Q. Evidence of Ms. McShane Background Pages 4 – 6: Would Ms. McShane accept that Mr Justice Lamont's definition came out of changed conditions in the money market and it is to the money market (now capital) market that we should look to estimate fair rates of return? If not why not?

A. Ms. McShane agrees that the Court's focus was on changed conditions in what it referred to as the money market; the decision states that "To properly fix a fair return the Board must necessarily be informed of the rate of return which money would yield in other fields of investment." In this context, the reference to the money market can be interpreted as what we refer to as the capital markets.

While Ms. McShane understands the *Northwestern* decision to be the principal Court case in Canada that defines a fair return, the interpretation of and the enunciation of the fair return standard and its requirements by Canadian regulators relies on additional legal precedents, including the *Hope* and *Bluefield* decisions of the U.S. Supreme Court.

For example, the Ontario Energy Board in its *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* issued in December 2009 (pages 16-17) stated as follows:

"The FRS [Fair Return Standard] is a legal concept, and has been articulated in three seminal court determinations as set out below:

1. In *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia* et. al. 262 U.S. 679 (1923), the FRS is expressed to include concepts of comparability, financial soundness and adequacy:

> 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 support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

2. In *Northwestern Utilities Limited v. City of Edmonton*, [1929] S.C.R. 186, the FRS concept was described as follows:

> 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.

3. In *Federal Power Commission v. Hope Natural Gas* 320 U.S. 591 (1944), the Court expresses that "balance" is achieved in the ratemaking process, and outlines three elements of a fair return:

> 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…the investor interest 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 Newfoundland and Labrador Board of Commissioners of Public Utilities in P.U. 7 (1996) similarly cited the *Northwestern* decision and the *Hope* and *Bluefield* "landmark decisions of the United States Supreme Court", as well as the 1960 Supreme Court of Canada decision, which, as cited by the PUB, stated, "in British Columbia Electric Railway vs Public Utilities Commission of British Columbia, et al, [1961] 25 D.L.R. (2d) 689, at pp.697-698, that "earnings must be sufficient ... to enable [the utility] to ... attract capital either by the sale of shares or securities.""