Q. At p. 38, lines 20 through 23, Dr. Kalymon states: "The performance of industrial firms tends to be more unstable and may violate the stability assumptions of the DCF approach. However, any concern over regulatory circularity is avoided by the use of the lower risk industrial sample." Please explain why the avoidance of regulatory circularity is a greater concern than relying upon data that may violate the stability assumptions of the DCF approach.

A. The statements do not make a judgement with respect to whether regulatory circularity or higher instability of earnings is a greater concern to avoid in measuring the cost of equity. The comments simply reflect that there are conceptual issues which must be recognized with the application of the DCF method to any industrial sample related to instability, but that concerns over regulatory circularity are avoided.