on common equity that is determined each quarter based on the findings made in the annual proceeding regarding the indexing procedure and the average cost of common equity. The cost of common equity is defined as the minimum rate of return that investors require to buy common stock, adjusted for the flotation costs incurred by a company when selling such stock. Finally, indexing procedure is defined as the method by which the average cost of common equity is updated between annual

[34] Petition of Edison Electric Institue for Promulgation of a Subsequent Specific Notice of Proposed Rulemaking, filed December 14, 1982.

[35] S. Doc. No. 248, 79th Cong., 2d. Sess. 200 (1946).

[36] *See, e.g.*, Regulatory Flexibility Act, 5 U.S.C. 603(c) (1982); Executive Order 12,291, section (d)(4), 1 CFR Part 127 (1981); Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 102 S. Ct. 2856, 2868–71 (1983); International Ladies' Garment Worker' Union v. Donovan, 772 F. 2d 795, 815–18 (D.C. Cir. 1983).

proceedings to determine quarterly benchmark rates of return.

Following the close of each calendar quarter, § 37.5 states that the Commission will determine and publish a benchmark rate of return by updating the annual estimate of the cost of common equity in accordance with the indexing procedure adopted in § 37.4. Each benchmark rate of return will be applicable for a three month period.

B. Application in Individual Cases

The rule has a transitional provision in § 37.8 which specifies that the benchmark rates of return resulting from the first two annual proceedings will be advisory only. They are intended to provide guidance to parties and serve as a point of departure for the Commission in setting allowed rates of return. During the advisory period, the Commission may take official notice of the benchmark rates of return in individual rate cases if they are not otherwise made a part of the record. Appropriate evidentiary weight will be given to these rates of return based on the record in each case. The Commission hopes that the initial two year period will provide a valid test of the potential consequences of moving to a rebuttable presumption standard. As a result, the Commission urges participants in rate cases to include in their testimony an evaluation of the reasonableness of the applicable benchmark rate of return in light of the special circumstances of the filing company.

Beginning with the benchmark rates of return resulting from the third annual proceeding, § 37.6(a) establishes a presumption that the allowed rate of return in an individual case is the benchmark rate of return in effect at the time a rate schedule is filed. No argument will be permitted concerning the applicable benchmark rate of return, since that issue will have already been decided by the annual proceeding and the procedures promulgated by this rule. The presumption is not operative, however, if there is a settlement based on a different rate of return. The presumption can also be rebutted by demonstrating that the risk of the public utility operations under the rate schedule at the time of filing is significantly different from the risk of the jurisdictional operations of electric utilities or that there is a situation of undue discrimination, such as price squeeze, which requires a remedy.[37] The rule, moreover, does not preclude a company from filing a rate schedule that includes a rate of return different from the benchmark rate of return and collecting its filed rate subject to refund in accordance with the Commission's suspension policy.

Under § 37.7, the burden of going forward with evidence rebutting the benchmark presumption is on any participant contesting the use of the applicable benchmark rate of return in an individual rate case. Although the ultimate burden of proof remains with the filing company, the presumption constitutes evidence sufficient to make a prima facie case and therefore shifts the burden to any participant wishing to rebut it.

The Commission recognizes that there will be some uncertainty as to what kind of showing will be required to substantiate a contention that the risk of the subject company is significantly different from the industry-average risk. All risk variables, whether measures of risk or determinants of risk, appear to suffer from shortcomings of one kind or another. Nevertheless, many of them have something useful to say about risk. The showing will require evidence on how the subject company compares to the industry in terms of pertinent financial and operating parameters. The problem is to incorporate these factors into an analytical framework which will allow a reasoned decision to be made on the relative risk issue.

As part of this showing, it also will be necessary to demonstrate how these data are used to establish the quantitative impact of any alleged risk difference. The Commission therefore anticipates there will be evidence on the increment or decrement that should be applied to the applicable benchmark rate of return to obtain the allowed rate of return for the subject company.

The Commission believes that its analyses of the relative risk issue in individual cases will provide some guidance to parties regarding this matter. The Commission also believes that a periodic industry profile report containing industry average data on significant financial and operating parameters would be useful in evaluating the relative risk issue. The report would provide further guidance to parties at the time of filing and would also be helpful to the Commission in resolving the risk issue if litigation ensues in an individual case. As a result, the Commission will request the staff to prepare and make available such a periodic report.

The Commission also believes that some guidance should be provided with respect to the procedures which will be followed in cases where there is an allegation of undue discrimination. For example, if a price squeeze is found in a particular case, the Commission may wish to remedy the price squeeze by lowering the allowed rate of return, although any such remedy may be limited.[38] Price squeeze cases at the commission are normally phased. The initial phase considers all issues other than price squeeze (including rate of return) and results in a Commission decision on the preliminary just and reasonable rate. If an intervenor continues to allege price squeeze after the Commission's Phase I decision, the proceeding may enter a second phase dealing with the price squeeze issue. At this stage a zone of reasonableness for the rate of return may be required to enable the Commission to remedy a price squeeze. Under such circumstances, a zone of reasonableness can be obtained in two ways.

First, in some cases, the record from Phase I will already contain evidence on the zone of reasonableness. This will be true if a significant risk difference is alleged in Phase I and found by the Commission, since the determination of the allowed rate of return necessarily requires that a decision be made within some zone of reasonableness supported by the record. The record probably will also contain sufficient evidence concerning the zone of reasonableness even if the Commission does not uphold an allegation of a significant risk difference in its Phase I decision.

Second, the administrative law judge can order the introduction of zone-of-reasonableness evidence into the record during Phase II of a price squeeze case if the Phase I record is not adequate. Such additional evidence would be necessary if no significant risk difference was alleged in Phase I. It also would be required if the Phase I record was incomplete, even though the Commission considered but did not uphold a significant risk difference allegation.

VI. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act (Act) requires Federal agencies to consider whether the rule, if promulgated, will have a "significant economic impact on a substantial number of small entities." The Notice contained a certification that

[37] A price squeeze occurs when the rates of an electric utility that sells at both the wholesale and retail levels discriminate against a wholesale customer. This situation creates the potential for an anticompetitive effect because it may impede the wholesale customer's ability to compete against the electric utility at the retail level.

[38] *See* Cities of Batavia v. FERC, 672 F.2d 64, 90, n. 52 (D.C. Cir. 1982), Cities of Bethany v. FERC, 670 F.2d 187, 200 (D.C. Cir. 1981), *as modified on rehearing.*

the proposed rule would not have a significant impact on a substantial number of small entities. The final rule will affect the same jurisdictional entities as the proposed rule, although the impact may differ with respect to individual utilities.

The Commission finds that the Act is not applicable to the final rule because it will not affect a "substantial number of small entities." Nearly all of the jurisdictional utilities which must comply with the rule proposed here are too large to be considered "small entities".[39] Also, since the utilities regulated by the Commission hold exclusive selling rights within their service areas and are presumed to be natural monopolies, they dominate their respective fields of operation. Therefore, the utilities cannot be considered to be "small entities" as that term is defined in the Act.[40]

VII. Effective Date

This final rule is effective August 24, 1984.

List of Subjects in 18 CFR Part 37

Electric power rates, Electric utilties, Rate of return.

In consideration of the foregoing, the Commission amends Chapter I. Title 18 of the Code of Federal Regulations, as set forth below, effective 30 days after publication in the **Federal Register.**

By the Commission.

Kenneth F. Plumb,

Secretary.

1. The Table of Contents in 18 CFR Chapter I, is revised by adding the following entry:

SUBCHAPTER B—REGULATIONS UNDER THE FEDERAL POWER ACT

2. A new Part 37 is added to read as follows:

PART 37—GENERIC DETERMINATION OF RATE OF RETURN ON COMMON EQUITY FOR PUBLIC UTILITIES

Sec.

Authority: Federal Power Act, 16 U.S.C. 792–825r (1982); Department of Energy Organization Act, 42 U.S.C. 7101–7352 (1982).

§ 37.1 Purpose.

The purpose of this Part is to establish procedures for determining benchmark rates of return for the jurisdictional operations of public utilities and for applying them in individual rate proceedings.

§ 37.2 Applicability.

This Part applies to any initial rate schedule or any rate schedule change filed under § 35.12 or § 35.13 of the Commission's regulations by any public utility, as defined in section 201(e) of the Federal Power Act.

§ 37.3 Definitions.

For purposes of this Part:

(1) "Benchmark rate of return" means the rate of return on common equity that is determined each quarter based on the findings made in the annual proceeding regarding the indexing procedure and the average cost of common equity for the jurisdictional operations of public utilities.

(2) "Cost of common equity" means the minimum rate of return that investors require to buy common stock, adjusted for the flotation costs incurred by a company when selling such stock.

(3) "Indexing procedure" means the method by which the average cost of common equity under this Part is updated quarterly between annual proceedings to determine benchmark rates of return.

§ 37.4 Annual proceedings.

An estimate of the average cost of common equity for the jurisdictional operations of public utilities and an indexing procedure to update this estimate quarterly will be determined annually through informal rulemaking proceedings under 5 U.S.C. 553.

§ 37.5 Quarterly determination of benchmark rate of return.

Following the close of each calendar quarter, the Commission will determine and publish a benchmark rate of return by updating the annual estimate of the cost of common equity in accordance with the indexing procedure adopted in § 37.4.

§ 37.6 Application of benchmark rate of return in individual rate proceedings.

(a) *General rule.* Except as provided in § 37.8 and paragraph (b) of this section, it will be presumed that the allowed rate of return on common equity in an individual rate proceeding is the benchmark rate of return in effect at the time a rate schedule is filed.

(b) *Exceptions.* The benchmark rate of return will not be binding if:

(i) There is a settlement based on a different rate of return on common equity; or

(ii) The Commission determines that the risk of the public utility operations under the rate schedule at the time of filing is significantly different from the average risk for the jurisdictional operations of public utilities; or

(iii) The Commission determines that a finding of undue discrimination requires that a different rate of return be allowed.

(c) *Suspension period.* This section does not preclude a public utility from filing a rate schedule that includes a rate of return on common equity different from the benchmark rate of return and collecting its filed rate subject to refund in accordance with the Commission's suspension policy.

§ 37.7 Burden of going forward.

The burden of going forward with evidence rebutting the presumption under § 37.6(a) will be on any participant contesting the use of the applicable benchmark rate of return in an individual rate proceeding.

§ 37.8 Transitional provision.

The benchmark rates of return resulting from the first two annual proceedings under this Part will be advisory only. During the advisory period, the Commission may take official notice of the benchmark rates of return in individual rate proceedings if they are not otherwise made a part of the record.

[FR Doc. 84–19563 Filed 7–24–84; 8:45 am]
BILLING CODE 6717–01–M

[39] In 1983, 206 entities had rate schedules on file with the Commission. Of these, 183 are Class A or B utilities (having annual electric operating revenues of more than $2,500,000 or $1,000,000 respectively), 16 are other investor-owned utilities, 3 are industrially owned, two are cooperatives, one is a state agency, and one is a non-profit organization. Thus, only 23 regulated entities complying with this rule have annual electric operating revenues of less than $1,000,000.

[40] The Act defines a "small entity" as a small business, a small not-for-profit enterprise, or a small governmental jurisdiction. 5 U.S.C. 601(6) (1982). A "small business" is defined, by reference to Section 3 of the Small Business Act, as an enterprise which is "independently owned and operated and which is not dominant in its field of operation." 15 U.S.C. 632(a) (1982).

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Part 74

[Docket No. 83C–0167]

D&C Blue No. 6; Listing as a Color Additive for Coloring Sutures

AGENCY: Food and Drug Administration.

ACTION: Final rule.

SUMMARY: The Food and Drug Administration (FDA) is amending the color additive regulations to provide for the safe use of D&C Blue No. 6 as a color additive for coloring polydioxanone synthetic absorbable sutures. This action is in response to a petition filed by Ethicon, Inc. FDA is also incorporating the listing of this color additive for use in sutures into the subpart of its regulations that the agency recently established for color additives used in medical devices. Elsewhere in this issue of the **Federal Register**, FDA is proposing to remove the restriction that bars migration of D&C Blue No. 6 from a suture to surrounding tissues.

DATES: Effective August 27, 1984. Objections by August 24, 1984.

ADDRESS: Written objections may be sent to the Dockets Management Branch (HFA-305), Food and Drug Administration, Rm. 4-62, 5600 Fishers Lane, Rockville, MD 20857.

FOR FURTHER INFORMATION CONTACT: Blondell Anderson, Center for Food Safety and Applied Nutrition (HFF-334), Food and Drug Administration, 200 C St. SW., Washington, D.C. 20204, 202-472-5740.

SUPPLEMENTARY INFORMATION: In a notice published in the **Federal Register** of June 17, 1983 (48 FR 27835), FDA announced that a color additive petition (CAP 3C0176) had been filed by Ethicon, Inc., Route 22, Somerville, NJ 08876, proposing that the color additive regulations be amended to provide for the safe use of D&C Blue No. 6 for coloring polydioxanone synthetic absorbable sutures. The petition was filed under section 706 of the Federal Food, Drug, and Cosmetic Act (the act) (21 U.S.C. 376).

With the passage of the Medical Device Amendments of 1976 (Pub. L. 94-295), Congress mandated the listing of color additives for use in medical devices where the color additive comes in direct contact with the body for a significant period of time (section 706(a) of the act). Because polydioxanone synthetic sutures containing D&C Blue No. 6 are placed in the body and remain there until absorbed, this use of the color additive will bring it into direct contact with the body for a significant period of time. Therefore, this use of D&C Blue No. 6 is subject to the listing requirement.

D&C Blue No. 6 (CAS Reg. No. 482-89-3) is currently listed for use in polyethylene terephthalate surgical sutures for general use, plain or chromic collagen absorbable sutures for general surgical use and for ophthalmic surgical use, and polypropylene surgical sutures for general surgical use, in Subpart B of 21 CFR Part 74, under § 74.1106 (21 CFR 74.1106). Sutures, which were regulated as drugs before the passage of the Medical Device Amendments of 1976, are now regulated as medical devices. Recently, in a regulation published in the **Federal Register** of March 29, 1983 (48 FR 13020), FDA amended the color additive regulations by establishing under 21 CFR Part 74 a Subpart D for color additives used in or on medical devices. To avoid redundancy and to simplify the regulations pertaining to D&C Blue No. 6, the agency is removing § 74.1106 from Subpart B and incorporating the provisions of that section in new § 74.3106 (21 CFR 74.3106) in Subpart D. To reflect further that sutures are now considered medical devices instead of drugs, the agency has made an editorial change and revised § 74.3106(c)(2) to indicate that sutures fall under sections 510, 515, and 520 of the act (21 U.S.C. 360, 360e, and 360j) (which provide for the regulation of medical devices) instead of section 505 of the act (21 U.S.C. 355) (which provides for the regulation of new drugs) as currently indicated in § 74.1106(c)(3). The agency has also made a second editorial addition by including the Chemical Abstracts Registry Number in this color additive listing.

Elsewhere in this issue of the **Federal Register** FDA also is proposing to remove § 74.3106(c)(3), which requires that there be no migration of D&C Blue No. 6 from a suture to the surrounding tissues under its conditions of use.

FDA has evaluated the data in the petition, data supporting previous petitions, and other relevant material and concludes that the proposed use of D&C Blue No. 6 is safe. This conclusion is based on the information in the petition that exposure to the color additive would be well below the level established as safe by toxicity studies submitted in previous petitions for use of D&C Blue No. 6. Toxicity studies previously submitted include 180-day implantation studies in rabbits using absorbable sutures with up to 0.5 percent D&C Blue No. 6 and the results of acute, subchronic, chronic, reproduction, and teratology studies on the neat dye. Consequently, FDA is amending its color additive regulations as set forth below.

In accordance with § 71.15(a) (21 CFR 71.15(a)), the color additive petition and the documents that FDA considered and relied upon in reaching its decision to approve the petition are available for inspection at the Center for Food Safety and Applied Nutrition (address above) by appointment with the information contact person listed above. As provided in 21 CFR 71.15, the agency will delete from the documents any materials that are not available for public disclosure before making the documents available for inspection.

The agency has carefully considered the potential environmental effects of this action and has concluded that this action will not have a significant impact on the human environment and that an environmental impact statement therefore will not be prepared. The agency's finding of no significant impact may be seen in the Dockets Management Branch (address above) between 9 a.m. and 4 p.m., Monday through Friday.

List of Subjects in 21 CFR Part 74

Color additives, Color additives subject to certification, Cosmetics, Drugs, Medical devices.

Therefore, under the Federal Food, Drug, and Cosmetic Act (secs. 701(e), 706, 70 Stat. 919 as amended, 74 Stat. 399-407 as amended (21 U.S.C. 371(e), 376)) and under authority delegated to the Commissioner of Food and Drugs (21 CFR 5.10), Part 74 is amended as follows:

PART 74—LISTING OF COLOR ADDITIVES SUBJECT TO CERTIFICATION

§ 74.1106 [Removed]

1. By removing § 74.1106 *D&C Blue No. 6.*

2. By adding new § 74.3106 to Subpart D, to read as follows:

§ 74.3106 D&C Blue No. 6.

(a) *Identity.* The color additive D&C Blue No. 6 is principally [$^{\Delta 2,2'}$-biindoline[=3,3' dione (CAS Reg. no. 482-89-3).

(b) *Specifications.* D&C Blue No. 6 shall conform to the following specifications and shall be free from impurities other than those named to the extent that such impurities may be avoided by good manufacturing practice:

Volatile matter at 135 °C (275 °F), not more than 3 percent.

Matter insoluble in *N,N*-dimethylformamide, not more than 1 percent.

Isatin, not more than 0.3 percent.

Anthranilic acid, not more than 0.3 percent.

Indirubin, not more than 1 percent.

Lead (as Pb), not more than 10 parts per million.

Arsenic (as As), not more than 3 parts per million.

Mercury (as Hg), not more than 1 part per million.

Total color, not less than 95 percent.

(c) *Uses and restrictions.* (1) D&C Blue No. 6 may be safely used at a level (i) not to exceed 0.2 percent by weight of the suture material for coloring polyethylene terephthalate surgical sutures for general surgical use; (ii) not to exceed 0.25 percent by weight of the suture material for coloring plain or chromic collagen absorbable sutures for general surgical use; (iii) not to exceed 0.5 percent by weight of the suture material for coloring plain or chromic collagen absorbable sutures for ophthalmic surgical use; (iv) not to exceed 0.5 percent by weight of the suture material for coloring polypropylene surgical sutures for general surgical use; and (v) not to exceed 0.5 percent by weight of the suture material for coloring polydioxanone synthetic absorbable sutures for ophthalmic and general surgical use.

(2) Authorization for these uses shall not be construed as waiving any of the requirements of sections 510(k), 515, and 520(g) of the Federal Food, Drug, and Cosmetic Act with respect to the medical device in which the color additive is used.

(3) When the sutures are used for the purposes specified in their labeling, there is no migration of the color additive to the surrounding tissue.

(d) *Labeling.* The label of the color additive shall conform to the requirements of § 70.25 of this chapter.

(e) *Certification.* All batches of D&C Blue No. 6 shall be certified in accordance with regulations in Part 80 of this chapter.

Any person who will be adversely affected by the foregoing regulation may at any time, on or before August 24, 1984 file with the Dockets Management Branch (address above) written objections thereto. Objections shall show how the person filing will be adversely affected by the regulation, specify with particularity the provisions of the regulation deemed objectionable, and state the grounds for the objections. Objections shall be filed in accordance with the requirements of 21 CFR 71.30. If a hearing is requested, the objections shall state the issues for the hearing and shall be supported by grounds factually and legally sufficient to justify the relief sought, and shall include a detailed description and analysis of the factual information intended to be presented in support of the objections in the event that a hearing is held. Three copies of all documents shall be filed and shall be identified with the docket number found in brackets in the heading of this document. Any objections received in response to the regulation may be seen in the Dockets Management Branch between 9 a.m. and 4 p.m., Monday through Friday.

Effective date. This regulation shall become effective August 27, 1984, except as to any provisions that may be stayed by the filing of proper objections. Notice of filing of objections or lack thereof will be announced by publication in the **Federal Register.**

(Secs. 701(e), 706, 70 Stat. 919 as amended, 74 Stat. 399–407 as amended (21 U.S.C. 371(e), 376))

Dated: July 19, 1984.

William F. Randolph,

Acting Associate Commissioner for Regulatory Affairs.

[FR Doc. 84-19603 Filed 7-20-84; 4:46 pm]

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21 CFR Part 522

Implantation or Injectable Dosage Form New Animal Drugs Not Subject to Certification; Cloprostenol Sodium

AGENCY: Food and Drug Administration.

ACTION: Final rule.

SUMMARY: The Food and Drug Administration (FDA) is amending the animal drug regulations to reflect approval of a supplemental new animal drug application (NADA) filed by Bayvet Division of Miles Laboratories, Inc., providing for use of cloprostenol sodium injection for the treatment of pyometra in beef and dairy cattle.

EFFECTIVE DATE: July 25, 1984.

FOR FURTHER INFORMATION CONTACT: Adriano R. Gabuten, Center for Veterinary Medicine (HFV–135), Food and Drug Administration, 5600 Fishers Lane, Rockville, MD 20857, 301–443–4913.

SUPPLEMENTARY INFORMATION: Bayvet Division of Miles Laboratories, Inc., P.O. Box 390, Shawnee Mission, KS 66201, filed supplemental NADA 113–645 providing for intramuscular use of a concentration of 250 micrograms of cloprostenol (as cloprostenol sodium) per milliliter of injection solution to induce luteolysis for the treatment of pyometra in beef and dairy cattle. Bayvet has an existing approval for intramuscular use of the solution in beef and dairy cattle for scheduling estrus, terminating unwanted pregnancies from mismatings, or treating unobserved (nondetected) estrus, mummified fetus, and luteal cysts. The supplemental NADA is approved and the regulations are amended to reflect the approval. The basis for approval is discussed in the freedom of information summary referred to below.

In accordance with the freedom of information provisions of Part 20 (21 CFR Part 20) and § 514.11(e)(2)(ii) (21 CFR 514.11(e)(2)(ii)), a summary of safety and effectiveness data and information submitted to support approval of this application may be seen in the Dockets Management Branch (HFA–305), Food and Drug Administration, Rm. 4–62, 5600 Fishers Lane, Rockville, MD 20857, from 9 a.m. to 4 p.m., Monday through Friday.

The Center for Veterinary Medicine has carefully considered the potential environmental effects of this action and has concluded that the action will not have a significant impact on the human environment and that an environmental impact statement therefore will not be prepared. The Center's finding of no significant impact and the evidence supporting this finding, contained in an environmental impact analysis report (pursuant to 21 CFR 25.1(j)), may be seen in the Dockets Managment Branch (address above), between 9 a.m. and 4 p.m., Monday through Friday.

List of Subjects in 21 CFR Part 522

Animal drugs, Injectable.

Therefore, under the Federal Food, Drug, and Cosmetic Act (sec. 512(i), 82 Stat. 347 (21 U.S.C. 360b(i))) and under authority delegated to the Commissioner of Food and Drugs (21 CFR 5.10) and redelegated to the Center for Veterinary Medicine (21 CFR 5.83), Part 522 is amended in § 522.460 by adding new paragraph (a)(3)(ii)(*c*) to read as follows:

PART 522— IMPLANTATION OR INJECTABLE DOSAGE FORM NEW ANIMAL DRUGS NOT SUBJECT TO CERTIFICATION

§ 522.060 Cloprostenol sodium.

(a) * * *

(3) * * *

(ii) * * *

(*c*) Single cloprostenol injection for the treatment of pyometra.

* * * * *

Effective date. July 25, 1984.

(Sec. 512(i), 82 Stat. 347 (21 U.S.C. 360b(i)))

Dated: July 18, 1984.

Gerald B. Guest,

Acting Director, Center for Veterinary Medicine.

[FR Doc. 84-19599 Filed 7-24-84; 8:45 am]

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