that the basic ATWACC principle holds true using book capitalization ratios over a narrow range. Recognition that the cost of capital is constant over a narrow range has the following attractive and desirable features from a regulatory perspective:

- Similar to the traditional method, the Board considers that utility management retains the flexibility to determine actual capital structure within a prudent narrow range.
- The Board considers the $ATWACC_{BV}$ model to be useful in demonstrating the relationship between common equity ratio and equity rate of return over the narrow range that is consistent with the allowed fair return and income tax.

The Board considers it extremely important to reconcile the results of the $ATWACC_{BV}$ model with the traditional model to ensure the allowed fair return has not increased or decreased on a relative basis solely as a result of using new regulatory models.

The Board, in the next section, will determine a fair return using a modification to TransAlta's $ATWACC_{MV}$ model.

In summary, for all of the above reasons, the Board finds it necessary to reject TransAlta's version of the ATWACC model which proposes the use of market capitalization ratios. Accordingly, the Board considers that it should place primary weight on the traditional method in the development of a fair return for these proceedings. Nevertheless, the Board considers that useful insights and assistance can be obtained from the principles of the ATWACC concept that will assist it in determining the fair return for the integrated company as well as by business function.

(E) Fair Return Using $ATWACC_{BV}$ Model

Board Findings

The following modifications are necessary to TransAlta's ATWACC results in order to arrive at an allowed fair return and income tax:

- Determine an ATWACC from Dr. Vilbert's sample Canadian and U.S. companies using book rather than market capitalization weightings.
- Determine an appropriate adjustment to the above ATWACC to eliminate any distortion caused by involvement in unregulated activities.
- Determine an appropriate adjustment to ATWACC consistent with Board approved market equity rate of returns
- Adjust the ATWACC for the differences between the embedded and current cost rates of debt and preferred.
- Gross up the adjusted ATWACC return by dividing by one minus the tax rate to arrive at the allowed fair return plus the book income tax.
- Determine the income tax adjustments to be added to the book income tax.

3. GENCO/TRANSCO/DISCO
(i) Return

The Board earlier in this Decision set out its approach to the determination of a fair return. The Board noted that it will use both the traditional method and a modified ATWACC as tools to arrive at the fair return for EPGI, EPTI and TransAlta, with primary weight placed on the traditional method. The Board also noted that since EPGI and EPTI do not pay income tax, the modified ATWACC model collapses to the traditional method used to determine the fair return. Or in other words, the ATWACC return grossed up by dividing by one minus the tax rate is mathematically equivalent to the traditional fair return plus income tax payable on the equity portion of the fair return.

For the purposes of this section, the Board will use the acronym $ATWACC_{BV}$ to refer to the modified ATWACC which is weighted based on book values for debt, preferred equity and common equity to distinguish it from the ATWACC proposed by TransAlta. The ATWACC proposed by TransAlta will be referred to using the acronym $ATWACC_{MV}$ to note the fact that it is weighted by market values for debt, preferred equity and common equity. The Board will also use the term $ATWACC_{BV}$ (current) or $ATWACC_{MV}$ (current) to refer to an ATWACC based on the current cost rate for debt and equity and the term $ATWACC_{BV}$ (embedded) or $ATWACC_{MV}$ (embedded) to refer to an ATWACC based on the embedded cost rates for debt and equity.

The Board, in the previous business risk, capital structure and equity return sections of this Decision made the following primary determinations respecting the parameters used to arrive at a fair return using the traditional method:

- The Board determined that a range of 40%-42% (midpoint 41%) is an acceptable range of common equity capital structure ratios consistent with the business risks of the integrated company in 1999 and 2000.
- The Board determined that 9.0% to 9.5% (midpoint 9.25%) is an acceptable range for the common equity rate of return using standard tests.

The Board, in the previous ATWACC section of this Decision, determined an ATWACC appropriate for an integrated utility, based on Dr. Vilbert's sample Canadian and U.S. companies. The Board made the following primary adjustments to the $ATWACC_{MV}$ proposed by TransAlta:

- The Board adjusted the proposed $ATWACC_{MV}$ downward by using book rather than market capitalization weightings in order to maintain the longstanding regulatory practice that fair return should be based on the book value (i.e. original cost) of the assets. The Board also found it unlikely that book ratios would have been significantly distorted by unregulated activities whereas market weighted ratios have the potential to be distorted by unregulated activities. The Board concluded that the above adjustment from market weighted capitalization ratios to book weighted capitalization ratios also purged out any effects of unregulated activities. The use of book weightings resulted in a 50 basis point reduction in the proposed $ATWACC_{MV}$