

notice of proposed rulemaking and an opportunity for public comment be given for this rule.

3. Because a notice of proposed rulemaking and an opportunity for public comment are not required to be given for this rule by section 553 of the Administrative Procedure Act (5 U.S.C. 553) or by any other law, under sections 603(a) and 604(a) of the Regulatory Flexibility Act (5 U.S.C. 603(a) and 604(a)) no initial or final Regulatory Flexibility Analysis has to be or will be prepared.

4. This rule involves a collection of information subject to the requirements of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*). This collection has been approved by the Office of Management and Budget under control number 0694-0005.

5. This rule does not contain policies with Federalism implications sufficient to warrant preparation of a Federalism assessment under Executive Order 12612.

Accordingly, this rule is being issued in final form. However, as with other Department of Commerce rules, comments from the public are always welcome. Comments should be submitted to Joan Maguire, Office of Technology and Policy Analysis, Bureau of Export Administration, U.S. Department of Commerce, P.O. Box 273, Washington, DC 20044.

List of Subjects in 15 CFR Part 799

Exports, Reporting and recordkeeping requirements.

Accordingly, Part 799 of the Export Administration Regulations (15 CFR Parts 768-799) is amended as follows:

PART 799—[AMENDED]

1. The authority citation for Part 799 continues to read as follows:

Authority: Pub. L. 96-72, 93 Stat. 503 (50 U.S.C. app. 2401 *et seq.*), as amended by Pub. L. 97-145 of December 29, 1981, by Pub. L. 99-64 of July 12, 1985, and Pub. L. 100-418 of August 23, 1988; E.O. 12525 of July 12, 1985 (50 FR 28757, July 16, 1985); Pub. L. 95-223 of December 28, 1977 (50 U.S.C. 1701 *et seq.*); E.O. 12532 of September 9, 1985 (50 FR 36861, September 10, 1985) as affected by notice of September 4, 1986 (51 FR 31925, September 8, 1986); Pub. L. 99-440 of October 2, 1986 (22 U.S.C. 5001 *et seq.*); and E.O. 12571 of October 27, 1986 (51 FR 39505, October 29, 1986).

Supplement No. 1 to § 799.1 [Amended]

2. In Supplement No. 1 to § 799.1 (the Commodity Control List), Commodity Group 4 (Transportation Equipment), ECCN 2409A is amended by revising the *Validated License Required* and *Reason for Control* paragraphs to read as follows:

2409A Naval equipment.

Controls for ECCN 2409A

Validated License Required: Country Groups QSTVWYZ, except marine water tube boilers, which require a validated license only for Country Groups QSWYZ, the People's Republic of China and Afghanistan.

Reason for Control: National security.

3. In Supplement No. 1 to § 799.1, ECCN 4409B is removed.

Dated: December 20, 1988.

Michael E. Zacharia,
Assistant Secretary for Export
Administration.

[FR Doc. 88-29515 Filed 12-22-88; 8:45 am]

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DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 37

[Docket No. RM88-25-000; Order No. 510]

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

Issued December 19, 1988.

AGENCY: Federal Energy Regulatory
Commission, DOE.

ACTION: Final rule.

SUMMARY: The Federal Energy Regulatory Commission (Commission) issues a final rule concerning the generic determination of the rate of return on common equity for public utilities. In prior rulemaking proceedings, the Commission established a discounted cash flow (DCF) formula to determine the average cost of common equity and a quarterly indexing procedure to calculate benchmark rates of return on common equity for public utilities. In this final rule, the Commission determines that 4.3 percent is an appropriate expected annual dividend growth rate for use in the quarterly indexing procedure during the 12 months beginning February 1, 1989. The Commission also determines that 0.03 percent is an appropriate flotation cost adjustment factor for that period. The benchmark rates of return determined through the procedures remain advisory and are intended to provide guidance to companies and intervenors in individual rate cases and to serve as reference points for the Commission in its deliberations.

EFFECTIVE DATE: January 18, 1989.

FOR FURTHER INFORMATION CONTACT:

For Further Technical Information
Contact: Marvin Rosenberg, Office of
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SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the *Federal Register*, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this document during normal business hours in Room 1000 at the Commission's Headquarters, 825 North Capitol Street, NE., Washington, DC 20426.

The Commission Issuance Posting System (CIPS), an electronic bulletin board service, provides access to the texts of formal documents issued by the Commission. CIPS is available at no charge to the user and may be accessed using a personal computer with a modem by dialing (202) 357-8997. To access CIPS, set your communications software to use 300, 1200 or 2400 baud, full duplex, no parity, 8 data bits, and 1 stop bit. The full text of this final rule will be available on CIPS for 10 days from the date of issuance. The complete text on diskette in WordPerfect format may also be purchased from the Commission's copy contractor, La Dorn Systems Corporation, also located in Room 1000, 825 North Capitol Street, NE., Washington, DC 20426.

Before Commissioners: Martha O. Hesse, Chairman; Charles G. Stalon, Charles A. Trabandt, Elizabeth Anne Moler and Jerry J. Langdon.

I. Introduction

The Federal Energy Regulatory Commission (Commission) issues this final rule estimating the average cost of common equity for the jurisdictional operations of public utilities¹ for the 12 months ending June 30, 1988 (the "base year"). In several earlier rulemaking proceedings concerning the generic determination of the rate of return for electric utilities, the Commission established a discounted cash flow (DCF) formula to determine the average cost of common equity and a quarterly indexing procedure to calculate

¹ The terms "public utilities" and "electric utilities" are used interchangeably.

benchmark rates of return on common equity for public utilities. In this fifth annual proceeding concerning that generic determination, the Commission determines that the growth rate and flotation cost factors to be used in the quarterly indexing procedure during the 12 months beginning February 1, 1989 will be 4.3 percent and 0.03 percent, respectively. Benchmark rates of return determined through the procedures remain advisory, as were those resulting from the previous four annual proceedings.²

II. Background

Section 205(a) of the Federal Power Act (FPA) requires that all electric rates subject to the jurisdiction of the Commission be "just and reasonable."³ In the exercise of this statutory responsibility, the Commission seeks to set rates of return on common equity that are fair to both ratepayers and utility stockholders. The allowed rate of return on common equity is now determined individually for each utility on a case-by-case basis.

In July 1984, the Commission adopted procedures for the generic determination of benchmark rates of return on common equity and for their application in individual cases.⁴ The Commission has conducted four prior proceedings to determine benchmark rates of return and has made those rates advisory only. In that advisory status, benchmark rates are intended to provide guidance to parties to rate proceedings and to serve as reference points for the Commission in setting allowed rates of return.⁵ The

Commission again requests that all rate case participants, including staff, evaluate the reasonableness of the applicable benchmark rate of return in light of the special circumstances of the specific utility. The Commission requests that litigants submit substantive analyses of the risks of individual utilities vis-a-vis the average utility represented through the benchmark rates of return, to enable the Commission to use those benchmarks as points of departure in setting allowable rates of return.

III. Discussion

As required by § 37.4 of the Commission's regulations, the Commission initiated a fifth annual proceeding to establish the growth rate and flotation cost adjustment factors to be used in the quarterly indexing formula for the year beginning February 1, 1989 by issuing a Notice of Proposed Rulemaking (NOPR or Notice) on August 5, 1988.⁶ The Commission received 12 timely comments in response to that Notice.⁷

In prior proceedings, the Commission established a DCF methodology for estimating the rate of return on common equity. Specifically, that formula is:

$$k = (1 + .5g)y + g$$

where:

k = market required rate of return

y = current dividend yield (current annual dividend rate divided by current market price)

g = expected annual dividend growth rate
(1 + .5g) = dividend adjustment factor for quarterly dividend payments

A. Dividend Yield

The dividend yield used in this DCF formula is the median of the dividend yields of those companies that remain in a sample of utilities after application of certain screening criteria. The Commission begins with a group of approximately 100 publicly-traded electric utilities or combination companies that meet the following standards:

- (1) The utility is predominantly electric;
- (2) The stock of the utility is traded on either the New York or the American Stock Exchange;
- (3) The utility is included in the Utility Compustat II data base; and
- (4) The utility is not excluded by the Commission based on a case-by-case

determination that its data is unavailable or inappropriate.⁸ The Commission then excludes companies from the sample if:

- (1) The company's common stock is no longer publicly traded due to merger or other action;
- (2) The company has decreased or omitted a common dividend payment in the current or prior three quarters; or
- (3) The Commission determines on a case-by-case basis that some other occurrence has caused the dividend yield for that company to be substantially misleading and to bias the resulting quarterly average.

The quarterly dividend yield for each company is computed by dividing the dividend rate by the price. The dividend rate is the "indicated dividend rate," which is the last declared quarterly dividend multiplied by four. The price used in calculating the quarterly dividend yield is the simple average of the three monthly high and low prices for the quarter. The dividend yield used in the quarterly indexing procedure is the average of the two most recent quarterly median yields.⁹

A list of the 99 remaining public utilities to be used in base-year dividend yield calculations and quarterly updates is included as Appendix B to this rule.¹⁰

B. Growth Rate

In the NOPR, the Commission proposed to rely on both a fundamental analysis approach and a two-stage growth model to estimate the expected growth rate, as it did in previous proceedings.¹¹ The fundamental analysis approach involves evaluation of the two underlying components of expected annual dividend growth, which are growth from retention of earnings and growth from sales of new common stock. Growth from retention of earnings, or internal growth, is a function of the expected retention ratio "b" and the expected return on common equity "r". Growth from sales of new common stock, or external growth, is a function of the amount of stock expected to be sold "s" and the expected price of those sales relative to book value "v". The formula for estimating the growth

² The annual proceedings were first established by Order No. 389, Generic Determination of Rate of Return on Common Equity for Electric Utilities, 49 FR 29946 (July 25, 1984) (Docket No. RM80-36-000) (final rule) (issued July 18, 1984) and Order No. 389-A, 49 FR 46351 (Nov. 26, 1984) (order denying rehearing) (issued Nov. 21, 1984). The first annual proceeding resulted in Order No. 420, 50 FR 21802 (May 29, 1985) (Docket No. RM84-15-000) (final rule) (issued May 20, 1985) and Order No. 420-A, 50 FR 34086 (Aug. 23, 1985) (Docket No. RM85-15-001, et al.) (order denying rehearing) (issued Aug. 20, 1985). The second annual proceeding resulted in Order No. 442, 51 FR 343 (Jan. 6, 1986) (Docket No. RM85-19-000) (final rule) (issued Dec. 26, 1985) and Order No. 442-A, 51 FR 22505 (June 20, 1986) (Docket No. RM85-19-001, et al.) (order granting in part and denying in part requests for rehearing) (issued June 11, 1986). The third annual proceeding resulted in Order No. 461, 52 FR 11 (Jan. 2, 1987) (Docket No. RM86-12-000) (final rule) (issued Dec. 24, 1986) and Order 461-A, 52 FR 5757 (Feb. 26, 1987) (order denying rehearing) (issued Feb. 19, 1987). The fourth annual proceeding resulted in Order No. 489, 53 FR 3342 (Feb. 5, 1988) (Docket No. RM87-35-000) (final rule) (issued Jan. 29, 1988) and Order No. 489-A, 53 FR 11991 (Apr. 12, 1988) (order denying rehearing) (issued March 30, 1988).

³ 16 U.S.C. 824(d) (1982).

⁴ Order No. 389, 49 FR 29946 (July 25, 1984).

⁵ *Id.*, at 29954.

⁶ Generic Determination of Rate of Return on Common Equity for Public Utilities, 53 FR 31883 (Aug. 22, 1988) (Docket No. RM88-25-000) (notice of proposed rulemaking) (issued Aug. 5, 1988).

⁷ See Appendix A for a list of commenters.

⁸ Southwestern Public Service Company, which meets the first three standards, is excluded from the sample because it has a non-standard fiscal year which does not end at the conclusion of a calendar quarter, causing its dividend yield to be out of step with the other companies in the sample.

⁹ 18 CFR 37.4 (1988).

¹⁰ The sample of 100 utilities used in the fourth annual proceeding has been reduced by one through the deletion of Savannah Electric & Power Company, which was acquired by the Southern Company.

¹¹ 53 FR at 31884-85 (Aug. 22, 1988).

rate based on this fundamental analysis is $g = br + sv$. The two-stage growth analysis involves separate evaluation of near-term and long-term growth expectations.

The Commission also proposed to consider other data and methods for estimating the expected growth rate, but primarily as a check on the reasonableness of its growth rate determination based on the fundamental and two-stage growth analyses.

Seven commenters make growth rate recommendations. These growth rate recommendations range from 3.70 percent by the Financial Analyses Branch, Office of Electric Power Regulation, Federal Energy Regulatory Commission (FAB-OEPR), to 5.09 percent by Southwestern Electric Power Service Company (SWEP). See Table 1. Most commenters recommend lower growth rates than those they recommended in the previous proceeding (RM87-35). SWEP is the only commenter to recommend a growth rate higher than its recommendation in RM87-35. Table 2 presents the raw growth rate data on which the commenters relied. Based on its review and evaluation of the growth rate analyses submitted by the commenters in this proceeding, the Commission finds the expected growth rate for use in the quarterly indexing procedure during the 12 months beginning February 1, 1989 to be 4.3 percent.

TABLE 1.—SUMMARY OF GROWTH RATE RECOMMENDATIONS

Commenter	Growth rate	Basis for recommendation
Utilities		
1. SWEP	5.086	1. Base-year fundamental analysis. 2. Analyst forecasts.
2. EEI	4.6	1. Hist. EPS and DPS growth rates. 2. Base-year fundamental analysis. 3. Projected fundamental analysis.
3. AUS	4.53	1. Hist. EPS and DPS growth rates. 2. Base-year fundamental analysis. 3. Projected fundamental analysis.

TABLE 1.—SUMMARY OF GROWTH RATE RECOMMENDATIONS—Continued

Commenter	Growth rate	Basis for recommendation
4. NEP	4.5/5.0	4. Analyst forecasts. 5. Two-stage growth analysis. 1. Hist. DPS growth rates. 2. Base-year fundamental analysis. 3. Analyst forecasts.
5. BEC	4.44	1. Hist. EPS and DPS growth rates. 2. Base-year fundamental analysis. 3. Projected fundamental analysis. 4. Analyst forecasts. 5. Two-stage growth analysis.
Other Commenters		
6. FAB-OEPR	3.70	1. Projected fundamental analysis.
7. GSA	3.5/4.0	1. Hist. DPS and Price growth rates. 2. Analyst forecasts.

TABLE 2.—RAW GROWTH RATE DATA

Rate(s)	Type of rate	Commenter
Historical DPS Growth Rates		
4.94	5-year median	AUS
4.20	5-year median	BEC
4.50	5-year median	EEI
4.9	5-year median	NEP
4.94	10-year median	AUS
5.10	10-year median	BEC
4.42/4.82	10-year mean/median	EEI
5.23	10-year median	NEP
Historical EPS Growth Rates		
5.50	5-year median	AUS
3.60	5-year median	BEC
4.19	5-year median	EEI
4.94	10-year median	AUS
5.60	10-year median	BEC
4.56/5.52	10-year mean/median	EEI
Base-Year Fundamental Growth Rates		
4.44	(b)(r) + (s)(v)	BEC
3.38	4.2 + 0.24	EEI
4.30	3.37 + 0.007	NEP
4.30	4.1 + 0.2	AUS
3.70	4.3 + (Not reported)	FAB-OEPR
5.90	3.6 + 0.1	SWEP
5.90	(Not reported)	SWEP
Projected Fundamental Growth Rates		
4.7	(b)(r) + (s)(v)	EEI
4.7	4.7 + 0.01	EEI

TABLE 2.—RAW GROWTH RATE DATA—Continued

Rate(s)	Type of rate	Commenter
Analyst Near-Term Forecasts		
3.87	1/B/E/S average	AUS
4.0	1/B/E/S median	BEC
3.45/3.7	1/B/E/S mean/median	EEI
4.0	Zack's median	NEP
3.25	Value Line DPS median	AUS
3.5	Value Line DPS median	BEC
3.13/3.5	Value Line DPS mean/median	EEI
Analyst Near-Term Forecasts		
3.0	Value Line EPS median	AUS
3.0	Value Line EPS median	BEC
2.85/3.0	Value Line EPS mean/median	EEI
2.7	Merrill Lynch DPS median	BEC
3.3	Merrill Lynch EPS mean/median	BEC
4.0/4.0	Salomon Brothers' Normalized Growth mean/median	EEI
3.8/4.0	Salomon Brothers' Normalized Growth mean/median	BEC
4.286	Salomon Brothers'	SWEP
4.556	First Boston DPS	SWEP
4.79	First Boston EPS	SWEP
Analyst Long-Term Forecasts		
4.0	Merrill Lynch EPS	GSA

1. Growth Rate Recommendations

BEC recommends a growth rate of 4.44 percent, based on a combination of historical growth, fundamental analysis, analysts' projections, and two different two-stage growth rate analyses.¹² Using a 90-company sample, BEC calculates that the median 5-year and 10-year historical growth rates in earnings and dividends ranged from 3.6 percent to 5.6 percent. However, BEC states that it considers the 5-year growth rate to be unusually low and that investors also regard that rate as atypically low.¹³

For its fundamental growth rate analyses, BEC calculates the individual components of internal growth, "b" and "r", and external growth, "s" and "v". BEC uses three methods to estimate the retention ratio "b" and the return on common equity "r".¹⁴ To estimate internal growth, BEC first calculates the payout ratio, (1-b), of the Value Line Electric Utility Composite for the period 1977-1987. In five of those years the payout ratio was greater than 70 percent and in the other six years it was less than 70 percent. BEC concludes that the payout ratio for the industry has been

¹² BEC at i.

¹³ BEC at 9.

¹⁴ BEC at 13-15.

roughly centered on the 70 percent level. Second, BEC examines the payout ratio for 90 electric utilities for the 12 months ending in each of the four quarters from June 1987 through March 1988. It finds that the average of the median payout ratios slightly exceeded 72 percent. Finally, BEC examines the projected retention rate data reported by the Value Line Investment Survey for 1987 and for 1990-1992. The averages of the median values for 1987 and 1990-1992 were 27.5 percent and 27 percent, respectively. BEC concludes that "[w]hile the base year and projected retention ratios are somewhat below historical levels of about 30 percent, it seems reasonable for investors to expect the retention rates to rise to the more traditional level the long run."¹⁵

To estimate the return on equity "r" for the industry, BEC first examines the rates of return for the Value Line Electric Utility Composite from 1977 through 1987. It finds that industry rates of return since 1982 have fluctuated between 13.5 and 14.5 percent, and have averaged 14.1 percent. Second, BEC examines average return on equity for 90 electric utilities for the 12 months ending in each of the four quarters from June 1987 through March 1988. It finds that the average of the median returns was 14.0 percent. Finally, BEC examines the 1987 average return on equity reported by the Value Line Investment Survey and Value Line's projections for 1990-1992. The averages of the median returns for 1987 and 1990-1992 were 14.0 percent and 13.8 percent, respectively. BEC concludes that investors expect a return on equity of approximately 14.0 percent.¹⁶

Using an expected retention ratio "b" of 30 percent and an expected return on average common equity "r" of 14 percent, BEC calculates an internal growth rate for the industry of 4.2 percent.

BEC then estimates external growth "sv".¹⁷ It adopts an "s" component (proportion of future new common stock financing) of 1.0 percent, based on its judgment and on common stock financing projections published by EEI. BEC estimates the "v" component to be 0.237, on the basis of a Value Line 1990-1992 projection of 1.31 for the price-book value ratio (calculated by multiplying the projected return on average equity of 13.8 percent by the projected price-earnings ratio of 9.5).¹⁸ Thus, "sv" is

equal to 0.24 percent (0.01×0.237). Total projected growth, the sum of internal growth and external growth, is 4.44 percent.

BEC then reviews near-term growth rate forecasts of earnings and dividends made by the following analysts and investment advisory services: Value Line (3.0-3.5 percent), Merrill Lynch (2.7-3.3 percent), I/B/E/S (4.0 percent), and Salomon Brothers (4.3 percent). BEC concludes that investors would not put much weight on growth projections below 4.0 percent because such growth rates would produce unreasonable costs of equity.¹⁹

BEC concludes with a pair of two-stage DCF analyses. Both are based on Value Line projections of dividends and prices for the 1990-1992 period. The resulting composite constant growth rate is 4.6 percent.

EEI recommends a growth rate of 4.6 percent on the basis of historical data, a fundamental analysis, and a two-stage growth analysis.²⁰ EEI begins by examining historical 5-year and 10-year growth rates in per share earnings and per share dividends. The median 5-year historical growth rates in earnings range from 1.44 to 3.46 percent. The 10-year historical growth rates range from 4.42 to 5.52 percent. EEI notes that if a number of utilities that reported negative growth rates are eliminated from the sample, the recalculated 5-year growth rates (4.19-4.50 percent) approach the lower end of the range of the 10-year growth rates.

EEI also examines historical 10-year payout ratios and returns on average common equity derived from Value Line data.²¹ The resulting distribution of payout ratios and rates of return is almost identical to the distribution found by BEC.

EEI relies on a base-year analysis and a projected fundamental growth rate analysis. For the base-year estimate, EEI calculates individual components of internal growth, "b" and "r", and of external growth, "s" and "v". To estimate the base-year internal growth rate, EEI calculates the payout rate ratio "b" and return on average equity "r" for each of 91 electric utilities for the 12 months ending in each of the four quarters from June 1987 through March 1988. It then computes the internal growth rate for each company. The average of the four quarterly median values is 3.37 percent.²²

where:
P/B=Price-Book Value Ratio.

¹⁹ BEC at 20-21.

²⁰ EEI at Attachment A-13.

²¹ EEI at Attachment A-8.

²² EEI at Attachment A-8.

To calculate the base-year external growth rate "sv", EEI first estimates the "v" component. Using the same sample of 91 utilities, EEI divides the average price for the 12 months ending June 30, 1988 by the 1986 book value and arrives at a price-book value ratio of 1.28 and a "v" of 0.219.²³ It then derives the "s" component (0.0003) from its own published data. The resulting external growth "sv" is 0.007 percent (0.0003×0.219). Total base-year growth, the sum of internal and external growth, is 3.38 percent.

For its projected fundamental growth rate, EEI projects "br" and "s" and "v". Internal growth is based on Value Line 1990-1992 projections of retention growth. The mean and median values of projected growth are 4.7 and 4.8 percent, respectively.

EEI then estimates the price-book value ratio used in the formula for the "v" component. EEI relies on the Value Line projected return on common equity for 1990-1992 (13.4 percent) and the Value Line projected price-earnings ratio for the same period (9.5 percent). The product of return on average equity and the projected price-earnings ratio is the price-book value ratio. The resulting price-book value ratio is 1.27 (0.134×9.5) and is equivalent to a "v" value of 0.214. EEI attempted to derive its projected "s" by subtracting its estimate of projected internal growth "br" from Value Line projections of growth in total equity. That result was negative (-0.007) and EEI discarded it. EEI then uses its own projections of external financing and obtains an "s" of 0.0007.²⁴ The resulting projected external growth, the product of "s" and "v", is 0.01 percent (0.0007×0.214). EEI's estimate of fundamental projected growth, the sum of internal and external growth, is 4.7 percent.²⁵

EEI also cites direct forecasts of near-term growth rates made by I/B/E/S, Value Line, and Salomon Brothers. These range from 2.9 to 4.0 percent, but center around 3.5 percent.

Finally, EEI presents a two-stage growth analysis. Its analysis uses an initial growth rate of 3.4 percent, based on EEI's base-year fundamental analysis, and assumes that growth will increase to a constant of 3.5 percent after five years, based on the analysts' near-term forecasts. This approach results in a composite growth rate of 3.49 percent.

EEI relies heavily on its projected fundamental growth rate of 4.7 percent

²³ *Id.* and Appendix 10.

²⁴ EEI at 9.

²⁵ EEI at Attachment A-10.

¹⁵ BEC at 14.

¹⁶ BEC at 15.

¹⁷ BEC at 15-19.

¹⁸ The "v" component is typically computed from the following formula:

$v = 1 - [1/(P/B)]$.

to arrive at its recommended growth rate of 4.6 percent. It discounts analysts' projections of earning and dividend growth because it believes that the analysts have been unduly influenced by "'temporary,' single events which have disrupted [utility] earnings", such as changes in accounting standards. EEI also discounts its own two-stage growth analysis because the analysis relied heavily on those analysts' projections.²⁶

NEP recommends a growth rate in the range of 4.5 to 5.0 percent.²⁷ Its analysis includes historical dividend growth rates, a fundamental analysis, and projections of earnings per share. The median 5-year and 10-year historical growth rates in dividends per share (for the period ending with 1987) are 4.45 and 5.15 percent, respectively. However, NEP believes that investors "expect dividend growth rates greater than zero." It therefore recalculates historical dividend growth excluding companies with historical dividend growth rates equal to or less than zero. The resulting median 5-year and 10-year historical growth rates in dividends are 4.9 and 5.23 percent.

In its fundamental analysis, NEP calculates a total growth rate of 4.3 percent, comprised of an internal growth rate of 4.1 percent and an external growth rate of 0.20 percent. NEP calculates an internal growth rate "br" for each utility based on Salomon Brothers' earned rates of return for the year ending June 30, 1988 (a median of 13.7 percent), and a payout ratio of 70 percent. The 70 percent payout ratio was "based on the FERC's conclusion in Order No. 489 that, regardless of recent data and near-term expectations, investors hold to long-term expectations of approximately 70 percent payout (i.e., 30 percent retention) of earnings."²⁸ NEP calculates an external growth rate "sv" for each utility from Value Line projections of the growth in the number of common shares outstanding ("s") and from 1987 stock prices and book values ("v").²⁹ NEP also relies on the 4.0 percent 5-year median projected earnings growth rate published by Zacks Investment Research in June 1988.

AUS recommends a growth rate of 4.53 percent on the basis of an equal weighting of the results of 4.75 percent from its two-stage growth analysis and 4.3 percent from its fundamental analysis.³⁰ The two-stage analysis uses

data derived by averaging seven historical and forecasted growth rates taken from Value Line and I/B/E/S. AUS uses the mean of these rates, 4.35 percent, for the first stage, and the median, 4.94 percent, for the long-run second stage beginning after five years.

AUS bases its retention growth rate "br" of 4.3 percent on retention growth rates projected by Value Line for 1988, 1989, and 1990-1992.³¹ Although AUS does not attempt to specify a particular "sv" component in its fundamental analysis, it notes that with price-book value ratios above 1.0, the "sv" component would be positive and thus produce additional growth.

AUS uses a totally different method to "test the reasonableness of growth rates developed from other sources."³² It notes that indicators of inflation, economic growth, and changing capital cost rates are higher now than last year, and then argues that the growth rate must also be higher. AUS presents a table showing that the average increase in these items between 1987 and 1988 was 0.85 percent. Forecasts of these factors for the coming year average a 0.20 percent increase. AUS weighs the historical and projected increases and concludes that an increase of approximately 0.5 percent in the Commission's prior annual growth rate (to 4.84 percent) would be appropriate.

FAB-OEPR recommends a growth rate of 3.70 percent on the basis of a fundamental analysis of 85 companies.³³ FAB-OEPR estimates a near-term retention ratio "b" of 27 percent, based on 1988 data from Salomon Brothers and on projected data from Value Line.

FAB-OEPR uses three methods to estimate a near-term return on equity "r" of 13.5 percent.³⁴ First, it reviews the Value Line rate of return projections for 1990-1993, concluding that "the Value Line data support a 13.6 percent estimate for the expected earned rate of return on average common equity during the next several years."³⁵

Second, FAB-OEPR uses a technique called attrition analysis to examine the difference between allowed rates of return and earned returns for the period 1982-1987. On the basis of its judgment about those differences, FAB-OEPR concludes that electric utilities will earn 12.5 percent (about 0.5 percent below the 1987 allowed rates of return) in the near term.

Third, FAB-OEPR uses a method described as "sustainable rate of return," based on the mathematical equality:

$$r = \frac{\text{Dividend Yield} \times \text{Price/Book Value Ratio}}{\text{Payout Ratio}}$$

FAB-OEPR determines that a sustainable rate of return on common equity is 14.04 percent. FAB-OEPR concludes on the basis of this analysis that "investors would reasonably expect the average electric utility to earn a 13.5 percent rate of return on common equity in the near-term."³⁶

Using an expected retention ratio "b" of 27 percent and an expected earned rate of return on average common equity "r" of 13.5 percent, FAB-OEPR calculates an internal growth rate for the industry of 3.6 percent.

FAB-OEPR next estimates external growth "sv."³⁷ It determines the "s" component to be 0.40 percent by subtracting its own estimate of internal growth (3.6 percent) from its analysis of Value Line's projections of growth in common stock equity (4.0 percent). FAB-OEPR's estimate of the "v" component is 0.219, based on a 1.28 price-book value ratio for the year ending June 30, 1988. Thus, external growth "sv" is 0.1 percent (0.004 × 0.219) and total projected growth, the sum of internal growth and external, is 3.7 percent.

GSA recommends a growth rate between 3.5 and 4.0 percent.³⁸ Its recommendation is based on both analyst growth forecasts and historical growth rates. GSA relies on Merrill Lynch's long-term (steady-state) growth rate for electric utility earnings of 4.0 percent. GSA also cites a finding that for each 5-year and 10-year period between 1955 and 1987 the average growth rate of Moody's Utility Common Stock Index ranged from 3.5 to 4.0 percent.

SWEP recommends a growth rate of 5.086 percent based on a 60-40 weighting of historical data and projections of future growth rates.³⁹ The historical data include a 5.9 percent fundamental growth rate derived from Standard and Poor's Compustat data. The projected growth rates average 4.5 percent and consist of 5-year projections of earnings per share and dividends made by First Boston and Salomon Brothers.

²⁶ EEI at Attachment A-13.

²⁷ NEP at 6.

²⁸ NEP at 3.

²⁹ NEP at Schedule No. 8.

³⁰ AUS at 39.

³¹ AUS at 35.

³² AUS at 31-32.

³³ FAB-OEPR at 9.

³⁴ FAB-OEPR at 3-6.

³⁵ FAB-OEPR at 4.

³⁶ FAB-OEPR at 6.

³⁷ FAB-OEPR at 6-7.

³⁸ GSA at 15.

³⁹ SWEP at 2.

2. Fundamental Analysis

a. *Earnings Retention Rate ("b") Analysis.* Six Commenters estimate the fundamental internal growth rate "br", either directly or through its individual components, the retention rate "b" and expected earned rate of return on book value of common equity "r". Three commenters, NEP, BEC and FAB-OEPR, present estimates of the earnings retention rate "b" (1.0 minus the payout ratio). NEP adopts the 30 percent rate from Order No. 489 without any independent analysis. BEC analyzes base-year data and projections and finds that both of these are below the 30 percent level. BEC also analyzes historical data and finds that the retention rate has fluctuated around the 30 percent level. BEC concludes that a 30 percent retention rate is appropriate.⁴⁰ FAB-OEPR also examines base-year and projected retention rates and concludes that a retention rate of 27 percent is appropriate.⁴¹

In Order No. 489, the Commission noted that in the two previous proceedings it had found that 28-32 percent represented a reasonable range of projected retention rates and used 30 percent in its own calculations. It further stated:

In this proceeding, evidence suggests that the dividend payout ratio has risen recently and that a ratio above 70 percent is projected for the near-term future. * * * However, the Commission believes that, despite recent data and near-term expectations for the dividend payout ratio, the evidence is not persuasive that investors have long-term expectations that deviate significantly from the 70 percent ratio the Commission has adopted in the last two proceedings.⁴²

The Commission concludes that the evidence in the record of this proceeding supports continuation of a long-term expected earnings retention rate of 30 percent.

b. *Expected Earned Rate of Return on Equity ("r") Analysis.* Two commenters, BEC and FAB-OEPR, explicitly comment on the expected earned rate of return on equity "r". The Commission also infers the rate of return for a third commenter, NEP. The three expected earned rates of return are in the relatively narrow range of 13.5 percent to 14.0 percent.

BEC examines historical and base-year data and projections of "r". Its historical analysis covers the six-year period 1982-1987. Its projections are based on Value Line's estimates for each utility for 1990-1992. The average

of the median returns for the projected period is 13.8 percent. On the basis of all of its analyses, BEC concludes that investors expect a return on equity of approximately 14.0 percent.

FAB-OEPR examines Value Line composite projections and projections for individual utilities. On the basis of that data, FAB-OEPR concludes that the projections support an estimate for "r" of 13.6 percent. FAB-OEPR also performs an "attrition analysis" which yields an estimated earned rate of return of 12.5 percent and a "sustainable rate of return analysis" which yields an estimated return of 14.04 percent. FAB-OEPR concludes that a 13.5 percent rate of return is appropriate.⁴³

NEP estimates a historical base-year "br" for each utility. Because NEP uses a retention rate of 30 percent for each company, the Commission is able to estimate that the rate of return implied in NEP's estimate is 13.7 percent.⁴⁴

The Commission believes that reliance on a purely historical approach to project an expected rate of return is not warranted. Although historical growth rates do provide a reference point, additional analyses are needed before one can conclude that investors expect the future to replicate the past. It is the judgment of the Commission that 13.8 percent is a reasonable expected earned rate of return on common equity for public utilities at this time.

c. *Internal Growth ("br") Analysis.* Three commenters, AUS, EEI and NEP, present estimates of the combined value of internal growth "br". AUS uses Value Line forecasts to arrive at its projected "br" of 4.3 percent. EEI estimates internal growth through a base-year fundamental analysis (3.37 percent) and a projected fundamental analysis (4.7 percent). As noted above, NEP uses base-year data to derive its internal growth estimate of 4.1 percent.

The Commission's estimate of "br", derived from separate estimates of "b" and "r", is 4.14 (0.3×0.138), which is in the lower to mid-range of these estimates.

d. *Proportion of New Stock Expected to be Issued ("s") Analysis.* The Commission adopts an "s" value (proportion of new stock expected to be issued) of 0.9 percent. Three commenters present specific estimates of "s", ranging from 0.03 percent in the base year (EEI) to a 1.0 percent long-term forecast (BEC). The use of the constant growth model requires evaluation of estimates of long-term industry trends. BEC presents a convincing argument that,

while investors expect relatively low construction and external common stock financing in the near term, they expect somewhat higher levels in the longer term. The Commission therefore gives relatively little weight to the near-term forecasts of EEI (0.07 percent) and FAB-OEPR (0.4 percent), and more weight to the long-term forecast of BEC, which is more in keeping with the findings of long-term expectations in previous proceedings.

e. *Expected Price of New Common Stock Financing Relative to Book Value ("v") Analysis.* The Commission adopts a "v" value (the expected price of new common stock financing relative to its book value) of 0.225. The estimates presented by commenters are in a narrow range. FAB-OEPR uses base-year data to arrive at a price-book value ratio of 1.28. BEC and EEI use the methodology favored in RM87-35 and arrive at projected price-book value ratios of 1.31 and 1.27, respectively. The commenters' results are so close that the Commission cannot meaningfully distinguish among them. The Commission therefore adopts the average, 1.29, which is equivalent to a "v" of 0.225. The resulting value of "sv" is 0.20 percent (0.9×0.225).

f. *Total Fundamental Growth ("br+sv") Analysis.* One commenter, SWEP, reports the result of its historically based fundamental analysis as one line of a table.⁴⁵ The Commission places little weight on SWEP's fundamental analysis because it does not provide sufficient information for the Commission to evaluate its study. In particular, the comments state neither which data SWEP uses to estimate "br" and "sv" nor how many years of data are included in the study. The Commission's estimate of total fundamental growth "br+sv" is 4.3 percent ($0.138 \times 0.30 + 0.009 \times 0.225$).

3. Two-Stage Growth Analysis

Three commenters present two-stage growth analyses. However, these analyses are not particularly helpful in determining a dividend growth rate for use in the constant growth rate model. In its two-stage DCF analyses, BEC employs a complex procedure to forecast utility stock prices in the 1990-1992 period. By forecasting stock prices directly, BEC bypasses the two-stage growth analysis the Commission asked commenters to utilize. The analysis desired by the Commission includes estimates for near-term growth and long-term growth in dividends per share. Long-term growth rates are implicit in

⁴⁰ BEC at 14.

⁴¹ FAB-OEPR at 2.

⁴² 53 FR at 3352.

⁴³ FAB-OEPR at 3-6.

⁴⁴ NEP at Schedule No. 7.

⁴⁵ SWEP at 2 and Exhibit B.

BEC's stock price forecasts, but the Commission has no way of appraising their reasonableness. For this reason, the Commission places little weight on BEC's results.

In its analysis, EEI uses its base-year fundamental analysis growth rate (3.4 percent) as the near-term growth rate estimate, and analysts' near-term forecasts as the long-term growth rate. EEI dismisses its own two-stage forecast, arguing that the analyst's near-term forecasts are understated. The Commission believes that the EEI analysis is deserving of little weight because EEI does not use a long-term growth rate forecast.

The Commission also does not place much weight on AUS's application of the two-stage growth model. AUS provides no theoretical justification for using the mean of its seven historical and forecasted growth rates as the short-term growth rate in the model or for using the median of these growth rates as the long-run growth rate.⁴⁶

NEP criticizes the use of a two-stage growth rate analysis on practical grounds. It argues that it is very difficult to establish two separate growth rate stages for the electric utility industry because most projected growth rates are for periods not longer than five years and are appropriate only for the first stage. The use of short-term forecasts for the second stage of the model has been a problem in this proceeding. The only commenter to offer a long-term growth rate (4.0) estimate (GSA) does not use that rate in a two-stage model.⁴⁷

The Commission cannot rely on the two-stage growth rate analysis in this proceeding because the two-stage analyses presented by commenters are each deficient in some manner, leaving the Commission without sufficient data to perform its analysis.

4. Other Growth Rate Estimates

The State of Connecticut Office of Policy and Management suggests that the evaluation of the data and methods for estimating the expected growth rate are reasonable and should be encouraged.⁴⁸ The Commission restates its position that it will place primary reliance on two specific methods of estimating the expected annual dividend growth rate—a fundamental analysis approach and a two-stage growth model, but that it will consider other data and methods as a check on the reasonableness of the results of the two primary methods.⁴⁹

AUS presents a hypothesized relationship between indicators of inflation, economic growth, and changing capital cost rates on the one hand and growth of electric utility dividends on the other, but fails to offer a persuasive justification for that relationship. In fact, some of the relationships may be the inverse of that hypothesized by AUS. For example, increases in interest rates and capital costs generally curb business expansion and demand for electricity. It is therefore unlikely that the result would be an expectation of an increased dividend growth for electric utilities. Furthermore, AUS does not present any evidence of the sensitivity of electric utility dividend growth rates to these factors. Finally, AUS test is tied to near-term phenomena and not to the long-term factors required by the constant growth rate model.

Four commenters submit historical growth rates of dividends and of earnings per share. These historical growth rates vary from 3.6 percent to 5.6 percent, with most estimates above 4.0 percent (See Table 2). Both BEC and EEI suggest that those 5-year growth rates may be biased downward because of negative earnings growth in recent years. EEI suggests that negative earnings growth may be due to one-time events such as changes in accounting standards.⁵⁰

Analysts' near-term forecasts vary from 2.7 to 4.8 percent, with most estimates at 4.0 percent or below. EEI also suggests that near-term forecasts may be biased downward by the same one-time events that affected the 5-year historic growth rates.

The Commission's fundamental analysis growth rate of 4.3 percent falls between historic growth rates and near-term forecasts.

5. Conclusion

The Commission concludes, on the basis of its review of the commenters' analyses and its own analysis developed above, that an expected annual dividend growth rate factor of 4.3 percent is appropriate for use in the quarterly indexing procedure for the 12 months beginning February 1, 1989. The Commission reaches this conclusion primarily on the basis of the fundamental analysis approach. The two-stage growth rate analysis proved unusable for determining growth rate in this proceeding due to the sparse data

and deficient analyses offered by commenters.

C. Flotation Costs

Flotation costs are incurred by utilities when they sell new shares of their common stock, and include issuance costs, such as underwriters' compensation and legal and printing fees. Although relatively small, flotation costs are not accounted for elsewhere in a utility's cost of service and are therefore included in the calculation of the allowance on common equity.

The Commission continues its policy of calculating an industry average adjustment to the required rate of return in order to compensate utilities for issuance costs only. The Commission also continues its policy of estimating the adjustment to the required rate of return for flotation costs using the following formula:⁵¹

$$k^* = \frac{fs}{(1+s)}$$

where:

k^* = flotation cost adjustment to required rate of return

f = industry average flotation cost as a percentage of offering price

s = proportion of new common equity expected to be issued annually to total common equity

Commenters' estimates for " f ", average flotation cost as a percentage of offering price, range from 2.68 to 3.56 percent.⁵² The Commission finds the analysis of BEC to include the most comprehensive set of new issues and adopts its estimated 3.56 percent value of " f " in deriving the value of flotation cost " k^* ".

The Commission determined in the growth rate section above that the expected proportion of new common equity issued annually, " s ", should be 0.9 percent. Applying the 3.56 percent estimate of issuance costs, " f ", and the 0.9 percent estimate of new equity financing, " s ", to the above formula, the Commission finds the flotation cost adjustment for use in the quarterly indexing procedure to be 0.03 percent, or 3 basis points.⁵³

D. Inclusion of Diversified Public Utilities in the Sample

The General Services Administration (GSA), commenting on behalf of the

⁴⁶ AUS at 34.

⁴⁷ GSA at 15.

⁴⁸ CONN at 1.

⁴⁹ See, 53 FR 31884-85.

⁵⁰ The EEI estimates of 5-year historical growth appearing in Table 2 have been recalculated to eliminate utilities with negative growth rates. Before the recalculation EEI's median 5-year historical dividend and earnings growth rates were 3.46 percent and 1.44 percent, respectively.

⁵¹ See, Order Nos. 420, 442, 461, and 489.

⁵² AUS at 37, BEC at 32, EEI Attachment A at 15, OEPR at 11, and SWEP at Exhibit C.

⁵³ Flotation cost adjustment = $0.0356 (0.009) \div 1.009 = 0.0003$.

consumer interests of Federal executive agencies, recommends that the Commission revise the criteria for inclusion of electric utilities in the sample used to determine the dividend yield factor in the DCF formula to recognize the increasing diversification of some of those firms into non-utility ventures. GSA maintains that diversification into non-utility ventures increases the investment risk of utility firms, thereby requiring them to offer higher dividend yields to attract investors. GSA concludes that inclusion of these diversified firms in the sample for calculating the median dividend yield for electric utilities inflates that median yield and thereby inflates the rate of return finding.⁵⁴

GSA cites three specific examples of diversification efforts which it suggests have altered the risk profiles of sample firms. Minnesota Power and Light has invested in leveraged leases and preferred stock, real estate, telecommunications, and paper mills, and 40 percent of its net income is currently derived from non-utility ventures.⁵⁵ Potomac Electric Power Company has invested in oil and gas exploration, venture capital firms, finance and operating aircraft leases, subway cars, communication satellites, real estate, power production projects, financing of low-income housing, and high-yield corporate bonds. Hawaiian Electric Industries has invested in banking, insurance, real estate, marine transportation services, and corporate securities. GSA argues that most diversification into non-utility areas has led to greater risks and higher expected and required returns on common equity. It supports its position by citing reports by credit rating agencies and other investment firms and a statement by the Minnesota State public utility commission recognizing that investors perceive non-utility ventures as relatively riskier than utility ventures. It discounts the likelihood that the "portfolio effect" of diversification (that is, investment in non-utility operations that are countercyclical to the firm's utility operations) will offset the increase in business risk.

GSA suggests that the sample group of utilities be changed to ensure that the rates charged for utility services reflect only the risks and costs, including capital costs, attributable to utility operations. It suggests inclusion of an earnings volatility measure to screen out those firms whose earnings volatility

has been significantly altered by diversification.

The Commission has previously considered this issue. In the fourth annual proceeding, FAB-OEPR identified a number of companies in the industry sample which had begun to diversify into unregulated businesses. It suggested that diversified companies have a different risk profile than firms which are solely regulated utilities because diversified companies as a group have lower dividend yields, higher expected earned returns, and, therefore, higher price-to-book value ratios. However, FAB-OEPR's analysis revealed that diversification had not had a significant impact on the industry cost of capital.⁵⁶ The Commission responded in Order No. 489 by noting that, although FAB-OEPR's data showed divergence between diversified and non-diversified utilities in dividend yields, expected earned returns, and price-to-book value ratios, they also showed that the costs of equity for the two groups remained very close. The Commission therefore declined to eliminate utilities from its sample on the grounds of diversification and concluded that its existing sampling procedures regarding diversified firms were adequate. However, the Commission did acknowledge that diversification is an increasingly important factor in the electric utility industry and did state its intent to monitor the effects of diversification on the industry average cost of equity in future proceedings.⁵⁷

The Commission continues to acknowledge that diversification activities may transform the risk profile of a public utility to such an extent that it is no longer appropriate to include that firm in the sample for calculation of median dividend yields for public utilities. In the current proceeding, FAB-OEPR again suggests that the inclusion of diversified companies in the sample has no material effect on the benchmark.⁵⁸ The Commission will continue to monitor the impact of diversification on the benchmark rate of return.

E. Advisory Status of Generic Rate of Return

Several commenters support the intention of the Commission, expressed in the NOPR in this proceeding, to continue to use the generic rate of return on an advisory basis.⁵⁹ During several

earlier annual proceedings, the Commission had considered treating the generic rate of return as a rebuttal presumption. However, that is not an issue in this proceeding because the NOPR did not propose to modify § 37.8 of the Commission's regulations, which provides that "[t]he benchmark rates of return under this part will be advisory only." The Commission decided in those earlier proceedings, most recently in Order No. 461, not to make the generic rate of return a rebuttal presumption at that time. The generic rates remain advisory.

Two commenters go further and suggest that the Commission declare that the generic rate of return will permanently remain advisory only.⁶⁰ The Commission declines to do so. This rule deals with the benchmark process for the 12 months beginning February 1, 1989, and the Commission did not propose to change the status of the generic rate of return for that period. Furthermore, the Commission in the future could choose to propose and implement such a change and would not be bound by any statement regarding permanence made in this rule. Therefore, the sense of permanence sought by those two commenters would be illusory.

F. Utility of Benchmark Rate of Return

BEC comments that the "benchmark experiment" now seems unlikely to achieve its three original purposes stated in Order No. 389. It suggests that the annual benchmark proceeding has become a purely mechanical process which does not give the Commission a "more current and direct understanding of the financial and operating circumstances of the electric utility industry." BEC notes that the Commission prepared industry financial profiles in 1985 and 1986 to implement this objective but has discontinued the practice. It also suggests that the procedure cannot achieve its purpose of rendering more accurate and consistent rate of return decisions without the agency's willingness to devote the time and resources needed for a meaningful exploration of factors affecting the cost of equity. Finally, BEC comments that the benchmark procedure has not achieved its purpose of saving resources, and that there is no reason to expect that it will.⁶¹

AUS also expresses concern that the generic rate of return proceedings have not accomplished the stated goals initially established by the Commission

⁵⁴ GSA at 1-2.

⁵⁵ *Id.*, at 3-5.

⁵⁶ 53 FR 3349, citing comments of FAB-OEPR staff at 1, 12.

⁵⁷ 53 FR 3349.

⁵⁸ OEPR at 1.

⁵⁹ Conn. at 1, CEC at 2.

⁶⁰ CEC at 2, EEI at 5.

⁶¹ BEC at 1-2.

and it criticizes the DCF model as presently employed by the Commission.

EEL comments that little use has been made of the benchmark rates of return by utilities, intervenors, Commission staff, or the Commission itself. It notes that the benchmark rate of return is rarely mentioned in Commission orders other than in the generic rate of return proceedings themselves and that, although Commission staff now includes benchmark information as exhibits in rate case proceedings, that information does not appear to play any significant role in the staff's recommendations.⁶² EEL states that reference to the generic rate of return in decisions of the Commission or administrative law judges has been generally limited either to matters of detail or to rejections of its use. EEL further notes that when public utilities have sought to use the benchmark to serve as a basis for automatic adjustment of the rate of return on equity, the Commission has refused permission. EEL finds this unfortunate "since automatic adjustment of a pre-established rate of return is at least one (perhaps the only) function that the benchmark rate of return procedure may be adequately equipped to perform."⁶³ EEL suggests that the Commission's failure to utilize the benchmark rate of return reflects a lack of confidence in its validity. EEL concludes that the benchmark rates of return developed by the Commission in earlier proceedings have "systematically and substantially understated the cost of capital to electric utilities" and that therefore the Commission's methodology fails the "end-result" test.⁶⁴

The Commission continues to believe that generic determination of rate of return on common equity for public utilities can provide several desirable benefits, including more accurate and consistent Commission decisions among companies and for the same company over time. The Commission also expects use of the generic rate of return to result ultimately in significant cost savings. Those benefits have not yet been realized to a major degree because adoption of the benchmark rate has been incremental and cases in which the benchmark could be applied have only recently begun to reach the Commission decision stage. In addition, the pace of change in long-standing practices and procedures is often slow. The Commission has utilized the generic rate in arriving at its rate of return conclusion in several recent cases,

including *Connecticut Light and Power, et al.*⁶⁵ and *Yankee Atomic Electric Company, et al.*⁶⁶ There have also been some innovative uses of the generic rate of return in proceedings such as *Ocean State Power*.⁶⁷ The Commission continues to encourage wider use of the generic rate of return by staff and other parties and remains confident that as its use broadens, its utility will become more evident.

American Electric Power Service Corporation (AEP) comments that the generic rate of return has not produced economically realistic results and should be abandoned. AEP asserts that in each recent year the required rate of return projected by the Commission's DCF model has failed "to even remotely approximate the actual return realized by investors in utility stocks."⁶⁸

Even if AEP's assertions are true, the test it implies is not a valid test of the model. As the Commission has stated in the past, the DCF model is used to estimate the return required by investors at the time the analysis is performed. It is not intended to forecast price changes, changes in market conditions, or changes in expectations. A year later, expectations about interest rates, dividends and growth rates will likely have changed. Prices change because expectations change. The Commission agrees that the DCF model is a poor method for predicting future stock prices.⁶⁹

AUS charges that the Commission's quarterly benchmark does not work properly. AUS argues that the benchmark does not change in unison with other indicators of capital costs. To make its point, AUS cites the reduction in the benchmark from 12.51 percent to 12.36 percent (calculated using dividend yield data for the period January through June 1988 and applicable between August 1 and October 31, 1988). It compares this decrease to the 34 basis point increase in the yield of "10-year Treasuries" between April 15 and July 15, 1988.

AUS has mismatched the time periods for comparison between the benchmark rate and bond yields. In partial response to a similar argument by AUS in RM87-35, the Commission stated:

In addition, some commenters mismatched the time periods for comparison between the benchmark rate and bond yields. While it is

⁶² 43 FERC ¶ 61,508 (June 22, 1988) at 62,264 and 62,267; 45 FERC ¶ 61,370 (Dec. 6, 1988) (order on rehearing).

⁶³ 40 FERC ¶ 61,372 (Sept. 30, 1987) at 62,210 43 FERC ¶ 61,232 (May 6, 1988) (order on rehearing).

⁶⁴ 44 FERC ¶ 61,261 (Aug. 19, 1988).

⁶⁵ AEP at 3, 8.

⁶⁶ 53 FR 3346.

true that a benchmark rate of return is meant to apply to a particular period, it is calculated by the Commission using dividend yield data from a period prior to the applicability period. Therefore, a fair comparison should contrast the benchmark rate of return with contemporaneous smoothed bond yields * * *

In the quarterly indexing procedure used to develop the benchmark rate, the Commission uses a six month dividend yield to smooth short-term market fluctuations inherent in spot yields. A similar smoothing process should be used to remove short-term fluctuations from bond yields before any comparison is made.⁷⁰

The same problem arises again with the AUS analysis in this proceeding. When 10-year Treasury bond yields are smoothed in a manner consistent with the dividend yield measurement period used in the quarterly indexing procedure, the result is a decrease in bond yields between the two periods. The smoothed bond yield is 8.77 percent for the first period and 8.66 percent for the second, a decline of 11 basis points, almost precisely equal to the 15 basis point decline in the generic rate of return for the same period.

G. Other Comments

AUS requests that the Commission conduct evidentiary hearings or appoint an administrative law judge to analyze the comments submitted in this proceeding to "provide the necessary forum for each commenting party to sustain its burden of proof through discovery and cross-examination of each participant."⁷¹ AUS suggests that the fact that the Commission has stated that it will take "official notice" of the benchmark rate of return in individual rate cases requires that hearings be conducted in this rulemaking proceeding before the Commission or an administrative law judge.

This is a generic rulemaking proceeding under the Administrative Procedure Act (APA). The APA does not require a formal evidentiary hearing in such circumstances and AUS has presented no justification for holding such a hearing in this case.

The State of Connecticut, on behalf of its Department of Public Utility Control, stresses its opposition to extension of the generic rate of return concept beyond the Commission. It argues that state regulatory agencies must maintain flexibility in their decision making and sovereignty over determination of rates of return allowed to local utilities.⁷²

⁷⁰ *Id.*

⁷¹ AUS at 5.

⁷² CONN at 2.

⁶² EEL at 8.

⁶³ *Id.* at 9.

⁶⁴ *Id.* at 6.

The NOPR in this proceeding did not propose to expand the applicability of the generic rate of return. The Commission regulations are applicable to utilities within this Commission's jurisdiction; Connecticut's concerns about their imposition on state regulatory agencies are groundless.

Two commenters suggest that the Commission consider methods and models other than its DCF formula to determine a benchmark rate of return, arguing that the Commission's DCF formula is flawed and inadequate.⁷³

The Commission's use of the DCF formula is not an issue in this proceeding. The Commission has thoroughly considered numerous and wide-ranging comments on that DCF formula in the four previous annual proceedings and has adopted the same formula in each final rule. In adopting its DCF formula for the fourth time in Order No. 489, the Commission stated that future proceedings may be limited to determination of the growth rate and flotation cost factors to be used in that formula in the quarterly indexing procedure.⁷⁴ The NOPR in this fifth annual proceeding did limit the inquiry to the growth rate and flotation cost factors. The Commission's DCF formula is an established methodology and comments promoting alternative methods are beyond the scope of the NOPR.

IV. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act⁷⁵ requires the Commission to describe the impact that a proposed rule would have on small entities or to certify that the rule will not have a significant economic impact on a substantial number of small entities. Nearly all of the jurisdictional utilities that would be affected by the proposed rule are too large to be considered "small entities" within the meaning of the Act.⁷⁶ Accordingly, the Commission certifies that this rule will not have a significant economic impact on a substantial number of small entities.

V. National Environmental Policy Act

Commission regulations require that

an environmental assessment or an environmental impact statement be prepared for a Commission action that may have a significant effect on the human environment.⁷⁷ The Commission has categorically excluded certain actions from these requirements as not having a significant effect on the human environment.⁷⁸ The Commission has found that matters affecting rates for the purchase or sale of electricity are not major federal actions that have a significant environmental impact.⁷⁹ The generic rate of return is a factor to be considered in the determination of electric rates. Thus, no environmental assessment or environmental impact statement is necessary for the requirements of this final rule.

VI. Paperwork Reduction Act

The Paperwork Reduction Act⁸⁰ and Office of Management and Budget (OMB) regulations⁸¹ require that the OMB approve certain information collection requirements imposed by agency rule. The final rule in this proceeding does not impose any information collection requirements. Therefore, the Commission has not submitted this rule to the OMB for review or approval.

VII. Timing of Quarterly Updates and Effective Date of Rule

The benchmark rates of return established through the Commission's quarterly indexing procedure will generally be published on or before the fifteenth of the month following the close of a calendar quarter.

The first quarter will run from February 1 to April 30, the second quarter from May 1 to July 31, the third quarter from August 1 to October 31, and the fourth quarter from November 1 to January 31.

This rule will be effective January 18, 1989.

List of Subjects in 18 CFR Part 37

Electric power rates, Electric utilities, Reporting and recordkeeping requirements.

By the Commission, Commissioner Trabandt concurred with a separate statement attached.

Lois D. Cashell,
Secretary.

Appendix A—Commenters in RM88-25-000

American Electric Power Service Corporation—AEP
Associated Utility Services, Inc.—AUS
Boston Edison Company, *et al.*—BEC
Commonwealth Edison Company—CEC
State of Connecticut/Office of Policy and Management—CONN
Edison Electric Institute—EEI
Financial Analyses Branch, Office of Electric Power Regulation, Federal Energy Regulatory Commission—FAB-OEPR
General Services Administration—GSA
New England Power Company—NEP
Southern Electric System—SES
Southwestern Electric Power Company—SWEP
Southwestern Public Service Company—SPSC

Appendix B—Public Utilities Used in Base-year Dividend Yield Calculations and Quarterly Updates

Utility	Ticker symbol
Allegheny Power System.....	AYP
American Electric Power.....	AEP
Atlantic Energy Inc.....	ATE
Baltimore Gas & Electric.....	BGE
Black Hills Corp.....	BKH
Boston Edison Co.....	BSE
Carolina Power & Light.....	CPL
Centerior Energy Corp.....	CX
Central & South West Corp.....	CSR
Central Hudson Gas & Elec.....	CNH
Central Ill Public Serv.....	CIP
Central Louisiana Electri.....	CNL
Central Maine Power Co.....	CTP
Central Vermont Pub Serv.....	CV
Cilcorp Inc.....	CER
Cincinnati Gas & Electric.....	CIN
CMS Energy Corp.....	CMS
Commonwealth Edison.....	CWE
Commonwealth Energy Syste.....	CES
Consolidated Edison of NY.....	ED
Delmarva Power & Light.....	DEW
Detroit Edison Co.....	DTE
Dominion Resources Inc-VA.....	D
DPL Inc.....	DPL
Duke Power Co.....	DUK
Duquesne Light Co.....	DQU
Eastern Utilities Assoc.....	EUA
Empire District Electric.....	EDE
Fitchburg Gas & Elec Ligh.....	FGE
Florida Progress Corp.....	FPC
FPL Group Inc.....	FPL
General Public Utilities.....	GPU
Green Mountain Power Corp.....	GMP
Gulf States Utilities Co.....	GSU
Hawaiian Electric Inds.....	HE
Houston Industries Inc.....	HOU
I E Industries Inc.....	IEL
Idaho Power Co.....	IDA
Illinois Power Co.....	IPC
Interstate Power Co.....	IPW
Iowa Resources Inc.....	IOR
Iowa-Illinois Gas & Elec.....	IWG
Ipalco Enterprises Inc.....	IPL
Kansas City Power & Light.....	KLT
Kansas Gas & Electric.....	KGE

⁷³ AUS at 5, SPSC at 4.

⁷⁴ 53 FR 3359.

⁷⁵ 5 U.S.C. 601-612 (1982).

⁷⁶ 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(b) (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).

⁷⁷ Order No. 486, Regulations Implementing National Environmental Policy Act, 52 FR 47897 (Dec. 17, 1987) FERC Stats. & Regs. ¶ 30,793 (Dec. 10, 1987), codified at 18 CFR Part 380.

⁷⁸ 18 CFR 380.4 (1988).

⁷⁹ 18 CFR 380.4(a)(15) (1988).

⁸⁰ 44 U.S.C. 3301-3520 (1982).

⁸¹ 5 CFR 1320.12 (1988).

Utility	Ticker symbol
Kansas Power & Light.....	KAN
Kentucky Utilities Co.....	KU
Long Island Lighting.....	LIL
Louisville Gas & Electric.....	LOU
Maine Public Service.....	MAP
Middle South Utilities.....	MSU
Midwest Energy Co.....	MWE
Minnesota Power & Light.....	MPL
Montana Power Co.....	MTP
Neco Enterprises Inc.....	NPT
Nevada Power Co.....	NVP
New England Electric Syst.....	NES
New York State Elec & Gas.....	NGE
Niagara Mohawk Power.....	NMK
Nipco Industries Inc.....	NI
Northeast Utilities.....	NU
Northern States Power-MN.....	NSP
Ohio Edison Co.....	OEC
Oklahoma Gas & Electric.....	OGE
Orange & Rockland Utility.....	ORU
Pacific Gas & Electric.....	PCG
Pacificorp.....	PPW
Pennsylvania Power & Light.....	PPL
Philadelphia Electric Co.....	PE
Pinnacle West Capital Cor.....	PNW
Portland General Corp.....	PGN
Potomac Electric Power.....	POM
PSI Holdings Inc.....	PIN
Public Service Co of Colo.....	PSR
Public Service Co of N H.....	PNH
Public Service Co of N ME.....	PNM
Public Service Co Enterprise.....	PEG
Puget Sound Power & Light.....	PSD
Rochester Gas & Electric.....	RGS
San Diego Gas & Electric.....	SDO
Scana Corp.....	SCG
Seacorp.....	SCE
Sierra Pacific Resources.....	SRP
Southern Co.....	SO
Southern Indiana Gas & El.....	SIG
St Joseph Light & Power.....	SAJ
Teco Energy Inc.....	TE
Texas Utilities Co.....	TXU
TNP Enterprises Inc.....	TNP
Tucson Electric Power Co.....	TEP
Union Electric Co.....	UEP
United Illuminating Co.....	UIL
Unitil Corp.....	UTL
Utah Power & Light.....	UTP
Utilicorp United Inc.....	UCU
Washington Water Power.....	WWP
Wisconsin Energy Corp.....	WEC
Wisconsin Public Service.....	WPS
WPL Holdings Inc.....	WPH

Trabandt, Commissioner, concurring

This, the fifth annual rule on the generic rate of return, serves a routine purpose. The Commission has only updated two elements in the formula for 1989: the growth rate and "floatation cost factors" (that part of the cost of capital that represents expenses for securities underwriters). Order at 1. If the majority had stopped there, I would have voted for the rule without again expressing my basic disapproval of the idea that the Commission should fix a generic rate of return. As the preamble, order at 37-42, meanders from solving algebraic equations to provide a response to comments questioning the "Utility of the Benchmark Rate of Return," I will offer mine.

I agree with Boston Edison Company and, to some extent, with the Edison Electric Institute (EEI)'s observations. Not only has the annual benchmark proceeding become a "purely mechanical exercise" [order at 37], I

have gone even further and suggested that "the generic rate of return has no meaning." *Connecticut Light & Power Company*, 43 FERC ¶ 61,508 (1988) at 62,272 (dissenting opinion). To me, the whole exercise reflects a lack of sensitivity to the proper method of setting rates of return.

The law and sound policy require that we also take the individual circumstances in which companies operate into account when we set the rate of return. See, *Ocean State Power*, 44 FERC ¶ 61,261 (1988) at 61,987 (dissenting opinion). With a generic rate of return, no matter how advisory, the Commission faces—and perhaps succumbs to—a severe temptation not to. (Indeed, I have pointed out the coincidence between the generic and the allegedly individual rates of return we have set in several cases, e.g., *Connecticut Light & Power*; *Yankee Atomic Electric Company*, 40 FERC ¶ 61,372 (1987) at 62,226 (concurring opinion), *reh. den.* 43 FERC ¶ 61,232 (1988).) Fixing a rate of return may be subjective but that does not entitle us to become completely arbitrary. *Public Service Commission of the State of New York v. FERC*, 813 F.2d 448, 465 (D.C. Cir. 1987).

One final comment: the majority, order at 39-40, hints strongly that they intend to take the generic rate of return beyond the advisory stage. Indeed, the order states with certain eloquence, in response to EEI's complaint that we have not used the benchmark enough, "the pace of change in long-standing practices and procedures is often slow." The order correctly cites to the fact that the Commission has used the generic rate of return several times. The majority encourages parties to make greater use of the benchmark in the future.

I dissented in the cases the majority cites and I will continue to oppose our imposing the generic rate of return on individual utilities in rate cases. In my opinion, change in long-standing practices and procedures may sometimes be unnecessary, and in some instances, may be harmful. The type of change the majority suggests here falls under both categories. I think we should abandon this approach altogether.

With these reservations, I concur in the order.

Charles A. Trabandt,
Commissioner.

[FR Doc 88-29516 Filed 12-22-88; 8:45 am]
BILLING CODE 6717-01-M

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR Parts 10, 24, and 148

[T.D. 89-3]

Customs Regulations Amendments Relating to the United States-Canada Free-Trade Agreement

AGENCY: Customs Service, Treasury.

ACTION: Interim regulations; solicitation of comments.

SUMMARY: This document amends the Customs Regulations to implement the duty preferences of the United States-Canada Free-Trade Agreement, commonly referred to as the CFTA.

DATES: Effective date: January 1, 1989. Written comments must be received on or before February 21, 1989.

FOR FURTHER INFORMATION CONTACT: Operational Aspects: Harrison Feese, Office of Trade Operations (202-566-7060), Harry Carnes, Office of Inspection and Control (202-566-8648); Audit and Forms Aspects: Marcus Sircus, Office of Regulatory Audit (202-566-2812); Legal Aspects: John Valentine, Office of Regulations and Rulings, (202-566-5868).

SUPPLEMENTARY INFORMATION:

Background

On January 2, 1988, the United States and Canada (the "Parties") entered into an agreement, the United States-Canada Free-Trade Agreement (CFTA). The objectives of the CFTA are to eliminate barriers to trade in goods and services between the two parties, facilitate conditions of fair competition within the free-trade area, liberalize significantly conditions for investments within the free-trade area, establish effective procedures for the joint administration of the CFTA and the resolution of disputes, and lay the foundation for further bilateral and multilateral cooperation to expand and enhance the benefits of the CFTA.

The provisions of the CFTA were adopted by the United States with the enactment of the United States-Canada Free-Trade Agreement Implementation Act of 1988 the ("Act") (100 Stat. 418, Pub. L. 100-449).

The role of the U.S. Customs Service is to implement those portions of the CFTA and the Act that relate to the rules of origin and other trade issues. The rules of origin are the basis for determining whether goods imported into the U.S. from Canada are eligible for the preferential treatment accorded to goods originating in Canada. These rules do not confer origin or establish a criterion for determining origin for any other purpose. For example, origin determinations for eligibility under subheading 9802.00.80, Harmonized Tariff Schedule of the United States (HTSUS), as well as for country of origin marking under 19 U.S.C. 1304, are not affected.

Preferential treatment is available for goods entered under certain designated provisions throughout Chapters 1-99 of the HTSUS. This preferential treatment is available only to goods which are determined to be originating goods in

accordance with General Note 3(c), of the HTSUS.

The CFTA and the Act provide that goods wholly obtained or produced in the United States and/or Canada will qualify for such preferential treatment. Goods containing third-country material will qualify for preferential treatment if the materials undergo, in one or both parties, a sufficient degree of processing or assembly to result in a designated change in tariff classification under the HTSUS; that is, processing and/or assembly must result in changes in the product that are physically and commercially significant. With respect to some goods (generally, assembled products), the CFTA and the Act also require that a specified percent of the cost of manufacturing the goods be attributable to U.S. or Canadian materials and/or direct cost of processing or assembly, incurred in the U.S. or Canada. In certain limited circumstances, the origin requirement may be met on the basis of meeting the value-content requirement above.

The CFTA and the Act contain a safeguard provision that will result in denial of preferential treatment to any goods altered merely to circumvent the rules of origin.

While regulations relating to automotive products are set forth below, specific regulations relating to textile and apparel products and other provisions will be the subject of a separate rule to be published at a later date. Following is a discussion of each section of the interim regulations.

Section-by-Section Discussion

Section 10.301 Scope.

This section sets forth a general statement of the coverage and statutory authority for the CFTA and the Act. It should be noted that excluded from the coverage of these provisions are such matters as marking and foreign assets control. Each of these is provided for elsewhere in this chapter.

Section 10.302 Eligibility criteria in general.

This section provides that the preferences shall be claimed under a HTSUS heading or subheading by use of the prefix "CA" in the "special" column of the entry summary or other appropriate customs document. This section further defines "originating goods", in general, which will be eligible for the preferences and which are more specifically defined in § 10.303. Such goods must be wholly obtained or produced in the United States or Canada, or transformed in accordance with General Note 3(c), HTSUS, in either

party. The section further states that such originating goods must be shipped to the United States directly from Canada with certain exceptions identified in detail in § 10.306(b).

Section 10.303 Originating goods.

This section more specifically defines originating goods that are eligible for a preference. Such goods must be wholly obtained or produced in Canada or have been transformed by a processing that results in a change in classification that is specified in the CFTA. In certain instances, eligibility for preference also requires that a value-content test be met, as set forth in General Note 3(c), HTSUS. This section also provides rules under which a very limited class of goods may qualify for preference without change in classification.

Section 10.304 Exclusions.

This section sets forth those circumstances in which, notwithstanding a change in tariff classification, goods will not be considered as eligible for a preference. Such goods include those that have undergone simple packaging or simple combining operations, or have been merely diluted with water or another substance that does not materially change the characteristics of the goods.

In addition, under certain circumstances, goods will not be considered as originating goods if they have undergone any process or work the sole purpose of which is to circumvent the rules of origin that thereby qualify for a preference.

Section 10.305 Value content requirement.

This section sets forth the definitions that apply whenever a specific rule of origin requires a value-content determination.

Paragraph (a) defines the terms "direct cost of processing" or "direct cost of assembling" as those costs directly incurred in, or reasonably allocated to, the production of goods.

Paragraph (b) defines the term "value of materials originating in Canada or the United States, or both", as the aggregate of the price paid by the producer for material originating in either party, or both, or for materials from a third country used or consumed in the production of originating goods. When not included in that price, specific costs are defined that may be included in the value of the originating material, when related thereto.

Paragraph (c) defines the term "value of the goods when exported to the United States" as the aggregate of the price paid by the producer for all

materials and the direct cost of processing and/or the direct cost of assembling the goods. When not included in the price paid for the materials, specific costs related thereto are specified.

Paragraph (d) provides that whenever a value-content determination is required, and whenever materials used in the production of goods in Canada or the United States originated in a third country, the value of the originating material may be included in the value-content only to the extent that the value is directly attributable to the goods under consideration.

Paragraph (e) sets forth specific costs that are excluded from the direct cost of processing or assembling. Such costs excluded include those related to the general expenses of doing business, brokerage charges, royalty payments, buildings costs and profit on goods.

Section 10.306 Direct shipment to the United States.

This section defines the circumstances under which goods will be considered to have been directly shipped to the United States from Canada in order to establish eligibility for preferences.

Paragraph (a) defines a through shipment as a direct shipment from Canada to the United States that does not enter the territory of a third country.

Paragraph (b) defines the circumstances under which goods will qualify for a preference if shipped through the territory of a third country. The requirements are that the goods not enter the commerce of any third country and not be subjected to any operation other than unloading, reloading, or any other operation necessary to transport or maintain them in good condition. Further, the documentation must reflect the United States as the final destination.

Section 10.307 Documentation.

This section sets forth the documentation required to claim a preference.

Paragraph (a) provides that a preference is claimed by including on the entry summary or equivalent document the symbol "CA" as a prefix to the subheading of the HTSUS under which the good is being entered.

Paragraph (b) requires that the claim for a preference be made at the time of filing of the entry summary, or liquidation will occur at the rate that would otherwise be applicable.

Paragraph (c) provides that a claim for a preference will be based on the exporter's written certificate of origin, Customs Form 353 (a copy of which is

set forth in Appendix A to this document), and that the certificate of origin must be available at the time the preference is claimed. The certificate under the regulations must be presented to the district director upon request.

Paragraph (d) requires that the certificate of origin be prepared on Customs Form 353 unless the exporter uses an approved computerized format or other format approved by the U.S. Customs Service. Such alternative format must contain the same information and certification as set forth on the Customs Form 353.

Paragraph (e) sets forth exceptions to the requirement for an exporter's certificate of origin that may be authorized by the district director. The exceptions include entries entitled to informal entry procedures provided for in §§ 143.21 and 143.22, Customs Regulations.

Paragraph (e) further requires that the invoice or other Customs release document for commercial goods that qualify for both informal entry and a preference must include a certification that the goods are eligible for a preference based upon the rules of origin. The certification must be signed by the manufacturer, supplier, or exporter. Further, special rules for automotive products are set forth in § 10.311.

Noncommercial goods which qualify for both informal entry and a preference may be exempt from the exporter's certificate of origin requirement if the goods are legally marked "Made in Canada", or it is otherwise shown that the goods qualify as originating goods.

Paragraph (e)(2) authorizes the district director to waive the requirement for evidence of direct shipment when he is satisfied that the otherwise qualifying goods were in fact imported directly from Canada.

Section 10.308 Records retention.

This section sets out the requirements for records retention by both U.S. importers and exporters. Paragraph (a) requires the importer to retain the exporter's certificate of origin for a 5-year period and requires that it be furnished to the appropriate Customs official upon request.

Paragraph (b) requires the exporter to retain, for a 5-year period, all of the information necessary to prepare the exporters certification of origin and to submit such information to the appropriate Customs official upon request.

Section 10.309 Verification of documentation.

This section authorizes the appropriate Customs official to require any evidence of country of origin or of direct shipment that he deems necessary to verify the claim for a preference.

Section 10.310 Election to average for motor vehicles.

Section 10.310 contains the regulations relating to the election to average for motor vehicles. Certain conforming amendments have also been made to § 10.84 that relate to automotive vehicles and articles for use as original equipment in the manufacture of automotive vehicles.

Paragraph (a) provides that the manufacturer may elect to average its calculation of the 50 percent value-content requirement for vehicles of the same class, assembled in the same plant, over a 12-month period. The election to average must be made before the importation of any vehicle produced within the 12-month period identified.

Paragraph (b) provides that an election to average becomes binding upon the first entry of vehicles for the identified 12-month period and that if the manufacturer's annual report fails to substantiate the claim that the vehicles are originating goods under the Act or a Canadian article under the Automotive Products Trade Act of 1965 (APTA), or if the manufacturer fails to comply with other reporting requirements, all vehicles covered by the averaging declaration will be liquidated without preference. Paragraph (c) sets forth the documentation requirements for a manufacturer of motor vehicles who elects to average in lieu of submitting an exporter's certificate of origin.

Section 10.311 Documentation for election to average for motor vehicles.

Paragraph (a) requires a declaration of election to average, signed by an authorized company official, and submitted to Customs on Customs Form 355. A sample of Customs Form 355 is set forth in Appendix B to this document.

Paragraph (b) requires that a quarterly report be submitted to Customs within 30 days of the end of each quarter on Customs Form 356. A copy of Customs Form 356 is set forth in Appendix C to this document. The manufacturer may elect to submit the required information in an approved computerized format or such other format as may be approved by Customs, provided the alternative format contains the information set forth on Customs Form 356. Negative quarterly reports are required.

Paragraph (c) requires that an annual report be submitted within 90 days of the end of the identified financial year on Customs Form 357. Again, the manufacturer may elect to submit the required information in an approved computerized format or such other format as may be approved by Customs, provided such alternative format contains the same information as required on Customs Form 357. A copy of Customs Form 357 is set forth in Appendix D.

Part 24 Customs Financial And Accounting Procedures

Section 24.23 sets forth an ad valorem fee on merchandise formally entered or withdrawn from warehouse for consumption. The Act provides for a gradual reduction of this fee on originating goods. The amendments establish the schedule for fee reduction from January 1, 1990, to January 1, 1994.

Part 148 Personal Declarations and Exemptions

Subpart J of Part 148 relates to noncommercial importations of limited value. Section 148.102 provides for a flat rate of duty. The Act provides for a gradual reduction of the flat rate for originating goods imported from Canada. The regulatory amendments establish the schedule for duty reductions.

In order to assist the public in understanding the application of the flat rate to originating goods imported from Canada and the relationship of this flat rate to the personal exemptions provided by law, an example has been included as Appendix E to this document.

Comments

Before adopting these interim regulations as a final rule, consideration will be given to any written comments (preferably in triplicate) timely submitted. Comments submitted will be available for public inspection in accordance with the Freedom of Information Act (5 U.S.C. 552), § 1.4, Treasury Department Regulations (31 CFR 1.4), and § 103.11(b), Customs Regulations (19 CFR 103.11(b)), on normal business days between the hours of 9:00 a.m. and 4:30 p.m. at the Regulations and Disclosure Law Branch, Customs Service Headquarters, Room 2119, 1301 Constitution Avenue, NW., Washington, DC 20229.

Inapplicability of Notice and Delayed Effective Date Requirements

Pursuant to the provisions of 5 U.S.C. 553(a) public notice is inapplicable to

this regulation because it is within the foreign affairs function of the United States. Not having regulations implementing the procedures for obtaining preferences for goods designated as eligible and other aspects of the United States-Canada Free-Trade Agreement on the date the United States-Canada Free-Trade Agreement Implementation Act of 1988, is expected to be effective, January 1, 1989, would provoke undesirable international consequences. In addition, because these regulations establish procedures which the public needs to know in order to claim a preference under the United States-Canada Free-Trade Agreement Implementation Act of 1988, it is determined pursuant to 5 U.S.C. 553(b)(B) that notice and public procedures are impracticable, unnecessary, and contrary to the public interest.

Furthermore, for the above reasons and because the regulations implement procedures for obtaining preferences for goods designated as eligible, thus conferring substantial benefits upon Canadian exporters and the public in general, it is determined that good cause exists under the provisions of 5 U.S.C. 553(d)(1) and (d)(3) for dispensing with a delayed effective date.

Executive Order 12291

Because this document will not result in a "major rule" as defined in E.O. 12291, a regulatory impact analysis is not required.

Regulatory Flexibility Act

Because no notice of proposed rulemaking is required for interim regulations, the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), do not apply.

Paperwork Reduction Act

This regulation is being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in this regulation have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1515-0164.

Comments concerning the collection of information and the accuracy of estimated average annual burden, and suggestions for reducing burden should be directed to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503, attention: Desk Officer for U.S. Customs Service, with copies to the U.S. Customs Service, Regulations and

Disclosure Law Branch, Room 2119, 1301 Constitution Avenue, NW., Washington, DC 20229.

The collections of information in this regulation are in § 10.84, 10.307, 10.310 and 10.311, title 19, Code of Federal Regulations. This information is required to claim a preference under the CFTA and Act and will be used by the U.S. Customs Service to determine eligibility for a preference. The likely respondents are business organizations including importers, exporters and manufacturers.

The estimated annual burden per respondent/recordkeeper varies from 15 minutes to 225 hours, depending on individual circumstances, with an estimated average of 3.55 hours. Estimated number of respondents and/or recordkeepers: 5,165. Estimated annual frequency of responses: 7.

Drafting Information

The principal author of this document was Marilyn G. Morrison, Office of Regulations and Rulings, U.S. Customs Service. However, personnel from other offices participated in its development.

List of Subjects

19 CFR Part 10

Customs duties and inspections, Imports, Motor Vehicles.

19 CFR Part 24

Customs duties and inspections, Imports.

19 CFR Part 148

Customs duties and inspections, Imports.

Amendments to the Regulations

For the reasons set forth above, Parts 10, 24 and 148, Customs Regulations (19 CFR Parts 10, 24 and 148) are amended as set forth below.

PART 10—ARTICLES CONDITIONALLY FREE, SUBJECT TO A REDUCED RATE, ETC.

1. The general authority citation for Part 10 is revised to read as follows:

Authority: 19 U.S.C. 66, 1202, 1481, 1484, 1499, 1508, 1623, 1624.

2. Section 10.84 is revised to read as follows:

§ 10.84 Automotive vehicles and articles for use as original equipment in the manufacture of automotive vehicles.

(a)(1) Certain motor vehicles and motor vehicle equipment are eligible for duty-free entry as proclaimed by the President under the Automotive Products Trade Act of 1965. The articles designated for such duty-free treatment

are defined in General Note 3(c)(iii), HTSUS (19 U.S.C. 1202). Specifically, such articles are those designated [as "Free (B)"] in the "Special" subcolumn in Chapter 87, HTSUS, and must qualify as "Canadian articles" as defined in General Note 3(c)(iii)(A)(1). To claim exemption from duty under the Automotive Products Act of 1965, an importer must establish, to the satisfaction of the appropriate Customs officer, that the article in question qualifies as a "Canadian article" for purposes of General Note 3(c)(iii)(A)(1). The Customs officer may accept as satisfactory evidence a certificate executed by the importer as set forth in paragraph (b) of the section, subject to any verification he may deem necessary. Alternatively, the Customs officer may determine that under the circumstances of the importation a certificate is unnecessary.

(2) Under the United States-Canada Free-Trade Agreement and implementing legislation (Pub. L. 100-449, 100 Stat. 418) a manufacturer of motor vehicles may elect to average, over its 12-month financial year, its calculation of the value-content requirement for vehicles in establishing its eligibility for tariff preference. Requirements for averaging are set forth in § 10.310 and 10.311.

(b)(1) When all materials used at any stage in the production of the imported article are wholly obtained or produced in Canada or the United States, or both, a certificate in the following form may be accepted as evidence that the commodity is a "Canadian article":

All materials contained in the product covered by the _____ (Describe the invoice, bill of lading, or other document or statement identifying the shipment) annexed or appended to this certificate of Canadian origin at the time it was subscribed were wholly obtained or produced in Canada or the United States, or both. No materials other than those which were wholly obtained or produced in Canada or the United States, or both, were incorporated into this product or any of its components at any stage of production or in the production of any intermediate product used at any stage in the chain of production in Canada or the United States, or both.

(2) When any material used at any stage in the production of an imported article or any of its components is not wholly obtained or produced in Canada or the United States, or both, a certificate in the following form may be accepted as evidence that the commodity is nevertheless a "Canadian article":

The product covered by the _____ (Describe the invoice, bill of lading, or other

document or statement identifying the shipment) annexed or appended to this certificate of Canadian origin at the time it was subscribed is an originating good so as to be a Canadian article. There were used in its production in Canada _____ (Description sufficient for tariff classification of the materials, and number of units) of third country materials of which the price paid was _____ per unit of quantity, plus _____ which represents all costs incurred in transporting the materials to the location of the producer and the duties, taxes, and brokerage fees on the materials, if such costs were not included in the price paid.

(3) If such Customs officer is satisfied that the revenue will be protected adequately thereby, he may accept in lieu of the certificate specified in paragraph (b)(2) of this section a certificate in the following form when the merchandise covered thereby has been produced with third country material but is an originating good under a specific rule of origin for the merchandise:

The product covered by the _____ (Describe the invoice, bill of lading, or other document or statement identifying the shipment) annexed or appended to this certificate of Canadian origin at the time it was subscribed is an originating good so as to be a Canadian article. There were or may have been used in its production in Canada or the United States, or both, materials of a third country.

It is impractical to ascertain the exact number of units of third country material, if any, used in its production or the price paid (and other costs required to be included in the price paid) of such materials but to the best of (my) (our) (its) knowledge the materials are described (sufficient for tariff classification purposes) as follows:

(4) The certificates described in paragraphs (b)(2) and (b)(3) of this section shall not be accepted if the statements therein make it evident that the importation is not a "Canadian article" within the meaning of General Note 3(c), HTSUS.

(5) If more than one kind of article is covered by a certificate provided for in paragraph (b) (1), (2), or (3) of this section, the information required by the certificate shall be shown with respect to each kind. When more than one kind of material, other than originating material, is used in the production of an article covered by such a certificate, the certificate shall state the number of units, a description sufficient for tariff classification purposes, the price paid, and, if not included in the price paid, the costs incurred in transporting the materials to the location of the producer and duties, taxes and brokerage fees paid in Canada and/or the United States on the material, per unit of each kind of materials.

(6) A certificate conforming to paragraph (b) (1), (2), or (3) of this section shall be accepted as evidence of the facts alleged therein only if:

(i) There is annexed thereto a copy of the commercial invoice or bill of lading covering the articles or other documentary evidence which identifies the article to which the certificate pertains,

(ii) The certificate is signed by the manufacturer or producer of the article to which it pertains, or by the person who exported the articles from Canada, and

(iii) It clearly appears that such copy or other documentary evidence was annexed to the certificate when it was signed.

(c) In lieu of the certification in paragraph (b) (1), (2), or (3) of this section, a manufacturer of motor vehicles who claims a preference under the United States-Canada Free-Trade Agreement and elects to average pursuant to § 10.310(a), shall be subject to the requirements of §§ 10.301 to 10.311 of this part.

(d) When an importer makes an entry, or withdrawal from warehouse, for consumption of articles for use as "original motor-vehicle equipment" as that term is defined in General Note 3(c)(iii), HTSUS, he shall file in connection therewith his declaration that the articles are being imported for use as original equipment in the manufacture in the United States of the kinds of motor vehicles specified in the General Note and furnish the name and address of the motor vehicle manufacturer. A copy of the written order, contract, or letter of intent shall be attached to the importer's declaration except that if the district director of Customs is satisfied that a copy of the written order, contract, or letter of intent will be made available by the importer or ultimate consignee for inspection by customs officials upon request during a period of 3 years from the date of such entry or withdrawal from warehouse, the production of such documents will not be required. Proof of use need not be furnished.

(e) If, after a Canadian article has been accorded the status of original motor-vehicle equipment, it is decided to divert the article from its intended use in the manufacture in the United States of motor vehicles, the importer or other person deciding to divert the article from such intended use shall give notice in writing of the decision to the district director of Customs of the district where entry was made or where the offices of the importer are located and either make arrangements for its destruction or exportation under Customs supervision

or pay duties in accordance with General Note 3(c)(iii)(B)(2), HTSUS. If such article is not destroyed or exported under Customs supervision or the duties paid, the article, or its value, shall be subject to forfeiture.

3. Part 10 is amended by adding at the end thereof a new heading followed by new §§ 10.301 through 10.311 to read as follows:

* * * * *

United States-Canada Free Trade Agreement

Sec.

- 10.301 Scope.
- 10.302 Eligibility criteria in general.
- 10.303 Originating goods.
- 10.304 Exclusions.
- 10.305 Value content requirement.
- 10.306 Direct shipment to the United States.
- 10.307 Documentation.
- 10.308 Records retention.
- 10.309 Verification of documentation.
- 10.310 Election to average for motor vehicles.
- 10.311 Documentation for election to average for motor vehicles.

United States-Canada Free Trade Agreement

§ 10.301 Scope.

The provisions of §§ 10.302-10.311 of this part relate to the procedures for obtaining preferences for imported goods designated as eligible in the "special" column of the Harmonized Tariff Schedules of the United States (HTSUS), and General Note 3(c), HTSUS. These preferences were the subject of the United States-Canada Free-Trade Agreement (the Agreement) entered into on January 2, 1988, and the United States-Canada Free-Trade Agreement Implementation Act of 1988 (100 Stat. 418). In situations involving goods subject to bilateral restrictions or prohibitions, or country of origin marking, other criteria for determining origin may be applicable pursuant to section 407 of the Agreement.

§ 10.302 Eligibility criteria in general.

Subject to the more specific explanations of the criteria in §§ 10.303 and 10.305 of this part, goods classifiable under an HTSUS heading or subheading for which the symbol "CA" appears in the "special" column are eligible for a preference if:

(a) *Originating goods.* The goods originate in Canada or the United States, or both, and

(b) *Direct shipment required.* Except as provided in § 10.306(b), are directly shipped to the United States from Canada.

§ 10.303 Originating goods.

For the purpose of eligibility for a preference under the Agreement, goods may be regarded as originating goods if:

(a) *Wholly of Canadian or United States origin.* The goods are wholly obtained or produced in the Territory of Canada or the United States, or both.

(b) *Transformed with a change in classification.* The goods have been transformed by a processing which results in a change in classification and, if required, a sufficient value-content, as set forth in General Note 3(c), HTSUS; or

(c) *Transformed without a change in classification.* An assembly of goods, other than goods of chapters 61 to 63 of the HTSUS, which does not result in a change in classification because the goods were imported in an unassembled or disassembled form and classified as the goods, unassembled or disassembled, pursuant to General Rule of Interpretation 2(a), HTSUS; or because the tariff subheading for the goods provides for both the goods themselves and their parts, shall nonetheless be treated as originating goods if:

(1) The value of originating materials and the direct cost of assembling in Canada or the United States, or both, as defined in § 10.305 constitute not less than 50 percent of the value of the goods when exported to the United States;

(2) The assembled goods are not subsequently processed or further assembled in a third country; and

(3) The goods satisfy the requirement in § 10.306.

(d) *Articles of Feather.* The goods are eligible to be treated as originating in Canada pursuant General Note 3(c)(vii)(Q)(12)(ee), HTSUS.

§ 10.304 Exclusions.

(a) *Changes based on simple processing.* No goods shall be considered originating for purposes of eligibility under the Agreement if they have merely undergone simple packaging or simple combining operations, or have undergone mere dilution with water or with another substance that does not materially alter the characteristics of the goods.

(b) *Other excluded processing.* No goods shall be considered to be originating merely by virtue of having undergone any process or work in which the facts clearly justify the presumption that the sole object was to circumvent the provisions of Chapter 3 of the Agreement.

§ 10.305 Value content requirement.

The following definitions apply whenever a specific rule of origin under

the Agreement requires a value content determination:

(a) *Direct cost of processing or assembling.* The terms "direct cost of processing" or "direct cost of assembling" mean the costs directly incurred in, or that can be reasonably allocated to, the production of goods, including:

(1) The cost of all labor, including benefits and on-the-job training, labor provided in connection with supervision, quality control, shipping, receiving, storage, packaging, management at the location of the process or assembly, and other like labor, whether provided by employees or independent contractors;

(2) The cost of inspecting and testing the goods;

(3) The cost of energy, fuel, dies, molds, tooling, and the depreciation and maintenance of machinery and equipment, without regard to whether they originate within the territory of the United States or Canada;

(4) Development, design, and engineering costs;

(5) Rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property used in the production of the goods; and

(6) Royalty, licensing, or other like payments for the right to the goods.

(b) *Value of originating materials.* The term "value of materials originating in the United States or Canada or both" means the aggregate of:

(1) The price paid by the producer of exported goods for materials originating in either the United States, or Canada, or both, or for materials imported from a third country used or consumed in the production of such originating materials; and

(2) When not included in that price, the following costs related thereto:

(i) Freight, insurance, packing and all other costs incurred in transporting any of the materials referred to in paragraph (b)(1) of this section to the location of the producer;

(ii) Duties, taxes and brokerage fees on such materials paid in the United States, or Canada, or both;

(iii) The cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or by-product; and

(iv) The value of goods and services relating to such materials determined in accordance with subparagraph 1(b) of Article 8 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade.

(c) *Value of goods when exported.* The term "value of the goods when exported

to the United States" means the aggregate of:

(1) The price paid by the producer for all materials, whether or not the materials originate in the United States, or Canada, or both, and, when not included in the price paid for the materials, the following costs related thereto:

(i) Freight, insurance, packing, and all other costs incurred in transporting all materials to the location of the producer;

(ii) Duties, taxes, and brokerage fees on all materials paid in the United States, or Canada, or both;

(iii) The cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or by-product; and

(iv) The value of goods and services relating to all materials determined in accordance with subparagraph 1(b) of Article 8 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade; and

(2) The direct cost of processing or the direct cost of assembling the goods.

(d) *Directly attributable.* Whenever a value-content determination is required by the rules of the Agreement and whenever originating materials and materials obtained or produced in a third country are used or consumed together in the production of goods in the United States or Canada, the value of originating materials may be treated as such only to the extent that the value is directly attributable to the goods under consideration.

(e) *Exclusions from direct costs of processing or assembling.* Excluded from the direct costs of processing or assembling are:

(1) Costs relating to the general expense of doing business, such as the cost of providing executive, financial, sales, advertising, marketing, accounting and legal services, and insurance;

(2) Brokerage charges relating to the importation and exportation of goods;

(3) Costs for telephone, mail, and other means of communication;

(4) Packing costs for exporting the goods;

(5) Royalty payments related to a licensing agreement to distribute or sell the goods;

(6) Rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes, and the cost of utilities for real property used by personnel charged with administrative functions; and

(7) Profit on the goods.

§ 10.306 Direct shipment to the United States.

Goods shall be considered as directly shipped to the United States from Canada for the purpose of eligibility for preferences under the Agreement only under the following circumstances:

(a) *Through shipment.* The goods have been shipped directly from Canada to the United States without passage through the territory of any third country; or

(b) *Shipment through a third country.* The goods were shipped through the territory of a third country but:

(1) The goods did not enter the commerce of a third country;

(2) The goods did not undergo any operation other than unloading, reloading, or any operation necessary to transport them to the United States or to preserve them in good condition; and

(3) All shipping and export documents show the United States as the final destination.

§ 10.307 Documentation

(a) *Claims for a preference.* A preference in accordance with the Agreement is claimed by including on the entry summary, or equivalent documentation, the symbol "CA" as a prefix to the subheading of the HTSUS under which each eligible good is classified.

(b) *Failure to claim a preference.* A claim for preference under the Agreement must be made at the time of the filing of the entry summary in accordance with § 10.307(a) of this part. Failure to make a timely claim will result in liquidation at the rate which would otherwise be applicable.

(c) *Documentation showing origin.* A claim for a preference for goods under paragraph (a) of this section shall be based on the Exporter's Certificate of Origin, properly completed and signed by the person who exports or knowingly causes the goods to be exported from Canada. The Exporter's Certificate of Origin must be available at the time the preference is claimed under paragraph (a) of this section and shall be presented to the district director upon request.

(d) *Exporter's Certificate of Origin.* The Exporter's Certificate of Origin shall be prepared on Customs Form 353. In lieu of the Customs Form 353, the exporter may use an approved computerized format or such other format as is approved by the Headquarters, U.S. Customs Service, Office of Trade Operations, Washington, D.C. 20229. Alternative formats must contain the same information and certification set forth on Customs Form 353.

(e) *Exceptions to documentation requirements.* Exceptions to the foregoing documentation requirements may be authorized at the discretion of the district director in the following circumstances:

(1) *Exception for informal entries.* As set forth in paragraphs (e)(1)(i) and (ii) of this section, an Exporter's Certificate of Origin may be waived in connection with an entry entitled to informal entry procedures as authorized in §§ 143.21 and 143.22 of this chapter if:

(i) *Commercial goods which qualify for informal entry.* The invoice, or an appropriate Customs release document, for commercial goods which qualify both for informal entry and a preference must include the following statement, on the invoice or appropriate Customs document:

I hereby certify that the goods described herein are eligible for a preference based upon the rules of origin enumerated in the United States-Canada Free-Trade Agreement.

Check One:

- () Manufacturer
() Supplier
() Exporter

Signature _____

Title _____

Date: _____

(ii) *Noncommercial goods which qualify for informal entry.* The importation of goods from Canada by a person for noncommercial use may be exempt from documentation requirements if the goods are legally marked "Made in Canada", or it can otherwise be shown that they are originating goods under the Agreement and there is no evidence to the contrary.

(2) *Waiver of evidence of direct shipment.* The district director may waive the submission of evidence of direct shipment when otherwise satisfied, taking into consideration the kind and value of the goods, that the goods were, in fact, imported directly from Canada, and that they otherwise qualify for a preference in accordance with the Agreement.

§ 10.308 Records retention.

(a) *Importer.* The importer of record shall retain the exporter's certificate of origin required by § 10.307(d) for a period of 5 years and it must be made available upon request by the appropriate Customs official.

(b) *Exporter.* Any person who exports, or who knowingly causes to be exported, any merchandise to Canada shall make, keep, and render for examination and inspection, such records (including certifications of origin or copies thereof), which pertain to such exportation for a period of 5 years from

the date of exportation. In the event that the appropriate Customs official requests submission of the records, they shall be submitted directly to the requesting official.

§ 10.309 Verification of documentation.

Any evidence of country of origin or of direct shipment submitted in support of a preference under the Agreement shall be subject to such verification as the appropriate Customs official may deem necessary. If the U.S. importer or U.S. exporter or their agent does not provide the information requested by the appropriate Customs officer, the district director may refuse to grant the claim for preference, in addition to other available sanctions.

§ 10.310 Election to average for motor vehicles.

(a) *Election.* In determining whether a motor vehicle is originating for purposes of the preferences under the Agreement or a Canadian article under the Automotive Products Trade Act of 1965 (APTA), a manufacturer may elect to average, over its 12-month financial year, its calculation of the value-content requirement for vehicles of the same class or sister vehicles which are assembled in the same plant as provided for in the Agreement. A manufacturer must declare its election to average before the importation of any vehicles produced within the identified 12-month period. The election to average is subject to the conditions and requirements set forth in §§ 10.310 and 10.311.

(b) *Effect of election.* An election to average shall be binding at the time of the first entry of vehicles for which the election has been made. If a manufacturer's annual report, required by § 10.311, does not verify the claim that the vehicles are originating goods under the Agreement of Canadian articles under APTA, or if a manufacturer otherwise fails to comply with the reporting requirements, entries of the vehicles identified in the averaging declaration will be subject to liquidation in accordance with the rate of duty which would otherwise apply.

(c) *Election in lieu of certificate of origin.* In lieu of the Exporter's Certificate of Origin required in § 10.307(c), an importer of vehicles covered by an election to average under this section may have its claim for preference based on a copy of the declaration of election.

§ 10.311 Documentation for election to average for motor vehicles.

A manufacturer who elects to average for motor vehicles shall submit a

declaration of election to average, quarterly reports, and an annual report in the form and manner as follows:

(a) *Declaration of election.* A declaration of election to average, signed by an authorized company official, shall be submitted by the manufacturer to the U.S. Customs Service, Regulatory Audit Division, Detroit, Michigan 48226-2568 on Customs Form 355, Declaration of Election to Average.

(b) *Quarterly Report.* A quarterly report shall be submitted to the Regulatory Audit Division, at the above address, on Customs Form 356, Vehicle Cost Report (Quarterly), within 30 days after the end of each quarter. In lieu of the Customs Form 356, the manufacturer may submit the information required on the form in an approved computerized format or such other format as is approved by the U.S. Customs Service, Regulatory Audit Division, Detroit, Michigan 48226-2568. Alternative formats must contain the same information set forth on the Customs Form 356. Negative quarterly reports are required.

(c) *Annual Report.* An annual report shall be submitted to the U.S. Customs Service, Regulatory Audit Division, Detroit, Michigan 48226-2568, on Customs Form 357, Vehicle Cost Report (Annual), within 90 days of the end of the financial year identified in the Election to Average, Customs Form 355. In lieu of the Customs Form 357, Vehicle Cost Report (Annual), the manufacturer may submit the information required on the form in an approved computerized format or such other format as is approved by the U.S. Customs Service, Regulatory Audit Division, Detroit, Michigan 48226-2568. Alternative formats must contain the same

information set forth on Customs Form 357.

PART 24—CUSTOMS FINANCIAL AND ACCOUNTING PROCEDURE

1. The general authority citation for Part 24 is revised to read as follows:

Authority: 19 U.S.C. 58, 66, 1202, 1624.

2. Section 24.23 is amended by adding a subparagraph (5) at the end of paragraph (b) to read as follows:

§ 24.23 Ad valorem fee.

* * * * *

(b) Exemptions. * * *

(5) Goods originating in Canada pursuant to General Note 3(c), HTSUS, according to the following schedule:

(i) With respect to goods entered or withdrawn from warehouse for consumption on or after January 1, 1990, the user fee shall be 80 percent of the user fee otherwise applicable on that date;

(ii) With respect to goods entered or withdrawn from warehouse for consumption on or after January 1, 1991, the user fee shall be 60 percent of the user fee otherwise applicable on that date;

(iii) With respect to goods entered or withdrawn from warehouse for consumption on or after January 1, 1992, the user fee shall be 40 percent of the user fee otherwise applicable on that date;

(iv) With respect to goods entered or withdrawn from warehouse for consumption on or after January 1, 1993, the user fee shall be 20 percent of the user fee otherwise applicable on that date;

(v) With respect to goods entered or withdrawn from warehouse on or after

January 1, 1994, there shall be no Customs user fee.

PART 148—PERSONAL DECLARATIONS AND EXEMPTIONS

1. The general authority citation for Part 148 continues to read as follows:

Authority: 19 U.S.C. 66, 1498, 1624.

2. Section 148.102(a) is amended by adding "Canada," before "American Samoa".

3. Section 148.102 is amended by adding a new paragraph (c) to read as follows:

§ 148.102 Flat rate of duty.

* * * * *

(c) *Canada.* The rate of duty on originating goods from Canada (exclusive of duty-free goods) as defined in § 10.303 of this chapter, accompanying any person, including a crew member, arriving in the United States directly or indirectly from Canada shall be a flat rate of 9 percent as established by the United States-Canada Free-Trade Agreement. The flat rate shall decrease at the rate of one percent every year commencing on January 1, 1990, until January 1, 1998, at which time a free rate of duty shall apply.

Michael H. Lane,
Acting Commissioner of Customs.

Approved:

December 9, 1988.

John P. Simpson,
Acting Assistant Secretary for the Treasury.

Appendices

Note: These appendices will not appear in the Code of Federal Regulations.

BILLING CODE 4820-02-M

Appendix A

DEPARTMENT OF THE TREASURY
UNITED STATES CUSTOMS SERVICEApproved through 4/30/89
OMB No. 1515-0164U.S.-CANADA FREE TRADE AGREEMENT
EXPORTER'S CERTIFICATE OF ORIGIN

19 CFR 10.307(d)

1. GOODS CONSIGNED FROM (Exporter's business name, address, country, tax identification number)	2. IF BLANKET CERTIFICATION EFFECTIVE DATE _____ EXPIRATION DATE _____
3. GOODS CONSIGNED TO (Consignee's name, address, country)	4. PRODUCER'S NAME, ADDRESS, COUNTRY, TAX IDENTIFICATION NUMBER (If different from exporter)

5. ORIGIN CRITERIA FOR GOODS COVERED BY THIS CERTIFICATE:

A. Wholly produced or obtained in Canada or the United States; or
B. The goods have been transformed in the United States or Canada so as to be subject:

- 1) to a change in tariff classification as described in the Rules of Annex 301.2; or
- 2) to a change in tariff classification as described in the Rules of Annex 301.2 and the value of originating materials plus the direct cost of processing in Canada or the United States is not less than 50 percent or, as required by Section VI Rule 15 of Annex 301.2, 70 percent of the value of exported goods; or
- 3) to Rule 5, Section XII of Annex 301.2; or

C. No change in tariff classification because goods and parts are provided for in the same tariff subheading or goods were imported in unassembled or disassembled form and were classified pursuant to General Rule of Interpretation 2a) of the Harmonized System, and the value of originating materials plus the direct cost of assembly in Canada or the United States is not less than 50 percent of the value of exported goods.

6. SPECIAL DECLARATION FOR TEXTILE PRODUCTS SUBJECT TO TARIFF RATE QUOTA:

- A. Apparel goods cut and sewn in Canada or the United States from fabric produced or obtained in a third country.
- B. Non-wool fabric and non-wool made-up textile articles, woven or knitted in Canada from yarn produced or obtained in a third country.

7. Origin Criterion (See Fields 5 or 6)	8. Description of Goods	9. Tariff Classification (To Six Digits)	10. Gross Weight or Other Quantity	11. Invoice Number(s) & Date(s)

11. CERTIFICATION OF ORIGIN

I certify that the information and statements herein are correct, that all the goods were produced in Canada or the United States, that they comply with the origin requirements specified for those goods in the United States-Canada Free Trade Agreement, and that further processing or assembly in a third country has not occurred subsequent to processing or assembly in Canada or the United States.

I agree to maintain, and present upon request, the documentation to support this certification and, if this is a blanket certification, to inform the importer or other appropriate party of any change that would affect the validity of this certification.

This certificate consists of _____ pages.

PLACE AND DATE	AUTHORIZED SIGNATURE	TITLE
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Customs Form 353 (120188)

INFORMATION FOR THE COMPLETION OF THE EXPORTER'S CERTIFICATE OF ORIGIN

Paperwork Reduction Act Notice: The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it and whether you have to give it to us. We ask for the information to carry out the terms of Annex 406 of the U.S./Canadian Free Trade Agreement and the Statement of Administrative Action for the implementing legislation (P.L. 100-449). Annex 406 requires that, upon request, an importer must provide the Customs Administration of the Party (U.S./Canada) with proof of the exporter's written certification of the origin of the goods. The exporter's certification, provided for in the Agreement, is essential to substantiate compliance with the rules of origin under the Agreement. You are required to give us this information.

Statement Required by 5 CFR 1320.21: The estimated average burden associated with this collection of information is 20 minutes per respondent or recordkeeper depending on individual circumstances. Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to U.S. Customs Service, Paperwork Management Branch, Washington, DC 20229, and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503, attention Desk Officer for U.S. Customs Service.

FIELD

1. Complete with the full legal name, address, country and tax identification number.
2. Complete with the effective and expiration dates (Maximum 6 months),¹ if this certificate is to cover multiple FTA qualified shipments to the same importer. NOTE: It is the exporter's responsibility to notify everyone to whom a blanket certificate is issued if changes occur in materials, costs, or production sites that would materially affect the accuracy or validity of the certification during the period. Failure to do so could make the exporter subject to penalties.
3. Complete with the consignee's full legal name, address, and country.
4. Complete with the full legal name, address, country and if known, the tax identification number. This field is to be completed only if the exporter is not the producer of the goods. If more than one producer's goods are included in a single or blanket certificate, attach a numbered list of the additional producers. Indicate the appropriate producer's number in parenthesis after the origin criteria in Field 7.
5. Fields 5 and 6 reflect the various origin criteria by which exported goods may be eligible for FTA treatment, and are to be identified in Field 7 for each corresponding item listed in Field 8.
- 5.A. Indicate this criterion if the goods are wholly produced or obtained in Canada or U.S. as defined in Article 304 of the Agreement.
- 5.B.1. Requires that a change in the tariff classification take place along with any other requirements, other than value-added, as described in the Rules of Annex 301.2 of the Agreement.
- 5.B.2. Also requires that a change in tariff classification take place. Additionally, it requires that the value of domestic materials and direct cost of processing, as described in the Rules of Annex 301.2, be either 50 or 70 percent, as specified in the Rules of Annex 301.2, of the value of the exported good.²
- 5.B.3. This field does not require that a change in tariff classification take place but other requirements as described in the Rules of Annex 301.2, other than value-added, be met.²
- 5.C. This criterion does not require that a change in tariff classification take place but requires that the value of domestic materials and direct cost of assembly is not less than 50 percent of the value of exported goods. The provisions of this criterion are in accordance with paragraphs 3, 4, and 5 of the interpretation of Annex 301.2 of the Agreement. The imported components from which the goods were produced in Canada must have constituted an unassembled or disassembled article as per the General Rule of Interpretation 2(a) of the Harmonized System, or the tariff subheading for the imported components must have provided for both the goods and their parts.
6. The special declarations for textile products are identified for use in Field 7.
7. Indicate the origin criterion selected from Fields 5 or 6 for each corresponding item listed in Field 8. If more than one article for export is covered by this certificate, the origin criterion for each is required. If necessary, a continuation sheet may be used to list the articles for export and their respective criteria. If more than one producer (Field 4) is identified, indicate next to the criteria the producer number assigned, e.g. 5.A.(3).
8. Fully describe the goods. If more than one article for export is covered by this certificate, a complete description of each article is required. If a change in tariff classification criterion is used and there are multiple constituent materials, indicate in parentheses, the number of third country constituent materials per unit. When third country constituent materials vary in a product, estimates are acceptable. The tariff classification, to six digits, of each article for export is required beside each description.
9. Indicate the gross weight or other pertinent quantities, as described on the invoice(s) or purchase order, of each good listed in Field 8. If this is a blanket certificate, indicate the contracted for weight or other quantity anticipated or contracted for during the blanket certification period, if known.
10. Indicate the invoice number(s) and date(s) for each item being shipped. If this is a blanket certificate, this field need not be completed.
11. Self-explanatory. The number of pages the certificate comprises must be indicated. NOTE: Unless the place, date, signature and title of the exporter appear on the space provided, this document will be considered invalid.

Note: Where the certificate or instructions makes reference to "Canada or the United States" or "domestic", this is to be interpreted as meaning either Canada or the United States or both.

¹ Canada will accept blanket exporter certificates with a validity period of twelve months; the United States will accept a validity period of six months.

² Canada requires the exporter to indicate the specific rule which the goods qualify; the United States simply requires an indication of the criterion.

Approved through 4/30/89
OMB No. 1515-0164

1. FINANCIAL YEAR TO WHICH THIS ELECTION APPLIES

19 CFR 10.311(a)

2. CANADIAN MANUFACTURER (Name and Address)	3. FINANCIAL YEAR--	
	3a. Starting Date	3b. Ending Date
	4. NAME AND LOCATION OF PLANT	

VEHICLES TO BE AVERAGED

VEHICLES TO BE AVERAGED			
5. Make	6. Model	7. FTA Class	8. Estimated Minimum Average Percentage U.S./Canadian Value

CERTIFICATION

In accordance with Article 1005, paragraph 2, of the U.S./Canada Free Trade Agreement, we hereby elect to average our calculations over a 12-month period on the same class of vehicles or sister vehicles (station wagons and other body styles in the same car line), assembled in the same plant for the financial year. Quarterly reports will be submitted to U.S. Customs within 30 days after the end of each quarter, and a final report for the financial year, based on actual costs and values, will be submitted to U.S. Customs within 90 days of the close of the financial year.

The estimated minimum average percentage of U.S./Canadian value and costs for the financial year is based upon an analysis of the projected foreign and U.S./Canadian costs of production for these vehicles and takes into account normal business fluctuations.

The accounting system used to arrive at these estimates is not expected to change during the financial year. Should it change, we will provide U.S. Customs with the details of such change at the time of implementation. The manufacturer will still be able to provide U.S. Customs with complete value and cost data on the vehicles identified herein to verify the FTA claim.

9. SIGNER'S TITLE	10. SIGNATURE OF AUTHORIZED CO. OFFICIAL	11. DATE SIGNED
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Paperwork Reduction Act Notice: The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it and whether you have to give it to us. We ask for the information to carry out the Statement of Administrative Action for the U.S. Implementing legislation (P.L. 100-449) which requires Customs to prepare a multi-year enforcement plan for enforcement of the FTA, with emphasis on the automotive sector. It also requires Canadian vehicle manufacturers to provide an "election to average for motor vehicles." This form is used by Canadian automotive vehicle manufacturers/assemblers electing to average their costs by automotive vehicle class over a 12-month period under the provisions of the U.S./Canada Free Trade Agreement. The submission of

this form is required to obtain or retain a benefit and once made is a binding election to average cost information by the automotive vehicle manufacturer/assembler.

Statement Required by 5 CFR 1320.21: The estimated average burden associated with this collection of information is 15 minutes per respondent or recordkeeper depending on individual circumstances. Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to U.S. Customs Service, Paperwork Management Branch, Washington, DC 20229, and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503, Attention Desk Officer for U.S. Customs Service.

Appendix C

DEPARTMENT OF THE TREASURY
UNITED STATES CUSTOMS SERVICEApproved through 4/30/89
OMB No. 1515-0164U.S./CANADA FREE TRADE AGREEMENT
VEHICLE COST REPORT (Quarterly)1. CLASS OF
VEHICLE

19 CFR 10.311(b)

2. REPORTING COMPANY (Name and Address)	3. FOR QUARTER ENDED	4. DATE OF THIS REPORT
	5. FINANCIAL YEAR —	
	5a. Starting Date	5b. Ending Date
	6. PLANT LOCATION	
7. CONTACT PERSON (Name and Phone Number)		

COST DATA—Direct Cost of Total Vehicles Produced in Canada

ARTICLE 304, PART TWO, CHAPTER THREE— U.S./CANADA FREE TRADE AGREEMENT	COST OF VEHICLES	
	U.S./Canadian	Foreign
8. Material		
9. Labor and Overhead		
10. Total Direct Costs		

INVENTORY ADDITIONS AND SUBTRACTIONS (Vehicles Produced, Shipped, Returned)

	NUMBER OF VEHICLES	
	Qualifying	Non-Qualifying
11. Beginning Inventory		
12. Total Vehicles Produced in Quarter		
13. Total Vehicles Available for Shipment (Item 11 Plus Item 12)		
14. Less:		
a. Vehicles Shipped to U.S.		
(1) Under Autopact (APTA)		
(2) Under FTA		
(3) Under MFN		
b. Vehicles Shipped to: —		
(1) Canadian Locations		
(2) Foreign Countries Other Than U.S.		
c. Vehicles Returned	()	()
d. Total Vehicles Shipped		
15. Ending Inventory (Item 13 less Item 14d)		

METHOD USED FOR DETERMINING INVENTORY COSTS

16. METHOD USED FOR FINANCIAL STATEMENTS (E.g., "LIFO", "FIFO", Etc.)	17. METHOD USED TO PREPARE THIS REPORT
18. ARE COSTS "ACTUAL" OR "STANDARD" (ESTIMATED)? ☐ ACTUAL ☐ STANDARD (On separate sheet, explain how and when actual costs are determined.)	19. IS THIS REPORT BASED ON AN AVERAGING METHOD? ☐ YES (On separate sheet, describe method in detail.) ☐ NO

CERTIFICATION

The reporting company identified in item 2 above certifies that the information and statements contained in this report are true and accurate, that all the vehicles were produced in Canada and/or the United States, that they comply with the origin requirements specified for those goods in the United States/Canada Free Trade Agreement, and that further processing or assembly in a third country has not occurred subsequent to processing or assembly in the United States or Canada.

The reporting company agrees to maintain the documentation to support this certification and it will be available for Customs review.

20. PLACE AND DATE SIGNED	21. AUTHORIZED SIGNATURE	22. TITLE
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Customs Form 356 (112288)

INFORMATION FOR THE
COMPLETION OF THE
VEHICLE COST REPORT (QUARTERLY)

Paperwork Reduction Act Notice: The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it and whether you have to give it to us. We ask for the information to carry out the Statement of Administrative Action for the U.S. Implementing legislation (P.L. 100-449) which requires Customs to prepare a multi-year enforcement plan for enforcement of the FTA, with emphasis on the automotive sector. It also requires Canadian vehicle manufacturers to provide "regular cost submissions." This form is used by Canadian automotive vehicle manufacturers/assemblers electing to average their costs by automotive vehicle class over a 12-month period under the provisions of the U.S./Canada Free Trade Agreement. The submission of this form is mandatory

once a binding election to average cost information is made by the automotive vehicle manufacturer/assembler.

Statement Required by 5 CFR 1320.21: The estimated average burden associated with this collection of information is 185 hours per respondent or recordkeeper depending on individual circumstances. Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to U.S. Customs Service, Paperwork Management Branch, Washington, DC 20229, and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503, Attention Desk Officer for U.S. Customs Service.

BLOCK

1. Designate the class of automotive vehicle as defined in Article 1006, class of vehicles—a through g.
2. Complete with the full legal name, address and country.
3. Date current financial quarter ended.
4. Self explanatory.
5. State your financial year starting and ending dates.
6. Street address, province and city.
7. Self explanatory.
8. These costs represent the total costs of finished vehicles whether shipped or ready for shipment from the plant.
9. Same as 8.
10. Totals of 8 & 9.
11. The number of vehicles represents finished vehicles ready for shipment from the plant.
12. Use only total of vehicles produced during quarter which represent finished vehicles shipped or ready for shipment.
13. Self explanatory.
14. Self explanatory. APTA=Automotive Products Trade Act;
FTA =U.S./Canada Free Trade Agreement;
MFN=Most Favored Nation: Tariff.
15. Self explanatory.
16. Attach explanation of inventory method used.
17. Attach explanation of inventory method used.
18. Explain on separate sheet methodology used to develop standard costs.
19. Self explanatory.

Appendix D

DEPARTMENT OF THE TREASURY
UNITED STATES CUSTOMS SERVICE
U.S./CANADA FREE TRADE AGREEMENT
VEHICLE COST REPORT (Annual)

19 CFR 10.311(c)

Approved through 4/30/89
OMB No. 1515-0164

1. CLASS OF
VEHICLE

2. REPORTING COMPANY (Name and Address)	3. FOR YEAR ENDED	4. DATE OF THIS REPORT
	5. FINANCIAL YEAR —	
	5a. Starting Date	5b. Ending Date
	6. PLANT LOCATION	
7. CONTACT PERSON (Name and Phone Number)		

COST DATA—Direct Cost of Total Vehicles Produced in Canada

ARTICLE 304, PART TWO, CHAPTER THREE— U.S./CANADA FREE TRADE AGREEMENT	COST OF VEHICLES			
	U.S./Canadian		Foreign	
	Standard	Actual	Standard	Actual
8. Material.....				
9. Labor				
10. Inspecting and Testing				
11. Energy, Fuel, Etc.				
12. Development, Design, Etc.				
13. Rent, Mortgage, Etc. Used in Production of Goods				
14. Royalty, Licensing, Etc. for Right to Goods				
15. Other.....				
16. Total Direct Costs				

INVENTORY ADDITIONS AND SUBTRACTIONS (Vehicles Produced, Shipped, Returned)

	NUMBER OF VEHICLES	
	Qualifying	Non-Qualifying
17. Beginning Inventory.....		
18. Total Vehicles Produced in Year		
19. Total Vehicles Available for Shipment (Item 17 Plus Item 18).....		
20. Less:		
a. Vehicles Shipped to U.S.		
(1) Under Autopact (APTA).....		
(2) Under FTA		
(3) Under MFN		
b. Vehicles Shipped to —		
(1) Canadian Locations		
(2) Foreign Countries Other Than U.S.		
c. Vehicles Returned	()	()
d. Total Vehicles Shipped		
21. Ending Inventory (Item 19 less Item 20d)		

METHOD USED FOR DETERMINING INVENTORY COSTS

22. METHOD USED FOR FINANCIAL STATEMENTS (E.g., "LIFO", "FIFO", Etc.)	23. METHOD USED TO PREPARE THIS REPORT
24. ARE COSTS "ACTUAL" OR "STANDARD" (ESTIMATED)? ☐ ACTUAL ☐ STANDARD (On separate sheet, explain how and when actual costs are determined)	25. IS THIS REPORT BASED ON AN AVERAGING METHOD? ☐ YES (On separate sheet, describe method in detail) ☐ NO

CERTIFICATION

The reporting company identified in item 2 above certifies that the information and statements contained in this report are true and accurate, that all the vehicles were produced in Canada and/or the United States, that they comply with the origin requirements specified for those goods in the United States/Canada Free Trade Agreement, and that further processing or assembly in a third country has not occurred subsequent to processing or assembly in the United States or Canada. The reporting company agrees to maintain the documentation to support this certification and it will be available for Customs review.

26. PLACE AND DATE SIGNED	27. AUTHORIZED SIGNATURE	28. TITLE
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Customs Form 357 (112288)

INFORMATION FOR THE
COMPLETION OF THE
VEHICLE COST REPORT (ANNUAL)

Paperwork Reduction Act Notice: The Paperwork Reduction Act of 1980 says we must tell you why we are collecting this information, how we will use it and whether you have to give it to us. We ask for the information to carry out the Statement of Administrative Action for the U.S. Implementing legislation (P.L. 100-449) which requires Customs to prepare a multi-year enforcement plan for enforcement of the FTA, with emphasis on the automotive sector. It also requires Canadian vehicle manufacturers to provide "regular cost submissions." This form is used by Canadian automotive vehicle manufacturers/assemblers electing to average their costs by automotive vehicle class over a 12-month period under the provisions of the U.S./Canada Free Trade Agreement. The submission of this form is

mandatory once a binding election to average cost information is made by the automotive vehicle manufacturer/assembler.

Statement Required by 5 CFR 1320.21: The estimated average burden associated with this collection of information is 225 hours per respondent or recordkeeper depending on individual circumstances. Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to U.S. Customs Service, Paperwork Management Branch, Washington, DC 20229, and to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503, Attention Desk Officer for U.S. Customs Service.

BLOCK

1. Designate the class of automotive vehicle as defined in Article 1006, class of vehicles—a through g, U.S./Canada Free Trade Agreement.
2. Complete with the full legal name, address and country.
3. Date current financial year ended.
4. Self explanatory.
5. State your financial year starting and ending dates.
6. Street address, province and city.
7. Self explanatory.
- 8-15. These costs represent the total costs of finished vehicles whether shipped or ready for shipment from the plant.
16. Totals of 8 through 15.
17. The number of vehicles represents finished vehicles ready for shipment from the plant.
18. Use only total of vehicles produced during year which represent finished vehicles shipped or ready for shipment.
19. Self explanatory.
20. Self explanatory. APTA = Automotive Products Trade Act;
FTA = U.S./Canada Free Trade Agreement;
MFN = Most Favored Nation Tariff.
21. Self explanatory.
22. Attach explanation of inventory method used.
23. Attach explanation of inventory method used.
24. Explain on separate sheet methodology used to develop standard costs.
25. Self explanatory.

BILLING CODE 4820-02-C

Appendix E—Example of Duty Calculation for Passengers Under the U.S./Canada Free Trade Agreement (FTA)

Mr. and Mrs. E return from a one-week visit to Canada where they have acquired merchandise having a fair retail value of \$10,000. Assume for this example that (1) \$5,800 of the merchandise is of Canadian origin and \$4,200 of the merchandise is of foreign origin other than Canada; (2) in addition to the personal exemptions of \$800 (\$400 each), \$5,200 of the merchandise carries a free rate of duty; (3) allowances and exemptions have not been used in the last 30 days; and (4) all articles in excess of allowances, exemptions and duty free articles are dutiable at rates other than the flat rate.

Mr. and Mrs. E present their baggage declaration for verification. Duty is figured as follows:

BREAKDOWN OF MERCHANDISE

Canadian origin	Duty rate	Foreign origin other than Canada
\$3,500	Free	\$1,700
1,800	3% ad valorem	
500	2% ad valorem	
	24% ad valorem	2500

	Fair retail value	Duty
(a) The \$400 personal exemption is grouped for a total of	\$800	0.00
(b) Articles which carry a free rate of duty	5,200	0.00
(c) The \$1,000 flat rate of duty allowance calculated at 9% on merchandise of Canadian origin and 10% on merchandise of foreign origin other than Canada. The flat rate is grouped for a total of \$2,000	1,700 (at 10% flat rate) 300 (at 9% flat rate)	\$170.00 27.00
(d) Balance of articles subject to duty at rates other than the flat rate	1,500 (at 3% ad valorem) 500 (at 2% ad valorem)	45.00 10.00
Total	10,000	252.00

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 228

[FRL-3493-3]

Ocean Dumping; Site Designation; Atlantic Ocean Offshore Brunswick Harbor, GA

AGENCY: U.S. Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: EPA today designates the existing, interim-approved Ocean Dredged Material Disposal Site (ODMDS) in the Atlantic Ocean offshore Brunswick Harbor, Georgia, as an EPA-approved ocean disposal site for the disposal of suitable dredged material. This action is necessary to provide an acceptable ocean disposal site for consideration as a disposal option for dredged material disposal projects in the greater Brunswick, Georgia, vicinity.

This Final Rule also corrects the discrepancies in the Brunswick Harbor ODMDS boundary coordinates relative to the draft and final Environmental Impact Statement (EIS), 40 CFR Part 228 (Revised as of July 1, 1984, and 1987), and 42 FR 2461 (January 11, 1977; pg. 2485).

EFFECTIVE DATE: This designation shall become effective on January 23, 1989.

ADDRESSES: Send comments to: Frank M. Redmond, Chief, Wetlands and Coastal Programs Section, Water Management Division, U.S. Environmental Protection Agency, Region IV, 345 Courtland Street, NE., Atlanta, Georgia 30365.

The file supporting this designation is available for public inspection at the following locations:

EPA Public Information Reference Unit (PIRU), Room 2904 (rear), 401 M Street, SW., Washington, DC 20460
EPA/Region IV, 345 Courtland Street, NE., Atlanta, Georgia 30365

FOR FURTHER INFORMATION CONTACT: Reginald G. Rogers, 404/347-2126.

SUPPLEMENTARY INFORMATION:

A. Background

Section 102(c) of the Marine Protection, Research, and Sanctuaries Act (MPRSA) of 1972, as amended, 33 U.S.C. 1401 *et seq.* ("the Act"), gives the Administrator of EPA the authority to designate sites where ocean disposal may be permitted. On December 23, 1986, the Administrator delegated the authority to designate ocean disposal sites to the Regional Administrator of the Region in which the sites are

located. This final designation of a site offshore Brunswick Harbor, Georgia, which is within Region IV, is being made pursuant to that authority.

The EPA Ocean Dumping Regulations promulgated under the Act (40 CFR Chapter I, Subchapter H, § 228.4) indicate that ocean disposal sites will be designated by promulgation in this Part 228. A list of "Approved Interim and Final Ocean Dumping Sites" was published on January 11, 1977 (42 FR 2461 (January 11, 1977)). The list established the existing Brunswick Harbor site as an interim site.

B. EIS Designation

Section 102(2)(C) of the National Environmental Policy Act (NEPA) of 1969, as amended, 42 U.S.C. 4321 *et seq.*, requires that Federal agencies prepare an EIS on proposals for legislation and other major Federal actions significantly affecting the quality of the human environment.

The object of NEPA is to build careful consideration of all environmental aspects of proposed actions into the agency decision-making process. While NEPA does not apply to EPA activities of this type, EPA has voluntarily committed to prepare EIS's in connection with ocean disposal site designations such as this (see 39 FR 16186 (May 7, 1974)). EPA, in cooperation with the Savannah District of the U.S. Army Corps of Engineers (COE), has prepared a draft and final EIS entitled "Brunswick Harbor, Georgia Ocean Dredged Material Disposal Site Designation." This Final Rule and the preceding Proposed Rule (53 FR 38032 (September 29, 1988)) are procedural follow-ups to the EIS. The EIS may be used (not necessarily "should be used" as stated in the Proposed Rule) as reference, particularly for literature citations, which are not cited in the Rules. This Final Rule includes excerpts from the Proposed Rule.

The action discussed in this EIS is the final designation for continuing use of the existing interim ocean dredged material disposal site near Brunswick Harbor, Georgia. The purpose of the action is to provide an environmentally acceptable location for ocean disposal. The need for ocean disposal is determined on a case-by-case basis as part of the process of issuing permits for ocean disposal.

For the Brunswick Harbor ODMDS, the COE and EPA would evaluate all dredged material disposal projects (not just "all Federal dredged material disposal projects" as stated in the Proposed Rule) pursuant to the EPA