Q. Referring to page 53, lines 31-32: Assume that electric utility market/book ratios were 169% because investors expected returns on book value that exceeded the cost of capital by 69%. If that assumption were true, would it be appropriate for regulators to allow returns that exceeded the cost of capital by 69%. Please provide a complete explanation of your answer.

A. No, it is not the function of the Board to allow returns designed to maintain a particular market/book ratio. Moreover, it could not, even if it desired to do so, since changes in market sentiment can result in swings in market value that are unrelated to the stock's underlying fundamentals. The referenced passage was trying to illustrate the internal inconsistencies in the growth expectations and the resulting implications regarding actual growth when the DCF model results, derived from market valuations in excess of book, are applied to book value.

There are, however, valid economic reasons for making an adjustment to a market value return that is applied to the book value, as discussed at page 54, lines 8-20.