National Energy Board | Office national de l'énergie

Reasons for Decision

TransCanada PipeLines Limited

RH-R-1-2002

February 2003

Review of RH-4-2001
Cost of Capital Decision

National Energy Board

Reasons for Decision

In the Matter of

TransCanada PipeLines Limited

Application dated 16 September 2002
requesting a Review and Variance of
National Energy Board RH-4-2001
Cost of Capital Decision

RH-R-1-2002

February 2003

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Abbreviations

Act	*National Energy Board Act*
Alliance	Alliance Pipeline Ltd.
Application or Review Application	TransCanada PipeLines Limited section 21 Application dated 16 September 2002 for Review and Variance of National Energy Board Decision RH-4-2001
ATWACC	After-Tax Weighted-Average Cost of Capital
Board	National Energy Board
CAPP	Canadian Association of Petroleum Producers
CGA	Canadian Gas Association
Coral	Coral Energy Canada Inc.
DTC	dividend tax credit
Enbridge	Enbridge Pipelines Inc.
Enbridge Gas	Enbridge Gas Distribution Inc.
M&NP	Maritimes and Northeast Pipeline Management Ltd.
Mirant	Mirant Canada Energy Marketing, Ltd.
RH-1-70	TransCanada Pipe Lines Rates Application, Phase I, National Energy Board Reasons for Decision dated December 1971
RH-2-94	Multi-Pipeline 1995 Cost of Capital Proceeding, National Energy Board Reasons for Decision dated March 1995
RH-4-2001	TransCanada PipeLines Limited Fair Return Application dated 6 June 2001 In Respect of Cost of Capital Matters, National Energy Board Reasons for Decision dated June 2002
Rules	*National Energy Board Rules of Practice and Procedure, 1995*
TransCanada or the Company	TransCanada PipeLines Limited
U.S.	United States

Glossary of Terms

capital structure	the way in which a business is financed - generally expressed as a percentage breakdown of the types of capital employed
cost of service	the total cost of providing service, including operating and maintenance expenses, depreciation, amortization, taxes, and return on rate base
deemed capital structure	a notional capital structure used for rate-making purposes that may differ from the company's actual capital structure
interest coverage ratio	the number of times that net income for a given year, before interest expense and income taxes, covers the annual interest expense - this ratio is one measure of the creditworthiness of a company
Mainline	TransCanada's Mainline natural gas transmission system
market-to-book ratio	the ratio of the market price of a common share to its book value
Part IV of the Act	the part of the *National Energy Board Act* dealing with all matters relating to traffic, tolls, and tariffs of gas and oil pipelines under the Board's jurisdiction
rate base	the amount of investment on which a return is authorized to be earned - it typically includes plant in service plus an allowance for working capital
RH-2-94 Formula	the formula for adjusting approved return on common equity set out in the RH-2-94 Decision - the formula sets approved return based on changes in forecast rates for long-term Canada bonds

Recital and Appearances

IN THE MATTER OF the *National Energy Board Act* and the regulations made thereunder;

AND IN THE MATTER OF an application dated 16 September 2002 by TransCanada PipeLines Limited pursuant to subsection 21(1) of the Act for review and variance of National Energy Board Decision RH-4-2001 dated June 2002 and Board Orders TG-3-2002, AO-1-TG-3-2002 and TG-4-2002.

BEFORE:

C. Dybwad	Presiding Member
E. Quarshie	Member
G. Caron	Member

Submitters

TransCanada PipeLines Limited

Canadian Association of Petroleum Producers

Canadian Gas Association

Centra Gas Manitoba Inc.

Coral Energy Canada Inc.

Enbridge Gas Distribution Inc.

Industrial Gas Users Association

Mirant Canada Energy Marketing, Ltd.

Ontario Minister of Energy

Chapter 1

Introduction

1.1 Background

By an application dated 6 June 2001 (Fair Return Application), TransCanada PipeLines Limited applied to the National Energy Board for, *inter alia*:

(a) a review and variance of the RH-2-94 Decision[1];
(b) an order approving an After-Tax Weighted Average Cost of Capital (ATWACC) of 7.5 percent (adjusted for the embedded cost of debt of the Company) as the return for TransCanada, or in the alternative, a rate of return of 12.50 percent on a deemed equity component of 40 percent; and
(c) an order directing that such return be utilized in the determination of final tolls to be charged by TransCanada on the Mainline for the period 1 January 2001 to 31 December 2002.

The Board issued Hearing Order RH-4-2001 on 26 July 2001. Thirty-nine parties intervened in the hearing, which was held in Calgary, Alberta from February to April of 2002. The Board, comprised of a panel of five Members, issued its RH-4-2001 Reasons for Decision on TransCanada Cost of Capital in June 2002. The Board maintained its reliance on the return on equity adjustment formula established in the RH-2-94 proceeding, and rejected TransCanada's ATWACC and alternative proposals. The Board approved a deemed common equity ratio of 33 percent for the Mainline.

1.2 The Review Application

On 16 September 2002, TransCanada applied, pursuant to subsection 21(1) of the *National Energy Board Act* and section 44 of the *National Energy Board Rules of Practice and Procedure, 1995*, for review and variance of the RH-4-2001 Decision and Orders TG-3-2002, AO-1-TG-3-2002 and TG-4-2002 by which that Decision has been implemented (Application or Review Application).

The Application was made on the grounds that the Board, in rendering the RH-4-2001 Decision, committed errors that raise doubts as to the correctness of the Decision. The errors, as presented in the Review Application, include errors of law, of jurisdiction, of fact, of mixed law and fact, and of evidentiary interpretation.

TransCanada submitted that the RH-4-2001 Decision resulted in prejudice or damage to the Mainline and its investor, TransCanada, by imposing an unfair return; prejudicing the ability of the Mainline to attract capital from TransCanada; placing the Company at a competitive disadvantage; and prejudicing its ability to invest in the Canadian pipeline industry, including the Mainline and northern pipelines. In

[1] National Energy Board RH-2-94 Reasons for Decision, Multi-Pipeline Cost of Capital, dated March 1995.

addition, TransCanada argued that the Board's failure to provide adequate reasons prejudiced its ability to conduct its business, and made its right of appeal illusory.

In the Application, TransCanada sought review and variance of the RH-4-2001 Decision and implementing Orders to establish a return for the Mainline for 2001 and 2002 represented by either the ATWACC or the alternative rate of return proposals originally applied for in RH-4-2001. TransCanada also sought adequate reasons for decision relating to the return for the Mainline.

1.3 The Board's Review Procedure

Section 21 of the Act provides:

> (1) Subject to subsection (2), the Board may review, vary or rescind any decision or order made by it or rehear any application before deciding it.

The Rules set out the requirements for a review application in section 44:

> (2) An application for review or rehearing shall contain ...
> (b) the grounds that the applicant considers sufficient, in the case of an application for review, to raise a doubt as to the correctness of the decision or order ... including
> (i) any error of law or of jurisdiction ....

There is no automatic right of review of a Board decision. A decision to review is discretionary. Normally, a review entails a two-step process: first, it must be determined whether a doubt has been raised as to the correctness of the impugned decision or order, and then, if that test has been met, the review is considered on its merits. These stages are commonly referred to as phase I and II and are not dissimilar to seeking leave to appeal from a court, and subsequently having the appeal heard.

By letter dated 1 November 2002, the Board solicited comments from all parties to the RH-4-2001 hearing on whether or not TransCanada had raised a doubt as to the correctness of the Board's Decision, which would require a review. In addition, parties were invited to provide submissions on the procedure that may be followed if a review were to be held. Eight parties submitted comments with respect to TransCanada's Application: Canadian Association of Petroleum Producers (CAPP), Canadian Gas Association (CGA), Centra Gas Manitoba Inc., Coral Energy Canada Inc., Enbridge Gas Distribution Inc. (Enbridge Gas), Industrial Gas Users Association (IGUA), Mirant Canada Energy Marketing, Ltd. and the Ontario Minister of Energy. TransCanada was provided with an opportunity to respond to the comments received.

1.4 Content of these Reasons for Decision

Many parties submitting comments did not address every point raised by TransCanada in its Review Application and some raised issues outside the scope of the Review. While the Board has considered all of the submissions on relevant matters presented in this Review proceeding, it has chosen in these Reasons for Decision to summarize the evidence and positions of the parties only to the extent necessary

to explain how the main issues were addressed in the decision-making process. The main issues are set out in the Chapters that follow.

The Board expects all parties to read this Decision as a whole, as they should for all Board decisions. While it is always possible to allege errors when individual elements are taken out of context, doing so does not call the correctness of the decision into question. The Decision must be examined in its entirety.

In preparing the "Views of the Board" for each main issue in these Reasons, the Board has not addressed every paragraph and separate argument raised in the TransCanada Application, nor is it required by law to do so, as further discussed in Chapter 6. Accordingly, while the Board has fully and carefully considered all submissions, only those portions of the submissions which the Board has found to be relevant to whether TransCanada has raised a doubt as to the correctness of the Decision in RH-4-2001 will be discussed.

In certain instances, the Board has found it convenient to categorize and summarize some of the grounds raised by TransCanada, addressing them as a group. Parties should not take this to mean that the Board did not separately consider each of the issues raised. Rather, the Board finds that a number of alleged errors did not merit an extensive response.

Chapter 2

The Standard of Review

TransCanada submitted that the standard of review is correctness, citing section 44 of the Rules. According to TransCanada, tolls must be just and reasonable, and, by law, must include a fair return, which is determined by applying the judicially-articulated fair return standard. Therefore, if doubt is raised with respect to the proper application of the legal standard, then a review is warranted.

CAPP indicated that the question of a fair rate of return is largely a matter of opinion and hardly capable of being reduced to certainty by evidence. Therefore, whether the RH-4-2001 Decision is correct is a function of whether it can be demonstrated to fall outside the range of opinions that different persons might reasonably have formed. To support this view, CAPP relied upon *Northwestern Utilities Limited* v. *City of Edmonton*[2] and *Trans Mountain Pipe Line Company* v. *National Energy Board et al*[3]. CAPP stated that the Board should resist the temptation to replace the judgment of the first Panel with its own judgment. It noted that RH-4-2001 was a review decision with five out of a possible eight Board Members sitting, and therefore there should be a clear demonstration of an error that was either so serious or so obvious as to render the Decision patently unreasonable or to establish that it was made without regard to the material before it.

With respect to the standard of review, IGUA indicated that the determination of the appropriate regulatory approach to apply to determine cost of capital is a policy issue. The policy option adopted in RH-4-2001 was reasonable and fell well within the range of policy options presented.

In reply, TransCanada indicated that while a determination of just and reasonable tolls may be a matter of opinion, as indicated in the *Trans Mountain* case cited by CAPP, a right of review exists if an applicant establishes a doubt regarding the correctness of the basis for the opinion.

Views of the Board

The Board agrees with TransCanada that the standard of review in this instance is set out in the Rules and is one of correctness. However, one must ask what it is that must be correct. The Decision in RH-4-2001 was, *inter alia*, a decision as to what a fair rate of return is for the Mainline. It is clear from the case law, discussed in Chapter 3, that the determination of a fair return is a matter of balancing a number of factors and involves the application of judgment. As the Court noted in *Northwestern Utilities (1929)*[4], such a decision is largely a matter of opinion and is hardly capable of being reduced to certainty by evidence. Accordingly, while the standard of review is correctness, the Board recognizes that what is being reviewed for correctness is largely a matter of informed judgment and opinion.

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2 [1929] S.C.R. 186 [hereinafter *Northwestern Utilities (1929)*].

3 [1979] 2 F.C. 118 (C.A.).

4 *Supr*a, footnote 2, at page 199.

As can be seen from the RH-4-2001 proceeding, and as recognized in the case law, informed and reasonable people can come to different opinions, based on the application of their own judgment and the weight they assign to the various factors that must be considered in coming to a determination of a fair rate of return for the Mainline. The Board's responsibility, at this stage of the Review Application, is not to re-weigh all the evidence and make its own assessment of it. Rather, the Board is to determine three things:

1. whether a doubt has been raised as to the correctness of the Decision in RH-4-2001, recognizing that the determination of a fair return is largely a matter of informed opinion;

2. whether a doubt has been raised because of an error in the basis upon which that opinion was made, or example, by examining whether the Board in RH-4-2001 relied on irrelevant evidence, did not consider relevant evidence, applied inappropriate tests, applied appropriate tests or factors incorrectly, or made the Decision in an arbitrary manner; and

3. whether a doubt has been raised as to the correctness of the RH-4-2001 Decision on the basis that the Board did not provide adequate reasons, as may be required given the state of the law on this matter.

Chapter 3

The Fair Return Standard

One of the grounds upon which TransCanada relied to establish an error in the Board's Decision was related to what it referred to as the "fair return standard". TransCanada stated that the Board has a legal obligation to apply the fair return standard in determining the rate of return and that the Board must, by law, apply the comparable investment, financial integrity and capital attraction standards to do so. TransCanada argued that the Board erred in the RH-4-2001 Decision by breaching the obligation to apply this standard.

TransCanada cited *Northwestern Utilities (1929)* and relied on United States Supreme Court case law, in *Bluefield Waterworks & Improvement Co.* v. *Public Service Commission of West Virginia et. al.*[5] and *Federal Power Commission* v. *Hope Natural Gas*[6] to support the proposition that the Board must fix rates which will secure a return to the Company as large as it would receive if it invested in business undertakings with similar risks, attractiveness and stability. This requirement exists, according to TransCanada, notwithstanding the wide latitude given to the Board in determining just and reasonable tolls.

The Application stated that the Board breached the obligation to apply the fair return standard by disallowing certain evidence of TransCanada, ignoring other evidence of the Company, making findings contrary to the weight of the evidence and basing portions of the Decision on matters not in evidence.

3.1 Legal Obligation to Apply the Fair Return Standard

TransCanada argued that the Board must apply the fair return standard and "is required by law to apply the comparable investment, financial integrity and capital attraction standards *to determine* a fair return for the Mainline."[7] [emphasis added]

The only party to specifically address the issue of a legal obligation to apply this standard was Mirant, who argued that neither the Board nor any intervenor ever stated that the standards are optional, but that any disagreement relates to the method by which the standards are applied.

Mirant submitted that TransCanada did not understand the Board's well-established approach to determining a fair or reasonable return. The RH-2-94 Decision describes the three main analytical methods used to estimate the cost of equity capital, all of which attempt to estimate the cost of equity capital for the utility by equating it to estimates, based on the empirical data, of the cost of equity capital for a sample of firms that are thought to be generally comparable to the utility in terms of business risk and other relevant variables. Therefore, Mirant submitted, by definition, the Board is determining a

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5 262 U.S. 679 (1923) [hereinafter *Bluefield*].

6 320 U.S. 591 (1944) [hereinafter *Hope*].

7 Review Application, at paragraph 28.

return that is comparable to the return available from capital invested in other enterprises of like risk. Mirant stated that by setting the authorized return at a level that reflects the cost of equity capital in the market, the return will permit incremental capital to be attracted to the utility on reasonable terms and conditions and enable the financial integrity of the regulated enterprise to be maintained.

Mirant submitted that the primary issue in any rate of return case is one of arriving at the best possible estimate of the cost of capital using the alternative methodologies that are available. In RH-2-94, the Board found this to be the equity risk premium approach. Mirant suggested that in the RH-4-2001 hearing all of the financial expert witnesses took the same basic view, with disagreements relating to the details of the analyses.

In reply, TransCanada stated that the Board's Decision contains no indication that the Board relied on any intervenor evidence in respect of the fair return standard. In TransCanada's view, the Decision includes no finding as to the return achieved by investments of comparable attractiveness, stability and certainty of the Mainline which, in its view, is clearly an error of law.

Views of the Board

Canadian Jurisprudence

The case law cited by TransCanada is relevant. However, in some instances the wording surrounding the quoted sections should also be considered. In *Northwestern Utilities (1929),* the Court said:

> The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise.[8]

The Supreme Court of Canada was not, in the Board's reading of the case, saying that the Board had to use certain tests in order to determine the tolls for the utility. Rather, the Court noted that fair and reasonable rates must balance consumer interests and the right of the company to secure a fair return.

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8 *Supra*, footnote 2, at pages 192-193.

The Federal Court of Appeal, in *Trans Mountain,* found that the method to be used and the factors to be considered determining tolls:

> must be left to the discretion of the Board which possesses in that field an expertise that judges do not normally have. If, as it has clearly done in this case, the Board addresses its mind to the right question, namely, the justness and reasonableness of the tolls, and does not base its decision on clearly irrelevant considerations, it does not commit an error of law merely because it assesses the justness and reasonableness of the tolls in a manner different from that which the Court would have adopted.[9]

That same Court stated in *British Columbia Hydro and Power Authority* v. *Westcoast Transmission* Co.:

> Plainly, the Board has authority to make orders designed to ensure that the tolls to be charged by a pipeline company will be just and reasonable. But its power in that respect is not trammeled or fettered by statutory rules or directions as to how that function is to be carried out or how the purpose is to be achieved. In particular, there are no statutory directions that, in considering whether tolls that a pipeline company proposes to charge are just and reasonable, the Board must adopt any particular accounting approach or device or that it must do so by determining cost of service and a rate base and fixing a fair return thereon.[10]

American Jurisprudence

In *Bluefield,* the U.S. Supreme Court stated:

> The company contends that the rate of return is too low and confiscatory. What annual rate will constitute just compensation depends upon many circumstances, and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and

---

9 *Supra*, footnote 3, at paragraph 9.

10 [1981] 2 F.C. 646 at page 656 (C.A.) [hereinafter *B.C. Hydro*].

> support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[11]

Thus, the Court listed a number of factors for consideration, but did not define these factors or prescribe tests. It said that regulatory bodies are to consider all relevant facts and to exercise enlightened judgment.

Finally, the pertinent provisions of *Hope* state:

> We held in *Federal Power Commission* v. *Natural Gas Pipeline Co.*, [12] that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its ratemaking function, moreover, involves the making of "pragmatic adjustments." And when the Commission's order is challenged in the courts, the question is whether that order "viewed in its entirety" meets the requirements of the Act. Under the statutory standard of "just and reasonable" it is the result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important. ... The rate-making process under the Act, i.e., the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests. Thus we stated in the *Natural Gas Pipeline Co.* case that "regulation does not insure that the business shall produce net revenues". But such considerations aside, the investor has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. The conditions under which more or less might be allowed are not important here. Nor is it important to this case to determine the various permissible ways in which any rate base on which the return is computed might be arrived at.[13]

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11 *Supra*, footnote 5, at page 692.

12 315 U.S. 575 (1942).

13 *Supra*, footnote 6, at pages 602-603.

RH-4-2001 Decision

In its Decision, the Board noted that it has no statutory obligation to specifically consider and establish a rate of return for companies it regulates. It noted that it must establish tolls that are "just and reasonable" and cited *B.C. Hydro* for the proposition that it is not bound to a particular approach in doing so. As pointed out by TransCanada in the Application, the Board noted that its practice is to set cost based tolls by considering, *inter alia*, the cost of capital - that is, the cost of equity and debt to the company's regulated activities.

The RH-4-2001 Decision refers to and cites extensively from the Board's RH-1-70 Decision, which was the first hearing under Part IV of the Act relating to tolls to be charged by TransCanada. The Board stated:

> The principles referred to in the Board's RH-1-70 Decision suggest that a fair return ought to have the following attributes. Specifically, a fair or reasonable rate of return should:
>
> - be comparable to the return available from the application of the invested capital to other enterprises of like risk (the comparable earnings standard[14]);
>
> - enable the financial integrity of the regulated enterprise to be maintained and permit incremental capital to be attracted to the enterprise on reasonable terms and conditions (the financial integrity and capital attraction standards); and
>
> - achieve fairness both from the viewpoint of the customers and from the viewpoint of present and prospective investors (appropriate balance of customer and investor interests).
>
> These principles are reflected in the application of the various accepted methodologies used to estimate the cost of capital, such as the Equity Risk Premium approach employed by the Board in the RH-2-94 Decision. The Board is of the view that these principles remain appropriate in the present case.
>
> In respect of the appropriate balance of customer and investor interests, the Board notes that customer interest in rate of return matters relates most directly to the impact the approved return will have on tolls. The Board is of the view that the impact of the rate of return on tolls is a relevant factor in the determination of a fair return.

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[14] Although this was referred to as the comparable earnings standard in RH-4-2001, TransCanada referred to this as the "comparable investment standard". This latter terminology will be used in this Decision to distinguish this standard from the comparable earnings test, which is a methodology which may be used to establish a rate of return; other approaches include the discounted cash flow and the equity risk premium methodologies.

> The Board is of the view that the determination of a fair return in accordance with these principles will, in conjunction with other aspects of the Mainline's revenue requirement, result in tolls that are just and reasonable.[15]

Legal Obligation to use the Fair Return Standard

The Board is of the view that TransCanada's statement that the Board "is required by law to apply the comparable investment, financial integrity and capital attraction standards *to determine* a fair return for the Mainline"[16] is an overstatement of the law on this issue.

The case law establishes that fair and reasonable rates must, *inter alia,* be fair to consumers and must secure a fair return to the company. However, the Courts do not say that a fair return to the company must be established without regard for other matters. They make it clear that this is one element to be balanced with other considerations.

In the Board's view it is clear that in determining rate of return, it must take into account factors in addition to providing a company as large a return as it would otherwise get by investing elsewhere. The Board must impose its judgment on the relevant issues and the weight to be given them; the case law makes it clear that the setting of tolls involves an exercise of judgment. One of the elements missing in the fair return standard cited by TransCanada is, as referred to in the case law discussed above, the balance of interests between consumer and investors in the utility. TransCanada acknowledged that fairness to toll payers was a relevant consideration within the context of prevention of monopolistic profits. However, the Board is of the view that a restricted use of this factor is not consistent with the jurisprudence on this matter. Consumer and pipeline interests must be balanced. To state that a tribunal must use the fair return standard (comparable investment, capital attraction, financial integrity) *to determine* the rate of return and thus provide as large a return as would be provided to similar investments would mean that the Board could not take into account other factors, including, *inter alia*, consumer interests.

The case law states that a company will be allowed a fair return but it does not establish how a fair return to the company must be determined. There is a fundamental difference between saying that certain standards must be used *to determine* the return, and stating that a return must meet certain standards or fulfill certain requirements. In the former case, those standards would be tests which could be used to establish the return. In the latter, other tests could be used but the end result would be measured against these standards to ensure that they are met. The case law is clear that there is no specific manner in which a fair return must be determined[17].

---

15 RH-4-2001 Reasons for Decision, at pages 11-12.

16 Review Application, at paragraph 28 [emphasis added]; see also Review Application at paragraphs 24 and 29 and Appendix B at paragraph 6 and TransCanada's reply dated 17 December 2002 to IGUA's submission at paragraph 12.

17 See for eg. *Hope, supra,* footnote 6, *TransMountain, supra*, footnote 3, and *B.C. Hydro, supra,* footnote 10.

Parenthetically, if regulatory tribunals could only use the "fair return standard" to determine tolls, one must wonder about the cost and time for the extensive evidence submitted by expert witnesses in this and other hearings regarding the discounted cash flow test, capital asset pricing model, etc. If it was judicially determined by the Supreme Courts of Canada and the United States that the fair return standard must be used to determine rate of return, this other evidence would be largely, if not wholly, irrelevant.

The Board, in RH-4-2001, agreed that the three components of the fair return standard cited by TransCanada, along with the balancing of customer and investor interests, should be attributes of a fair return. It further stated that these principles are reflected in the various accepted methodologies to establish cost of equity capital, such as the equity risk premium approach, which is the basis of the RH-2-94 Formula[18]. No one, including TransCanada, took issue with this statement.

In the Board's view, it is implicit that the application of a test that reflects these standards would result in a return that meets these standards. Therefore, the Board in RH-4-2001 did not have to state explicitly that the resulting return would meet the comparable investment, financial integrity and capital attraction standards. The answer to TransCanada's question: "How can there not be doubt about the correctness of a decision that does not include an express finding that discharges the fundamental legal obligation of the regulator?"[19] is simple. An express finding is not necessary when the standards which must be met are imbedded in the methodology used to determine the return and the reasons given for the decision make this clear. However, to the extent that an express finding may be necessary, the Board stated in the Disposition section of the RH-4-2001 Reasons that:

> The Board is of the view that the decisions reached in RH-4-2001 are consistent with the principles set out in Chapter 2 of these Reasons for Decision and will result in a fair return for the Mainline.[20]

There is no legal obligation to use a fair return standard (comprised of the comparable investment, financial integrity and capital attraction standards) to determine tolls. Rather, in normal circumstances, a fair return established by the Board should meet those three elements. This was accomplished in RH-4-2001 through the methodology which was used to determine the return. There has been no error by the Board in respect of any obligation to apply the fair return standard.

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18 In the RH-2-94 Decision, the Board introduced a formula for calculating the allowed return on common equity. This formula is based on an equity risk premium methodology and adjusts the allowed return based on changes in forecast rates for long-term Canada bond yields.

19 TransCanada reply dated 6 December 2002, at paragraph 24.

20 RH-4-2001 Reasons for Decision, at page 64.

3.2 Application of the Fair Return Standard

TransCanada submitted that the Board had made a number of errors in applying the Fair Return Standard in the RH-4-2001 Decision. These errors were presented under three main headings: improper application of the comparable investment standard; improper application of the capital attraction and financial integrity standards; and misinterpretation of the ATWACC proposal.

3.2.1 Comparable Investment Standard

Regarding the comparable investment standard, TransCanada asserted that the Board erred in three ways. First, the Board removed relevant evidence, Exhibit B-64, from the record [21]. TransCanada argued that this evidence was requested by the Board and that it was relevant to the relative risk and potential returns associated with alternative uses of capital by TransCanada. In TransCanada's submission, the second error occurred when the Board held that comparisons of the Mainline to the pipelines of Alliance Pipeline Ltd., Maritimes and Northeast Pipeline Management Ltd. (M&NP), and Enbridge Pipelines Inc. (Enbridge) were not particularly meaningful in establishing a fair return for the Mainline. TransCanada asserted that to examine the comparable investment standard the most germane comparisons are to other pipelines regulated by the Board. TransCanada went on to discuss the relevance of those comparisons. Finally, TransCanada alleged that the Board set an unattainable evidentiary standard when it suggested at page 35 that a "thorough assessment of the relative business risks of each pipeline as well as an estimation of what each pipeline's cost of capital might be absent differences in circumstances" would be more meaningful. TransCanada asserted that this kind of comparison would require insider knowledge of the comparison companies.

CAPP argued that, in its ruling on the removal of the evidence from the record, the Board concluded that the information in this exhibit was of limited probative value. In CAPP's view, striking this evidence does not raise any doubt about the reasonableness of the fair return. On refusing to consider relevant evidence on the record, CAPP argued that the Board did not ignore the evidence cited by TransCanada, it simply gave it little weight. The evidence is summarized in the Decision and later addressed in the Views of the Board. CAPP pointed out that there is a difference between ignoring and rejecting evidence. Finally, CAPP stated that the Board did not establish an unattainable evidentiary standard. The Board stated that it was seeking a meaningful comparison of the circumstances of the comparison companies, as was done by several experts in the RH-2-94 proceeding and by CAPP's witness, Mr. Kaslik, on U.S. pipelines in the RH-4-2001 proceeding.

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[21] Prior to the commencement of the RH-4-2001 hearing, the Board asked information requests about investments of similar risk which TransCanada had claimed offer higher returns and evidence supporting the view that certain other pipelines have lower risk than the Mainline. During examination Board Counsel, and then the Panel Chairman, requested that TransCanada provide additional evidence to that provided in the information request response and information on other investments which could provide a more extensive response. This information was filed by TransCanada as Exhibit B-64.

After a motion by IGUA, the Board ruled that the exhibit should be removed from the record on the grounds that because of confidentiality concerns raised by TransCanada, the information was very general and could not be adequately tested and responded to by the parties. Further, receiving this evidence would have been unduly prejudicial to parties who had prepared and submitted their evidence and, more importantly, completed their cross-examination on TransCanada's case.

Mirant argued that retaining Exhibit B-64 on the record would have been prejudicial to intervenors. Concerning the comparisons with Alliance, MN&P and Enbridge, Mirant argued that TransCanada had not demonstrated that they were comparable with the Mainline in attractiveness, stability and certainty. Mirant stated that the comparable investment standard is met by determining an allowed return that reflects the pipeline's cost of capital. This is done using the equity risk premium, comparable earnings, and discounted cash flow methodologies. Finally, Mirant suggested that the evidentiary standard may be unattainable but that is because the whole approach of determining a fair return for the Mainline via direct comparisons is misconceived from the outset. Such comparisons are meaningless in the absence of further evidence that the Board found necessary and TransCanada failed to provide.

In reply, TransCanada noted that Mirant's concept of conventional quantitative financial market analysis appears nowhere in the RH-4-2001 Decision.

Views of the Board

The Board has the responsibility to determine whether evidence in a proceeding is relevant and to assign the appropriate weight to that evidence. With respect to the disposition of Exhibit B-64, the Board stated that, "without detailed supporting information, the filed material, even if it could be adequately tested and responded to by parties, is of limited assistance."[22] It goes without saying that if evidence cannot be tested, there is a presumption against allowing it to be considered. Further, in considering the admissibility of evidence, especially that filed later in the proceeding, the Board must consider whether prejudice will be caused to other parties by its admission. The Board was entirely correct in considering these matters and, given those factors, deciding as it did on the admissibility of Exhibit B-64.

With respect to the second ground, the Board provided views along a similar vein on page 35 of the RH-4-2001 Decision, when it said it "does not consider the evidence pertaining to comparisons of the Mainline with Alliance, M&NP and Enbridge to be particularly meaningful in establishing a fair return for the Mainline." The text goes on to detail the concerns the Board had with that evidence. Again, it is the duty of the trier of fact to examine the evidence and assign the appropriate weight. The Board is of the view that the RH-4-2001 Reasons for Decision show that the Board examined the evidence and considered the appropriate factors to determine the weight to be assigned. Given that it was based on the proper foundation, such a decision need not be reviewed. TransCanada has not raised a doubt as to the correctness of this decision.

Concerning the setting of an unattainable evidentiary standard, the Board notes CAPP's reference to evidence comparing relative pipeline business risks and the attendant impacts on cost of capital submitted by several parties in the RH-2-94 proceeding and by CAPP in the RH-4-2001 proceeding. The Board does not believe that an unattainable standard was set in the RH-4-2001 Decision.

The Board is of the view that these three allegations by TransCanada are not errors. Rather, they are determinations on the appropriate evidence to be considered and the

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[22] RH-4-2001 proceeding, transcripts (v15), paragraph 20538.

weight to be given that evidence. The Board is therefore of the view that a doubt as to the correctness of the RH-4-2001 Decision has not been raised on these grounds.

3.2.2 Capital Attraction and Financial Integrity Standards

In the Review Application, TransCanada suggested that the Board had improperly applied the capital attraction and financial integrity standards in six ways, which are discussed below.

Ability to Attract Capital

TransCanada alleged that the Board addressed the wrong question in considering the ability of TransCanada, rather than the Mainline, to attract capital. In TransCanada's view, the unquestioned ability of the Company to access capital and the prospects for the Company's bond ratings are irrelevant to the issue of the ability of the Mainline to access capital. TransCanada argued that the Board further erred by violating the stand-alone principle when it used these parameters to conclude that the Mainline could attract capital.

CAPP stated that the Board's conclusion at page 34 of the Decision that "the Mainline's ability to attract capital on reasonable terms and conditions is not in jeopardy" shows that the Board did not err. CAPP pointed out the Board's statement on page 3 of the Decision: factors relating to TransCanada would be considered in determining return for the Mainline because the reality is that TransCanada, and not the Mainline, raises capital. CAPP noted that much of this evidence was presented by TransCanada itself.

Mirant argued that the Mainline does not raise capital, have a credit rating and generally does not have an objectively determined and independent financial position. Mirant also stated that TransCanada did not present any evidence based on market information to substantiate its view that the Mainline is not able to raise capital on reasonable terms and conditions. Further, it was submitted that it is clearly open to the Board to draw inferences about the Mainline from the information available about the consolidated entity.

Enbridge Gas stated that the Decision failed to apply the fair return standard when it concluded that the RH-2-94 Formula continues to provide returns on equity that are appropriate for the Mainline. In its view, the Application demonstrated in detail that the Board's conclusion is erroneous.

Attracting Capital on Reasonable Terms and Conditions

TransCanada submitted that it is the investor in the Mainline. In its view, the approved return at the time of the RH-4-2001 proceeding would not result in reasonable terms and conditions for its investment in the Mainline. It argued that investment on those terms would dilute the value of the investment shareholders have made in TransCanada.

CAPP's position was that the Board did consider TransCanada's evidence respecting the return that would attract investment by TransCanada in the Mainline and explained, on page 35 of the Decision, why it gave that evidence little weight. There is no basis for re-weighing this evidence in a review.

Mirant stated that, "[i]n substance, and in an economic sense, TransCanada's shareholders invest in or own all of TransCanada's businesses, including the Mainline."[23] Although the shares in TransCanada represent a blend of various businesses, the capital market's views on the Mainline have a major effect on its views of TransCanada's shares. In Mirant's view, it is completely reasonable for the Board to draw inferences about the Mainline from market indicators for the consolidated company.

Globalization of Capital Markets

TransCanada argued that the Board misunderstood its evidence on the effects of the globalization of capital markets. TransCanada stated that the U.S. capital market offered higher returns on firms with risks comparable to the Mainline, that the risk premium is lower in Canada than in the U.S. and that there has been a recent outflow of capital from Canada. Because TransCanada can invest globally, the return for the Mainline has to be competitive with the returns earned on similar risk investments in the global market. In TransCanada's view, the RH-4-2001 Decision ignores these issues and thereby is incorrect.

CAPP noted that the Board addressed TransCanada's globalization arguments on page 35 of the Decision and no error exists that would justify a review. Mirant questioned what specific wrong decision resulted from the Board's alleged error. Mirant further noted that TransCanada implied, at paragraph 75 of its submission, that the Board reduced the approved return for the Mainline because of the dividend tax credit, which, in Mirant's view, the Board did not.

Security and Safety

TransCanada submitted that the Board confused the issue of security and safety with the issue of fair return. TransCanada filed evidence that if maintenance capital for the Mainline were considered as a stand-alone incremental investment, it would not be undertaken in the present cost of capital environment. In the hearing, TransCanada assured the Board that it would maintain the standards of safety and security at least at their present levels. In TransCanada's view, this issue was irrelevant to the determination of a fair return for the Mainline.

CAPP submitted that the Board is naturally concerned about safety and security and to suggest that these comments provide a basis for the fair return opinion formed by the Board is folly. Mirant argued that the portion of the Decision quoted appears not to involve any decision by the Board.

"Going Concern Value" Return

It was alleged in the Application that in the RH-4-2001 Decision, the Board confused a going concern value return with a fair return. TransCanada described the going concern value return as the minimum return required to attract only the incremental capital required to maintain the going-concern value of the regulated investment. If TransCanada has alternative investments of similar risk to the Mainline that pay a higher level of return than approved for the Mainline, it is unfair, in TransCanada's view, to ask it to invest any capital in the Mainline.

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[23] Mirant submission, dated 22 November 2002, at page 12.

CAPP cited the Board's statements on pages 11 and 34 of the Decision regarding attracting capital on reasonable terms and conditions. From this, CAPP submitted that it is clear that the Board had the correct capital attraction principle in mind.

Mirant noted that TransCanada did not identify any passage in the Decision where the Board indicated that it sought to set the Mainline's return at the minimum required to maintain the going-concern value of the pipeline. Mirant suggested that TransCanada had repudiated the capital attraction standard by suggesting that, while TransCanada could attract capital at an ATWACC of 5.95 percent (i.e., RH-2-94 Formula at 30 percent deemed common equity), it would be unfair to require TransCanada to do so.

Interest Coverage Ratios

In the RH-4-2001 Decision, the Board made statements regarding interest coverage ratios of the Mainline. TransCanada alleged that the statement that the interest coverage resulting from the approved deemed common equity ratio for the Mainline would be higher than it had been in the past, demonstrated that the Board had made part of its decision based on matters not in evidence. Further, TransCanada suggested that the Board misunderstood or misinterpreted the evidence on the relationship between interest coverage ratios and bond ratings, and thus erred.

CAPP stated that the increase in the deemed common equity ratio from the RH-4-2001 Decision will increase interest coverage ratios and this is one indication that the financial integrity of the Mainline is preserved. CAPP suggested that the difference between the wording in the Decision and the statements made by TransCanada's witness on interest coverage ratios were semantic.

Mirant argued that the statements on interest coverage ratios were not the basis for the Board's decision. Rather, the statements asserted a fact, which TransCanada could have disputed in its Review Application if it believed them to be incorrect. Mirant submitted that TransCanada summarized its witness's statement about interest coverage ratios exactly as the Board stated.

Views of the Board

Ability to Attract Capital

TransCanada alleged that the Board erred by considering TransCanada's, rather than the Mainline's, ability to attract capital. The Board notes that the Introduction of the RH-4-2001 Decision states:

> In this proceeding, the Board is required to make decisions on cost of capital matters for TransCanada's Mainline, which is only one component of TransCanada's overall business enterprise. Although cost of capital is considered within the context of the Mainline as a stand-alone entity, in reality it is often necessary to consider factors which pertain to the consolidated entity. For example, many financial indicators (e.g., credit ratings, raw beta estimates) are only available for

> the consolidated entity and often provide the best estimates as to what these indicators would be for the Mainline as a stand-alone entity.[24]

This statement makes it clear that the Board did consider, as the central question, the cost of capital for the Mainline but that in doing so it found it necessary and appropriate to consider factors related to the consolidated operations of TransCanada. In the RH-4-2001 proceeding, evidence was submitted demonstrating TransCanada's overall ability to attract capital. The Board is not convinced that it is an error for this fact to be considered in assessing the ability of the Mainline to attract capital, particularly in light of the fact that the Mainline does not access capital markets as a stand-alone entity.

Attracting Capital on Reasonable Terms and Conditions

In the Review Application, TransCanada argued that the Board erred in finding, against the weight of its evidence, that the Mainline's ability to attract capital on reasonable terms and conditions was not in jeopardy. The Board notes that TransCanada's assertion that the Mainline is an unattractive investment, is very subjective and is difficult, if not impossible, to prove or test. To this end, the Board notes IGUA's comments, cited on page 33 of the Decision, that the position is self-serving and lacks the requisite degree of independence. In the Board's view, the fact that the Board, in RH-4-2001, did not rely on TransCanada's statements indicates the weight the trier of fact, who heard the evidence and was able to gauge its credibility, chose to give it. In a matter of weight, the Board will always show deference to the original Panel in the absence of evidence of an error.

The Board would also note that this finding is consistent with other findings in the RH-4-2001 Decision. The Decision states at page 28 that although the level of business risk facing the Mainline had increased since the RH-2-94 proceeding, it remained low. Further, the Board found that the RH-2-94 Formula would yield a fair return to the Mainline at page 64. Thus, there is no reason to believe that the Mainline, with a low risk level and appropriate returns, would have trouble attracting capital on reasonable terms and conditions.

Globalization of Capital Markets

The Board discussed its views on the globalization of financial markets and alternative investments at page 35 of the RH-4-2001 Decision. TransCanada asserted that these passages demonstrate a misreading of the evidence and a failure to recognize the actual issue.

The Board notes the passage in the Decision, at page 31, which states, "Mirant acknowledged that the Canadian market is influenced by global market forces, but submitted that Canadian government rates already reflect this influence." This passage, along with the rest of the evidence on globalization summarized in the Decision, indicate that the Board recognized the relevant issue. This summary shows that parties to the RH-4-2001 proceeding were of the view that there are differing risk factors faced by U.S. firms and differences in the investment climate between the two countries. The Board, after weighing this evidence, concluded that Canadian market data continued to be the

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[24] RH-4-2001 Reasons for Decision, at page 3.

most relevant benchmarks. The Board has not been convinced by TransCanada's submission in this proceeding that this determination was in error.

Security and Safety

TransCanada submitted that the Board confused the security and safety of the Mainline with the issue of fair return in the RH-4-2001 Decision. The Board notes that TransCanada chose to place the evidence on safety and security of the Mainline on the record. It cannot expect that the Board would remain silent in the face of a statement that could undermine the public perception of the safety of the Mainline. The Board has not been convinced that this paragraph in any way demonstrates a confusion of safety and security with fair return.

"Going Concern Value" Return

With regard to TransCanada's argument that the Board confused a fair return with a "going concern value" return, the Board notes that the concept of a "going concern value" is not mentioned in the Board's views in the RH-4-2001 Decision. The Board is of the view that there is nothing in the Reasons to suggest that the Board determined anything other than a fair return. This alleged error appears to stem from TransCanada's own interpretation of the RH-4-2001 Decision and does not constitute an error which would call the correctness of the Decision into question.

Interest Coverage Ratios

In discussing its views on capital structure, at page 59 of the RH-4-2001 Decision, the Board found that the approved common equity ratio would result in "interest coverage ratios for the Mainline in 2001 and 2002 that exceed those experienced in the last 12 years." TransCanada correctly points out that interest coverage ratios resulting from the approved 33 percent deemed common equity ratio were not on the record. However, from a reading of the Reasons as a whole, it is clear that this statement was not the basis for the approved common equity ratio. It was made after the Board cited several factors it took into consideration in reaching its decision on the common equity ratio. The Board also notes that TransCanada did not question the validity of the assertion. The Board is of the view that the statement did not form a central part of the Board's decision on the appropriate deemed common equity ratio for the Mainline. Further, given that the ratios could be readily determined by a knowledgeable person, based entirely on the information on the record, there was no need to show the calculations.

TransCanada alleged that the Board made a further error when it stated that TransCanada had claimed it required a 2.0x interest coverage ratio to maintain its "A" credit rating. TransCanada quoted the evidence of its witness, Mr. Lackenbauer, who asserted that an interest coverage ratio below 2.0x would not continue to justify an "A" rating. The Board is of the view that the statement about interest coverage made by the Board is functionally equivalent to the evidence presented by Mr. Lackenbauer. The Board is not convinced that an error has been identified in this regard.

Conclusion

In conclusion, having had regard to the grounds raised by TransCanada in this matter, the Board has not found any errors which could cast doubt on the correctness of the Board's application of the capital attraction and financial integrity standards in the RH-4-2001 Decision.

3.2.3 The ATWACC Proposal

Reliance on Consolidated Book Capital Structure

TransCanada submitted that the record unambiguously shows that the overall cost of capital and risks faced by a company depend on the market-value capital structure, not the book-value capital structure. Further, because its market-to-book ratio exceeds 1.0, the market-value capital structure contains more equity than is reflected in the book-value capital structure. TransCanada asserted that the Board erred by ignoring the record and drawing an inference about the risk level of TransCanada's consolidated operations from the book-value capital structure.

CAPP and Mirant both noted that on page 59 of the RH-4-2001 Decision the Board stated that it reached its decision on the Mainline's deemed capital structure, "on the basis of the evidence presented to it with respect to the business risk faced by the Mainline." Mirant also asserted that the Board was not making any inferences about the risk level of the Mainline or TransCanada's consolidated operation, only noting that the deemed equity it approved for the Mainline was consistent with the actual book equity management felt was appropriate for the consolidated operation.

Check for Consistency

During the RH-4-2001 proceeding, TransCanada recommended that the Board adopt the ATWACC methodology as a standard and, failing that, at least make an explicit consistency check of the cost of equity and deemed capital structure using the sample companies. TransCanada submitted that the Board ignored the second recommendation despite considerable evidence on the record showing that such a check is required.

CAPP asserted that, given the Board's reservations about the ATWACC sample evidence, it was logical for the Board to decline to use this method as a check. Mirant discussed the evidence presented by TransCanada and suggested that the Board did not accept the views put forth by TransCanada's witnesses.

Dividend Tax Credit

TransCanada argued that the Board was not consistent in applying the effects of the dividend tax credit (DTC). The Application notes that the Board relied on the existence of the DTC in Canada to reject the increasing importance of globalization on the cost of capital for the Mainline but did not mention the effects of the DTC in its discussion of ATWACC. TransCanada cited evidence on the RH-4-2001 record claiming that, when debt ratios rise, the cost of equity rises faster for Canadian firms than for U.S. firms because of the DTC. TransCanada submitted that the Board erred by not explicitly mentioning this factor in relation to ATWACC.

CAPP submitted that the Board provided detailed reasons for rejecting the ATWACC proposal and that it need not have also addressed the DTC in this context. Mirant stated that relying on the existence of the DTC in one situation but not mentioning it in another does not suggest an error on the part of the Board.

ATWACC is not a Popularity Contest

TransCanada quoted from page 43 of the RH-4-2001 Decision, where the Board discussed the lack of support for the ATWACC methodology by TransCanada's stakeholders and the relevance of this factor in its determination. TransCanada asserted that the Board erred by considering stakeholder support for the ATWACC methodology in this case. The Board's legal responsibility, stated TransCanada, was to determine just and reasonable tolls and stakeholder support for the ATWACC methodology is irrelevant to this determination. TransCanada also noted a further error in that the Board ignored the evidence that the stakeholders themselves also use ATWACC, even though they objected to using this methodology for the Mainline.

CAPP asserted that it was the absence of advantages, not the absence of popularity, that caused the Board to reject the ATWACC proposal. Mirant argued that TransCanada's submission misrepresented the Board's Decision. Mirant suggested that the section of the RH-4-2001 Decision, at most, is a comment by the Board on the reliability of TransCanada's evidence.

Views of the Board

Reliance on Consolidated Book Capital Structure

With regard to reliance on consolidated book structure, the Board notes that the Mainline forms part of the overall business operations of TransCanada and, as such, does not have a market-value capital structure of its own. The Board has been setting a deemed capital structure on the book value of the Mainline's assets, based on the business risks faced by the Mainline, since 1980. The RH-4-2001 Decision does not depart from this practice. On page 59 of the RH-4-2001 Decision, the Board noted a consistency between the book-value capital structure deemed for the Mainline and the equivalent parameter chosen by TransCanada for its consolidated operation. The Board is not convinced that this comparison leads to any error in the RH-4-2001 Decision.

Check for Consistency

TransCanada argued that the Board erred by failing to apply ATWACC as a check for consistency. The Board discussed the ATWACC methodology extensively on pages 43 to 45 of the RH-4-2001 Decision. The Board explained its reasons for rejecting the use of the ATWACC methodology to establish a fair return for the Mainline in the RH-4-2001 proceeding. The Board cited several problems with the samples proposed by TransCanada and expressed doubt as to whether the samples are actually comparable to the Mainline. Having shown serious concerns for the ATWACC samples, the Board stated, "that there would be limited value in using the ATWACC approach as a check on the appropriateness of the awarded returns."[25] The Board is of the view that the RH-4-2001 Decision clearly addressed TransCanada's recommendation that a

[25] RH-4-2001 Reasons for Decision, at page 44.

consistency check be performed using the ATWACC samples. Accordingly, the Board does not find that the correctness of the Decision is brought into question by TransCanada's assertion.

Dividend Tax Credit

The Board is of the view that TransCanada's own submissions, on the issue of reliance on the divided tax credit clearly show that Canadian and U.S. firms face different investment circumstances, due in part to the existence of the DTC in Canada. At page 44, the RH-4-2001 Decision states, "The Board also considers that sample firms should face comparable investment circumstances to ensure they face similar cost-minimizing incentives in adopting their capital structure" and goes on to question whether or not significant reliance on U.S. firms would be appropriate. The Board finds that the views expressed in the RH-4-2001 Decision demonstrate that the Board turned its mind to the issue.

ATWACC is not a Popularity Contest

With respect to the allegation of a "popularity contest", it is noted that the Board's views on the ATWACC methodology are divided into two sections in the Decision: Regulatory Precedent, and TransCanada's ATWACC Methodology. Under Regulatory Precedent, the Board stated that given the lack of support, clear benefit from the new approach must be shown. In the Board's view this goes without saying: before utilizing any new methodology clear advantages over the previously accepted approach must be found. Without benefits, there would be no reason to effect a change. At no time does the Board indicate that the ATWACC proposal was rejected on the basis of its popularity with stakeholders. In the remainder of the Views of the Board, serious methodological concerns about the ATWACC samples presented by TransCanada were discussed. Further, the Board stated that it was not persuaded that the approach offered significant advantages. The Board has not been convinced by TransCanada's submission that the Board erred by relying on an irrelevant consideration in rejecting the ATWACC methodology.

Conclusion

In the Board's view, TransCanada has not raised a doubt regarding the correctness of the Board's RH-4-2001 Decision regarding the ATWACC methodology.

Chapter 4

Continued Use of the RH-2-94 Formula

TransCanada argued that the Board did not explain why it found that the RH-2-94 Formula continued to provide a return on equity that is appropriate for the Mainline. It alleged that this determination was based on a series of decisions that were made without factual evidentiary support, addressed the wrong issue, were circular, or misinterpreted evidence. Further, in TransCanada's submission, the Board failed to address whether the RH-2-94 Formula correctly estimates the cost of equity capital, presuming as it does a specific, constant and empirically correct correlation between bond returns (long-term Canada bond yields) and the cost of equity capital for the Mainline. In addition, according to TransCanada, the Board's assertion of a "general recognition" that the cost of equity capital is influenced by expected bond returns was not supported by evidence.

TransCanada asserted that the Board also erred by considering and deciding an issue not before it, that is, the unreliability of short-term interest rates. In the Company's view, there was a misinterpretation of the evidence of Dr. Schink, who used the long-run view of short-term rates. Further, TransCanada is of the view that the Board erred by presuming a stable relationship between changes in long-term government bond yields and the cost of equity capital, which presumption was refuted by the evidence of Dr. Schink.

According to TransCanada, the RH-2-94 Formula must generate a fair return. In TransCanada's view, it is irrelevant whether it is "well established", "well understood by interested parties" and "transparent". Consequently, the Board erred when it took into account these attributes of the RH-2-94 Formula in deciding to continue its use.

Mirant's position is that it is a judgment call whether long-term government bonds are appropriate to measure the risk-free rate; but almost all applications of the equity risk premium approach in a regulated setting use this yield, and the weight of expert opinion is that this is an appropriate starting point for developing a proxy for the risk-free rate.

Mirant stated that, contrary to TransCanada's claims, the RH-2-94 Formula presumes a non-linear relationship between long-term government bond yields and cost of equity, with cost of equity changing less quickly than the forecast long-term government yield. The RH-2-94 Formula being well established and understood are other mildly desirable factors. However Mirant did not believe that these factors formed the basis of the Board's continued acceptance of the RH-2-94 Formula.

In CAPP's view, the Board found that Dr. Schink did not present "meaningful evidence" with respect to the correlation of bond yields and the cost of equity capital to justify a departure from the RH-2-94 Formula. The Board should not, at this time, re-weigh that evidence. According to CAPP, the Board understood Dr. Schink's evidence, however it rejected his use of long-run forecasts of short-term U.S. 90 day treasury rates. The Board's rejection of an adjustment to reflect increased yield spreads between government and corporate bond yields was supported by evidence of Drs. Booth, Berkowitz and Chua. Further, it is a long established practice to use long-term Canadian government bond rates as the risk-free rate.

CAPP argued that the ATWACC approach, advocated by TransCanada, is not "well established", "well understood by interested parties" and "transparent". However, this was not the basis for the Board's decision to retain RH-2-94 Formula; the Board's decision was based on all the evidence.

CGA agreed with TransCanada that long-term government bonds are no longer an appropriate benchmark for a return on equity. The RH-2-94 Formula incorrectly assumes cost of equity and Canadian bond yields move in lockstep, and is not a reliable estimate of cost of equity capital for a utility.

Views of the Board

The Fair Return Application was, among other things, an application for review of the RH-2-94 Decision and related orders, pursuant to subsection 21(1) of the Act. The onus was on TransCanada to prove to the Board in RH-4-2001 that the RH-2-94 Formula was no longer appropriate for determining the Mainline's return on equity. Neither the intervenors nor the Board had the onus in the RH-4-2001 proceeding to justify the continued use of the Formula. The Formula was appropriate unless and until TransCanada persuaded the Board otherwise.

TransCanada failed to meet the burden and accordingly, the RH-2-94 Formula continued to apply. The Board was not required in the RH-4-2001 Decision to justify that the Formula was appropriate; that determination was made in the RH-2-94 proceeding.

TransCanada's argument that the Board based part of its continued acceptance of the RH-2-94 Formula on irrelevant considerations, such as the fact that it is "well established", "understood" and "transparent" is without merit. It is clear from a reading of the Decision as a whole that the Board was not convinced by TransCanada that the RH-2-94 Formula was no longer appropriate. Further, the Decision was based on the consideration of the evidence presented and not the fact that the Formula is well established, understood and transparent. As previously mentioned, it is imperative that the Reasons for Decision from any proceeding be read as a whole. Every sentence and word should not be dissected or separately analyzed in an attempt to support a meaning that is clearly contrary to a reasonable interpretation of the Decision in its entirety.

The Board finds that this allegation does not raise a doubt about the correctness of the RH-4-2001 Decision.

Chapter 5

The Stand-alone Principle

In its submissions, TransCanada suggested that the Board had erred by violating the stand-alone principle which it defined as:

> Under the stand-alone principle, a utility is regulated as if the provision of the regulated service were the only activity in which the company was engaged. The cost of providing utility service and rates for provision of that service are to reflect only the expenses, capital costs, risks and required returns associated with the provision of regulated service.[26]

In TransCanada's submission, the stand-alone principle has been accepted and applied by the Board and various other regulators. However, TransCanada alleged that in this case, the Board failed to consider the Mainline on a stand-alone basis separate and distinct from TransCanada.

TransCanada submitted that the financial indicators for TransCanada are not the best estimates of the indicators for the Mainline because the Mainline comprises only 40 percent of TransCanada on a net income basis. Share price of TransCanada is also not an indicator of the reasonableness of the return achieved by the Mainline. Further, the consolidated equity ratio of TransCanada is irrelevant to the determination of the appropriate equity ratio of the Mainline. TransCanada argued that the Board erred by focusing on the financial position, ability to raise capital, share price and credit rating of TransCanada, all to the exclusion of the regulated entity that is the Mainline.

According to TransCanada, the stand-alone principle was violated by the Board first in considering the typical investor in TransCanada rather than TransCanada as the investor in the Mainline, and second in making any conclusion about the cost of capital for the Mainline, such as giving the most relevance to Canadian market data, on the basis of the makeup of shareholders of TransCanada.

In TransCanada's opinion, the Board also erred by considering the investments of TransCanada in pipelines other than the Mainline to be relevant in determining the business risk of the Mainline.

CAPP pointed out that the Mainline does not itself raise capital, or have a stock price or a credit rating, which is why all parties, including TransCanada, referred in evidence to indicators which pertain to TransCanada. In CAPP's view, this information is relevant in determining a fair return for the Mainline. However, the Board was cognizant of, and applied, the stand-alone principle throughout its Reasons. Mirant stated the view that TransCanada confused the issue of the determination the Board was obliged to make, with the issue of what evidence the Board could use in making that determination. The Board was obliged, in Mirant's view, to determine a fair return for the Mainline alone. In making this determination, the Board considered the evidence it found relevant about the consolidated entity. Mirant submitted that the Board is entitled to draw reasonable inferences from the available evidence.

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[26] Review Application, at paragraph 160.

There is no other evidence available with respect to the credit rating and empirical beta of the Mainline in Mirant's submission; information on the consolidated company provides the best evidence, and is therefore relevant to the Board's Decision. Mirant argued that the Board was aware that this evidence may not be completely reliable, however, that does not mean that the evidence was completely irrelevant.

Mirant also submitted that TransCanada's financial position and ability to attract capital are relevant since there is no direct objective evidence on the Mainline's credit rating and ability to attract capital. While this evidence does not strictly imply that the Mainline would be similarly situated, again that does not mean the information is completely irrelevant. In the absence of objective evidence for the Mainline, Mirant argued that the Board was entitled to draw the inference that it did.

The share price performance of TransCanada, in Mirant's view, is also indirectly relevant to the adequacy of the Mainline's return. Mirant argued that the Board found that this evidence did not support TransCanada's claim of inadequate returns.

Mirant indicated that it is relevant who the investors are, since TransCanada's investors, who are mostly Canadian, own the majority of Mainline, no matter what proportion of TransCanada the Mainline represents.

In reply, TransCanada argued that the investor in the Mainline is TransCanada; accordingly, evidence about TransCanada's debt and equity investors, capital requirements, ability to attract capital, stock price and credit rating were relevant only to TransCanada's perspective on investing in the Mainline.

Views of the Board

The Board agrees with TransCanada that the stand-alone principle is a fundamental concept of utility regulation and a concept that it should continue to apply in regulating TransCanada's Mainline. The Board does not, however, agree with the implication made by TransCanada that the stand-alone principle would prevent the Board from examining whatever evidence it found to be relevant to its decisions on those expenses, capital costs, risks and required returns associated with the provision of regulated service.

It is interesting to note TransCanada's own words in its Fair Return Application, where it requested a review of the RH-2-94 Decision to allow a "fair return for *TransCanada*"[27] for the years 2001 and 2002; and an order approving an ATWACC of 7.5 percent "(adjusted for the embedded cost of debt of the *Company*) as the fair return for *TransCanada*."[28] [emphasis added] Following the logic that TransCanada set out in its Review Application, each of these highlighted references should be to the Mainline, not TransCanada or the Company.

In making its decisions on the parameters in question in the RH-4-2001 Decision (approved return on common equity for the Mainline and the deemed capital structure for the Mainline) the Board made specific references to the applicability of the approved

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27 TransCanada Fair Return Application, RH-4-2001 Exhibit B-1, 6 June 2001, Tab I Application, page 3.

28 *Ibid.*

parameters to the Mainline[29], despite the relief requested by TransCanada in that application.

The Board is not convinced that the Decision violates the stand-alone principle because certain information or opinions relating to TransCanada's consolidated operations were found to be relevant in comparison to the Mainline or in setting the business context for the Mainline. Indeed, in the section TransCanada identified as the first alleged violation, at page 3 of the RH-4-2001 Decision, the Board clearly indicated that "cost of capital is considered within the context of the Mainline as a stand-alone entity". However, the Board noted that, in reality, it is often necessary to consider factors pertaining to TransCanada, as many financial indicators are only available for the consolidated entity and often provide the best estimates as to what these indicators would be for the Mainline as a stand-alone entity. This section of the RH-4-2001 Reasons was previously discussed in Chapter 3.2.2.

The Board is of the view that this explanation, along with others through the Decision[30], clearly shows that the Board in RH-4-2001 addressed its mind to the Mainline as a stand-alone entity, but that in doing so it found that certain indicators pertaining to TransCanada's consolidated operations were relevant to the Board's determinations for the Mainline. As stated in RH-4-2001, for many factors this is the only and best information available.

In light of the foregoing, the Board is not convinced that there are any violations of the stand-alone principle in the RH-4-2001 Decision. Thus, there can be no question about the correctness of the Decision from this perspective.

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29 See for eg. page 56 of the RH-4-2001 Decision, "The Board has decided that the rate of return on common equity resulting from the RH-2-94 Decision should continue to apply to the *Mainline*." and page 59 of the Decision, "The Board approves an increase in the *Mainline's* deemed common equity ratio from 30 percent to 33 percent" [emphasis added]

30 Reasons for Decision, RH-4-2001, pages 34 and 59, concerning Investment Perspectives and relative risk.

Chapter 6

Adequacy of Reasons in RH-4-2001

TransCanada argued that, as a result of the recent case law in *Baker* v. *Canada (Minister of Citizenship & Immigration)*[31], the Board has a duty to provide adequate reasons for decision in circumstances where the decision has important significance to the individual, there is a statutory right of review or in other circumstances. The reasons themselves must meet a certain standard, as set out in *Baker*, *Via Rail Canada Inc.* v. *Canada (National Transportation Agency)*[32], *Monsanto Company* v. *Commissioner of Patents*[33], and *Northwestern Utilities Ltd.* v. *The City of Edmonton*[34].

According to TransCanada, adequate reasons serve the functions for which the duty to provide them is imposed and are required where there is a statutory right of appeal. It is insufficient to recite the fact that evidence and argument have been considered, and then state a conclusion. The Board must set out the findings upon which its decision is based with sufficient detail that the parties, and a reviewing tribunal or court, are able to determine whether the Board has acted within its jurisdiction and the law.

It is an error of law, in TransCanada's submission, if the reasons are not adequate to allow meaningful appellate review of the correctness of a decision. Further, inadequate reasons create a legitimate concern that there was not adequate analysis of the case, or important issues or evidence were overlooked.

TransCanada claimed that, in this case, the financial significance of the Decision for the Mainline and the statutory rights of review and appeal require adequate Reasons for Decision. It indicated that the lack of reasons in this case has prejudiced its ability to conduct business and exercise its right of appeal. In addition, the Application stated that the Reasons in this case do not meet, let alone exceed, the requirements of the law, contrary to the Board's policy to provide greater detail than is required by the law[35]. According to TransCanada, in these Reasons, the Board merely recited the evidence and arguments advanced, and then stated conclusions; this manner of providing reasons is not sufficient to satisfy the current legal standard for reasons.

In TransCanada's submission, the Board erred by not providing adequate reasons for a number of conclusions that it reached in the Decision. Further, TransCanada submitted that the Reasons are inadequate to discharge the Board's duty of fairness.

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31 [1999] 2 S.C.R. 817.

32 (2000), 193 D.L.R. (4th) 357 (F.C.A.).

33 [1979] 2 S.C.R. 1108.

34 *Northwestern Utilities Ltd.* v. *The City of Edmonton*, [1979] 1 S.C.R. 684 [*hereinafter* referred to as *Northwestern Utilities (1979)*].

35 This policy was set out in the National Energy Board Letter Decision dated 28 June 1993, CAPP Application for Review of the RH-2-92 Decisions, File No. 4200-T001-7.

CAPP submitted that if TransCanada was of the view that it required clarification and elaboration of the RH-4-2001 Reasons, it ought properly to have posed its questions to the Panel that wrote the Decision. That Panel is in the best position to explain its Reasons. CAPP also argued that either the Reasons were adequate enough to allow TransCanada to make its allegations of errors, or the Review Application is illusory. Further, CAPP indicated that there was no post-decision market evidence of prejudice suffered by TransCanada.

The Board's policy, according to CAPP, is that reasons should show an awareness of the primary issues in the proceeding and indicate the basis upon which the decision was made. A review of the RH-4-2001 Reasons leaves no doubt but that this policy was satisfied.

Mirant agreed that the Board has a common law duty to provide adequate reasons for its decisions. However, it argued that in this case, the Reasons were consistent in terms of the nature and extent of the analysis provided, with the Board's usual practice in writing reasons for decision in significant pipeline cases, and with the legitimate expectations of TransCanada and the intervenors. Further, Mirant stated, it is not the Board's practice to go over every bit of evidence and either accept or reject it.

However, Mirant was not prepared to concede that, as a matter of law, TransCanada has a common law right to "adequate reasons" on the grounds that a failure to provide adequate reasons compromised its right to seek review of the Decision by the Board itself. In addition, Mirant found TransCanada's claim that its appeal rights were prejudiced suspect, as no appeal was sought within the time permitted, no action was taken to preserve appeal rights and no additional reasons were sought from the original Panel. Further, TransCanada did not provide evidence on how a lack of detail in the Reasons prejudiced TransCanada with respect to its business plans, negotiations or with respect to how it deals with its assets.

In Mirant's opinion, TransCanada is really seeking a review of the RH-4-2001 Decision on the merits, as TransCanada claimed that the correction of errors it identified would entitle it to a decision consistent with its Fair Return Application. In Mirant's view, requesting detailed Reasons now makes little sense given that TransCanada is seeking a review of the Decision on the merits. Mirant submitted that either there is a significant problem with the Board's Reasons, in which case TransCanada should now simply be seeking better reasons, or there are grounds for reversing the Decision on the merits, in which case TransCanada has no need for better reasons in relation to the Decision.

IGUA argued that reasons for decision are sufficient if there is evidence to reasonably support the finding, but that evidence need not be specifically referred to in the reasons for decision, nor is there an obligation to give reasons for every stated fact. It submitted that the "adequacy" of reasons must be assessed in context, and that the duty of fairness allows various types of written explanations for administrative decisions. Further, the adequacy of reasons, in IGUA's submission, goes to the duty of fairness and not to the correctness of the Board's Decision. Therefore, inadequate reasons should not be grounds to find that a doubt as to the correctness of the RH-4-2001 Decision has been raised.

Coral argued that the RH-4-2001 Decision was well-reasoned and explained, and the key factors were considered. It also noted that there has been no change in the stock price of TransCanada, which indicates that the market did not believe the Decision was negative in terms of the value of TransCanada as an investment.

In reply, TransCanada argued that the Board's policy as put forward by CAPP has been superceded by the judicial decisions in *Baker* and *Via Rail*. Showing "an awareness of the primary issues raised in the proceeding" and an "indication of the basis upon which the decision was made" as suggested by CAPP, is no longer adequate.

In TransCanada's view, adequate reasons are required to show that a decision is correct. Further, the fact that Mirant provided interpretations of the Reasons that were inconsistent with conclusions reached by TransCanada, CAPP and the Board itself is a clear indication that the Reasons are inadequate.

TransCanada also argued that there was no legal obligation to seek adequate Reasons for Decision from the original Panel before applying for review of the entire Decision on a range of errors. TransCanada suggested that the reviewing Panel could affirm or modify the original Decision and give Reasons for doing so, or it could return the matter to the original Panel with a direction to provide adequate Reasons.

Views of the Board

The Duty to Provide Reasons for Decision

TransCanada relies, in part, upon the Supreme Court case of *Baker*. This case involved a woman with Canadian-born children who was ordered to be deported. The only reasons given were the handwritten notes of the investigating immigration officer, which were used by the senior immigration officer to make his decision that insufficient humanitarian and compassionate reasons existed to allow the woman to remain in Canada. In the course of finding that these notes constituted adequate reasons, the Court indicated that procedural fairness is flexible and variable and depends on the context of the particular statute and the rights affected[36].

The Court outlined several purposes for giving reasons[37]. First, the process of writing reasons may guarantee a better result by ensuring that issues and reasoning are well articulated and therefore more carefully thought out. Second, reasons allow parties to see that the applicable issues have been carefully considered. Reasons are also invaluable if a decision is to be appealed, questioned or considered on judicial review. Finally, it indicated that those affected by a decision may be more likely to feel they were treated fairly and appropriately if reasons are given.

The Court also set out a non-exhaustive list of factors to consider in determining whether a duty to give reasons exists, including the nature of the decision being made and the process followed in making it; the nature of the statutory scheme and the terms of the statute pursuant to which the body operates; the importance of the decision to the individual affected; the legitimate expectations of the person challenging the decision; and the choices of procedure made by the agency itself[38].

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36 *Supra*, at footnote 31, at page 837, per L'Heureux-Dubé, J.

37 *Ibid*, at pages 845-6.

38 *Ibid*, at pages 837-840.

The Board agrees with the purposes and factors to be considered in determining whether to provide reasons for decision, as set out in *Baker*. In certain instances, reasons may also serve to educate or act as precedents for the public and regulated community. However, as the Board in RH-4-2001 decided to provide written Reasons for Decision, it is not necessary to determine at this time whether the Board is always obligated to give reasons for decision, either written or oral. When reasons are given, they must be adequate.

The Standard for Reasons for Decision

Given that the Reasons must be "adequate", the key issues before the Board in this case are what the standard of "adequacy" for Reasons for Decision is; and whether the Board in RH-4-2001 provided adequate Reasons for Decision.

Good reasons do at least two things:

1. They explain how the agency reached the decision it did. To do this, as a minimum, the reasons should set out the facts, laws and reasoning which formed the basis for the decision reached.

2. They show that due regard was had to the balance of the evidence and arguments advanced by the parties. This serves to avoid claims that the agency failed to consider some relevant evidence or argument which should have been considered.[39]

However, this does not mean that a decision maker is required to give reasons on each and every element of an argument presented, although those elements must be considered[40]. Accordingly, the Board's reasons need not address each issue or sub-issue raised by each party in a proceeding; such reasons would be unnecessarily lengthy and time consuming to produce. The reasons must only make it clear that the Board considered and weighed all of the evidence and establish the grounds for the basis of the Board's findings.

In the RH-2-92 Review Decision, the Board considered the principles set out in *MacDonald* v. *R*[41], *Nova, An Alberta Corporation* v. *Guelph Engineering Company*[42], and *Monsanto,* among others, and stated the following general principles:

1. the common law does not impose on decision-makers a general duty to provide reasons; and

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39 Macaulay, R.W., *Practice and Procedure before Administrative Tribunals*, (Toronto, Ontario: Thomson Canada, looseleaf service 2002) at page 22-74.

40 *SEIU Local 333* v. *Nipawin District Staff Nurses Association,* [1975] 1 S.C.R. 382 at page 391.

41 [1977] 2 S.C.R. 665.

42 [1989] 70 Alta. L.R. (2d) 97 (C.A.).

2. when an administrative tribunal does provide reasons, either by choice or because it is statutorily required to, it is not required to make an explicit written finding on each constituent element, however subordinate, leading to its final conclusion. However, the reasons should be sufficiently detailed to assure the parties that in reaching its decision, the decision-maker addressed its mind to the evidence and issues at play in the hearing and, in cases where there is a right to appeal, sufficiently detailed to enable parties to assess that option.[43]

More often than not, the case law does not provide concrete guidance as to what constitute adequate reasons. For example, while the Supreme Court in *Baker* found that, in a case of extreme importance to the individual involved, a mere six paragraphs of handwritten notes of the investigating officer constituted adequate reasons for decision, the courts in many of the other cases cited to the Board in this proceeding only indicated what was not sufficient.

In *Northwestern Utilities (1979)*, in which the "whereas" clauses in a rate increase interim order were the only "reasons" provided, the Court found that the Public Utility Board had effectively failed to give any reasons to establish the basis upon which the rates had been determined. The reviewing tribunal was unable to determine from the order whether the Public Utility Board acted within or outside the ambit of its statutory authority or jurisdiction. In the context of these extremely limited reasons, the Court stated that a board cannot merely recite the submissions and evidence of the parties and then state a conclusion, but must set out its findings of fact and the principal evidence upon which those findings of fact were based. It must address the major points in issue and set out the reasoning process followed. The reasons must show that there was consideration of the main relevant factors.

In the *Via Rail* case, the agency stated a conclusion that one section of a tariff, concerning the attendants of disabled persons, was an obstacle to the mobility of disabled persons, and that such obstacle was undue. The Court found that, while reasons had to be looked at in light of the particular circumstances of each case, these were not adequate reasons. The railway needed sufficient guidance to formulate its tariff without running afoul of the agency[44]. The agency erred by not addressing how a tariff provision created an obstacle. The Court found that the agency did not provide insight into the reasoning it followed or the factors it considered in determining whether an obstacle was undue and this constituted an error in law[45].

While there may be general guidance provided by the case law about what constitutes adequate reasons for decision, there is no template or universal standard which must be met. The Board recognizes that it has a duty of fairness and the provision of adequate reasons may be one aspect of the duty of fairness. However, what constitutes adequate

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43 *Supra*, footnote 35, at pages 6-7.

44 *Supra*, footnote 32, at page 364.

45 *Ibid*, at page 370.

reasons will vary with the nature of the decision to be made, the effect of the decision on the parties and the various other factors addressed above. The Board is of the view that a reviewing tribunal should look at the circumstances surrounding the provision of particular reasons, making a contextual analysis to determine whether the particular reasons are adequate on the facts of the case before it.

In addition, as previously mentioned, it is important in determining whether a doubt has been raised as to the correctness of the RH-4-2001 Decision to read the Decision as a whole. While there may appear to be an absence of reasoning in one section, it is possible that further reasoning on that issue may be found elsewhere in the Decision.

The Board will now consider the adequacy of the RH-4-201 Reasons in light of the above noted case law and discussion.

The Adequacy of Reasons in RH-4-2001

The Board notes that there is some appeal to the submitters' arguments that the fact that TransCanada could draft such a lengthy Review Application indicates that there were adequate reasons given and TransCanada just disagreed with those reasons. However, the Board is of the view that even lengthy reasons for decision, which allegedly contain sufficient factual errors to support a review application, may be inadequate. Therefore, TransCanada's ability to prepare its Review Application on the basis of the Reasons given in RH-4-2001 does not relieve the Board of the obligation to determine whether the Reasons for Decision are adequate.

The Board, as stated before, is of the view that reasons need not be given for each and every point made in a hearing. Therefore, in drafting this section of these Reasons for Decision, the Board has discussed only those issues which, at least on the face of the record, appeared to have merit. On a review of the entire Reasons for Decision in RH-4-2001, the Board is of the view that the other areas claimed by TransCanada as lacking adequate reasoning were sufficiently addressed in the RH-4-2001 Decision or without merit, and warrant no further response.

One issue raised by TransCanada concerns the Mainline's ability to attract capital. At page 34 of the Decision, the Board stated its view that "the Mainline's ability to attract capital on reasonable terms and conditions is not in jeopardy." TransCanada argued that this conclusion with respect to the Mainline is surrounded by comments on TransCanada as a whole, which TransCanada had previously argued are irrelevant. Therefore, in TransCanada's view, the Board did not provide any explanation for that decision.

As discussed in Chapter 5 of these Reasons, the Board does not agree that the comments it made relating to TransCanada's consolidated operations are irrelevant to its determination on the ability of the Mainline to attract capital. Further, in section 3.2.2 of these Reasons, the Board found that it was not an error for information about the consolidated operations of TransCanada to be considered in assessing that ability. Accordingly, given that the comments on the consolidated company are relevant to the determination of the Mainline's ability to attract capital, those comments in the RH-4-2001 Decision provide the reasons TransCanada is seeking on this issue.

TransCanada also argued that there were inadequate reasons concerning the alternate uses of TransCanada's capital. In the Decision, the Board found that the relative risk and potential return associated with alternative uses of capital by the corporation may be a relevant consideration when assessing the Mainline's cost of capital. The Board did not, however, specifically indicate whether or not the evidence on alternative investments presented by TransCanada was accepted or rejected. However, the Board notes the extensive discussion of alternative investments set out on page 35 of the Decision. It is clear from the RH-4-2001 Reasons as a whole that alternative uses of capital were considered in the Decision. Accordingly, the Board does not believe that the Decision contains inadequate reasons for its views relating to the alternative investment evidence presented by TransCanada.

TransCanada submitted that there were inadequate reasons surrounding the issue of reliance on U.S. firms. At page 44 of the RH-4-2001 Decision, the Board stated that it is inappropriate to simply apply Canadian parameters to U.S. firms because they "potentially face substantially dissimilar investment circumstances". TransCanada asked the Board to explain what those circumstances might be and what evidence this view is based on. In the Board's opinion, it is axiomatic that firms in foreign countries face different legal, fiscal, monetary and taxation systems than Canadian firms and thus potentially different investment circumstances. This is a general comment within the Board's, and most people's, understanding and requires no further explanation.

The Board dismissed a suggestion by Drs. Kolbe and Vilbert to adjust the return for the Mainline to reflect differences in capital structure between the Mainline and the sample group, at page 54 of the Decision, stating that the differences in leverage reflected differences in business risk or investment circumstances. TransCanada asserted that the Board gave no reasons or references to evidence supporting its view. The Board notes the statement on page 13 of the RH-4-2001 Decision where the Board said, "Business risk has traditionally been reflected in the establishment of a deemed common equity ratio in a pipeline's capital structure." The Board is of the view that the Decision clearly states that business risk factors should be reflected in deemed capital structure, not approved return on equity. The Board also notes the reference in the paragraph in the Decision where the suggestion by Drs. Kolbe and Vilbert is discussed, to section 4.3 of the RH-4-2001 Decision, where appropriate deemed capital structure is addressed. In the Board's view, when the Reasons are read as a whole, as they should be, this matter has been adequately addressed.

TransCanada argued that the Board did not give adequate reasons for its rejection of the use of several adjustments to the return on common equity for the Mainline, as recommended by Dr. Vilbert. The Decision notes, on page 54, that all of the adjustments increase the estimated cost of equity and states that the Board, "has not been persuaded that the use of all of these adjustments is simultaneously justified." The Board is of the view that there may not be reasons included in the Decision to understand the basis upon which the Board makes its statement about whether or not the adjustments are simultaneously justified. However, the Board is also of the view that, despite the lack of particulars in this instance, a question as to the correctness of the RH-4-2001 Decision has not been raised. The Board notes that the adjustments in question pertain to Dr. Vilbert's calculations of cost of equity and not to the methodology approved by the Board. The issue of simultaneous adjustments that appear in Dr. Vilbert's calculations

was not a central issue in the decision to retain the RH-2-94 Formula for determining appropriate returns for the Mainline.

In its Reply, TransCanada argued that the fact that CAPP and Mirant interpreted the Reasons in different ways is an indication that the Reasons were inadequate. It listed several instances where it claimed that CAPP and Mirant had different interpretations about what the Board said.

If there were clearly different interpretations with respect to substantial and substantive aspects of the Decision, this likely would raise a concern as to the adequacy of the Reasons. However, in the Board's view, after a careful reading of the Decision, and both CAPP and Mirant's submissions, many of the instances TransCanada set out were not different at all, were related to non-substantive issues or were irrelevant to the final Decision. For example, CAPP and Mirant, at times, addressed certain aspects of the Decision from different levels, one taking a high level approach and the other looking at the Reasons in a more detailed manner. In another instance, CAPP remained silent on issues on which Mirant provided comments. Another example concerns the different use of terminology, which in the Board's view boils down to semantics. The Board does not find that any of these instances warrant further discussion or demonstrate that the Reasons for Decision were inadequate.

There were three areas in which it appeared that CAPP and Mirant had, at least superficially, divergent interpretations of the Reasons. The first was with respect to the application of the fair return standard. TransCanada stated that Mirant's position was that the Board met its legal obligation to apply the fair return standard by conducting an equity risk premium analysis, and that the fair return standard was properly applied through the sole application of "conventional quantitative financial market analysis". TransCanada asserted that CAPP claimed that evidence removed from the record was of limited probative value and the alternative pipeline evidence was not particularly meaningful.

However, the Board finds that this is another example of different approaches taken by the submitters in addressing TransCanada's allegations. CAPP's position addressed one aspect of TransCanada's argument: the removal of Exhibit B-64 from the record and not the overall approach taken by Board, which was Mirant's approach in that portion of its submission. The Board does not find that these differing positions responding to different aspects of TransCanada's argument are an indication of inadequate reasoning in the RH-4-2001 Decision with respect to the application of the fair return standard.

The second issue on which there appears to be inconsistent interpretations is whether the Board set an "unattainable evidentiary standard" with respect to pipeline comparisons. CAPP essentially said that the provision of this type of evidence is not "an unattainable standard": this assessment was provided by other parties in previous proceedings and by CAPP in the RH-4-2001 proceeding. Mirant, however, submitted that it may be an unattainable standard but that is because the whole approach of determining a fair return for the Mainline via direct comparisons is misconceived from the outset. According to Mirant, such comparisons are meaningless in the absence of further evidence that the Board found necessary and TransCanada failed to provide.

Again, the Board views these comments as reflecting different approaches taken by the submitters in responding to TransCanada, and not as an indication of a lack of adequate Reasons. CAPP's statements indicate the type of evidence the Board suggested as being helpful is the type of evidence that can be, and has been, provided in the past. Mirant's statements critique the approach taken by TransCanada in its Fair Return Application in advocating a determination of a fair return for the Mainline on the basis of direct comparisons, and the failure of TransCanada to provide evidence which the Board found to be necessary.

The last issue on which CAPP and Mirant appear to have differing interpretations concerns the congruence of TransCanada's consolidated capital structure with the deemed capital structure for the Mainline. TransCanada indicated that CAPP stated that the Board made its capital structure decision on the basis of business risk alone. It asserted that Mirant, on the other hand, said that the Board simply stated a fact and then hypothesized about the relative risk of the Mainline and the consolidated operations of TransCanada. TransCanada argued that this disagreement as to the use of TransCanada's capital structure supports the view that inadequate reasons were given on this important issue.

The Board does not find that there is a disagreement at all in this area. CAPP merely points to a particular section of the Reasons where the Board indicated it made its conclusion to increase the common equity component to 33 percent "on the basis of the evidence presented to it with respect to the business risk faced by the Mainline"[46]. Accordingly, CAPP does not provide an interpretation with which Mirant can be in disagreement. In addition, page 58 of Reasons indicates the Board's awareness of the absence of a specific capital structure for the Mainline. As noted by CAPP, the Reasons clearly state that the conclusion was based on the evidence presented with respect to the business risk of the Mainline. Since the Board does not find a differing interpretation with respect to this point, there is no support for TransCanada's allegation that there were inadequate reasons on this point. It just demonstrates, once again, the importance of reading the Decision as a whole.

Given all of the above and considering the specific instances raised by TransCanada in its Application and reply submissions, the Board is of the view that when read as a whole, adequate reasons for the decisions set out in RH-4-2001 have been given. The Board finds that no doubt on the correctness of the RH-4-2001 Decision has been raised on these grounds.

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46 RH-4-2001 Reasons for Decision, at page 59.

Chapter 7

Final Determination

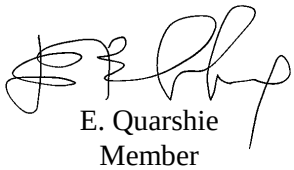
It is clear from the Review Application, and the Board's findings herein with respect to the alleged errors, that TransCanada disagrees with the Board regarding the evidence which should be considered, the weight to be given that evidence and the conclusions reached on the basis of that evidence. Disagreement does not indicate that a doubt has been raised as to the correctness of the RH-4-2001 Decision. The Board has the authority to determine the weight to be given to certain factors and what evidence to place more or less weight on. The setting of tolls requires a combination of reliance on quantitative methodologies and the use of informed judgment. It is for this reason that Parliament and the courts have assigned to administrative tribunals the responsibility of weighing evidence, exercising their expertise, applying their judgment and balancing interests. It will always be a matter of opinion, and potentially dispute, as to what the range of reasonable tolls may be and where on that range a specific toll may be found.

It is also clear from the Review Application and the Board's findings in this Decision that the importance of reading the Reasons for Decision as a whole cannot be over emphasized. Given the interconnectedness of the issues in a hearing such as RH-4-2001, reasons relating to a particular issue may often be found in more than one place in the Decision.

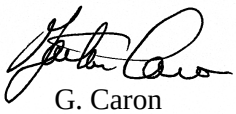
The Board has considered each element of TransCanada's Application and is of the view that the Application has not raised a doubt as to the correctness of the Board's RH-4-2001 Decision.

This and the foregoing Chapters constitute our Decision and Reasons for Decision in respect of the Application to Review and Vary Board Decision RH-4-2001 and the orders connected therewith.

C. Dybwad
Presiding Member



E. Quarshie
Member



G. Caron
Member

Calgary, Alberta
Feburary 2003