Alberta Energy and Utilities Board

IN THE MATTER OF the *Alberta Energy and Utilities Board Act*, R.S.A. 2000, c. A-7, and the Regulations under it;

IN THE MATTER OF the *Gas Utilities Act*, R.S.A. 2000, c. G-5, and the Regulations under it;

IN THE MATTER OF the *Public Utilities Board Act*, R.S.A. 2000, c. P-45, as amended, and the Regulations under it; and

IN THE MATTER OF an Application by NOVA Gas Transmission Ltd. (NGTL) to the Alberta Energy and Utilities Board for an order fixing NGTL's 2004 revenue requirement and approving NGTL's Code of Conduct.

Rebuttal Evidence
of
NOVA Gas Transmission Ltd.

March 9, 2004
EUB Application No. 1315423

I. INTRODUCTION

Q.1 What is the purpose of NOVA Gas Transmission Ltd.'s (NGTL) written rebuttal evidence?

A.1 NGTL in this written rebuttal evidence (Rebuttal Evidence) responds to and refutes statements made and positions taken by the Canadian Association of Petroleum Producers (CAPP) in its written evidence dated January 9, 2004 (Exhibit No. 05-003). Specifically, NGTL disagrees with CAPP's position that:

- NGTL's forecast 2004 employee long term incentive compensation (LTIC) costs should be disallowed on the basis that NGTL uses total shareholder return as an LTIC measurement benchmark, or on any other basis; and
- NGTL's forecast 2004 pension costs associated with TransCanada PipeLines Limited's (TCPL) 2003 conversion from a defined contribution (DC) pension plan to a defined pension (DB) pension plan should be disallowed on the basis of "management generosity", imprudence, or any other basis.

NGTL explains in this Rebuttal Evidence why CAPP's positions are unreasonable and without merit, and ultimately should be dismissed by the Board.

Q.2 CAPP and other interveners in this proceeding filed written evidence opposing other components of NGTL's 2004 General Rate Application - Phase 1 (the Application or GRA), or otherwise making their own proposals on matters raised in the Application. Does NGTL respond to the evidence of these interveners in this Rebuttal Evidence?

A.2 No. However, the Board and interested parties should not conclude from NGTL's silence in the Rebuttal Evidence on other matters raised in interveners' evidence that NGTL agrees with, or is otherwise indifferent to, any opposing or contrary positions and proposals advanced by these interveners. NGTL generally disagrees with these parties' positions to the extent they differ from NGTL's stated positions in the Application.

However, NGTL recognizes the purpose of rebuttal evidence is for the applicant to provide an evidentiary response to new and previously unaddressed matters interveners have raised in their evidence. Rebuttal evidence is not a forum to simply reiterate and argue existing evidence.

In this context, NGTL has determined it requires no evidence in rebuttal to respond to the statements made and positions taken by other interveners in their evidence. NGTL will explore, challenge, and respond to the merits of these interveners' assertions through cross-examination and argument.

II. 2004 LTIC EXPENSES ARE REASONABLE AND PRUDENT

Q.3 What is CAPP's claim about NGTL's forecast 2004 LTIC expenses?

A.3 CAPP states in its written evidence:

> Employee monetary incentives that support ratepayer interests such as safety, reliability, cost efficiency, customer service and operational improvements are appropriately paid for by ratepayers. However, NGTL shareholders should pay for the costs of incentives that have as their focus the maximization of shareholder value.[1]

CAPP contends that TCPL's LTIC program is aimed at increasing shareholder value rather than ratepayer value, and on this basis it consequently argues that NGTL's forecast 2004 LTIC costs should be disallowed.[2]

[1] CAPP Written Evidence dated January 9, 2004, page 2, ll. 5-9.

[2] CAPP Written Evidence dated January 9, 2004, page 4, ll. 4 to page 5, ll. 10, and page 6, ll. 17-19.

Q.4 What is NGTL's response to CAPP's claim?

A.4 NGTL disagrees with CAPP's position and the underlying premises.

NGTL believes that CAPP misses the real issue the Board must address in determining whether to approve NGTL's forecast 2004 compensation costs. The Board must specifically determine whether the aggregate level of Total Direct Compensation is reasonable. The performance measures for the components of the Total Direct Compensation are not directly relevant to this determination. In other words, it is the aggregate level of compensation that is important and not the methods used to measure the individual components of it.

NGTL believes the level of its forecast 2004 Total Direct Compensation, which includes LTIC costs, is reasonable. If the Board agrees, and finds the forecast 2004 Total Direct Compensation costs in aggregate to be reasonable, then NGTL should on this basis alone be entitled to include these costs in its 2004 revenue requirement.

Q.5 Why does NGTL believe its forecast 2004 Total Direct Compensation costs are, in aggregate, reasonable?

A.5 NGTL has in the Application substantiated the basis on which TCPL determines its overall compensation costs and the specific components of its total compensation program through the use of appropriate comparator groups.[3]

Specifically, Total Direct Compensation is considered to be market competitive when it is within ± 10% of the target level. TCPL's target level is the 50^{th} percentile of its comparator group. Based on a comprehensive sample of job families in the comparator group for 2003, TCPL's overall weighted average of Total Direct

3 NGTL's Application, as amended February 13, 2004 (Exhibit No. 02-10), Section 2.3.2, Total Direct Compensation and Benefits, pages 1-15.

Compensation is 4.2% above the market median. Accordingly, the aggregate level of Total Direct Compensation is reasonable.

Q.6 Has CAPP opposed or challenged the forecast level of NGTL's 2004 total compensation costs?

A.6 No. CAPP has not taken issue with NGTL's forecast overall level of compensation. Rather, it asserts that one component of the total compensation, LTIC, should be disallowed solely because the measure of the incentive is tied to the creation of shareholder value. CAPP's position is irrelevant to, and should be disregarded, in the Board's determination of the reasonableness of NGTL's Total Direct Compensation costs.

Q.7 Are long-term incentives an appropriate element to include in the determination of total compensation?

A.7 Yes. The overall level of Total Direct Compensation and the mix of elements that make up that total must both be market competitive.

Long-term incentives are a common element of compensation programs within general industry and within the energy industry in particular. Towers Perrin has specifically determined that within TCPL's compensation comparator group, 100% of the companies offer some form of long-term incentives. Given the prevalence of long-term incentives amongst TCPL's peer group, TCPL must include such incentives in its overall compensation mix to effectively compete for skilled employees. The exclusion of long-term incentives from its compensation package would put TCPL at a competitive disadvantage relative to other companies with whom it must compete for employees.

Q.8 Have TCPL's compensation practices been considered previously in a regulatory forum?

A.8 Yes. The National Energy Board (NEB) considered TCPL's compensation practices in its hearing on TCPL's 2003 Mainline Tolls Application. The NEB concluded in Decision RH-1-2002 that:

> The evidence provided suggests that the proposed per-employee total compensation (salaries, IC, LTIC, and benefits) for the Mainline is in line with the compensation provided by companies of similar size and scope.[4]

The NEB stated further:

> The Board accepts that TCPL, in order to be competitive in the marketplace for employees, must offer a suite of compensation components similar to its comparator group.[5]

Q.9 Have TCPL's compensation practices changed since the NEB considered them in the RH-1-2002 proceeding?

A.9 No. TCPL used the same methodology to establish the components and quantum of employee compensation for 2004.

However, there has been a change in mandated accounting practices commencing in 2004 for the treatment of stock options. Specifically, Canadian companies, including TCPL, are now obligated to recognize the cost of stock options as an expense.[6]

Stock options are one part of TCPL's LTIC program. TCPL adopted the new accounting rules early on and first expensed stock options in 2002. TCPL has, as now mandated, continued this practice in 2004. NGTL has included its proportionate allocated share of these expenses in its 2004 revenue requirement.

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[4] National Energy Board Reasons for Decision RH-1-2002, page 20.

[5] National Energy Board Reasons for Decision RH-1-2002, page 21.

[6] Canadian Institute of Chartered Accountants Handbook, Section 3870 – Stock-Based Compensation and Other Stock-Based Payments.

Q.10 CAPP contends, independent of the level of TCPL's total direct compensation, that the components of TCPL's LTIC program are all tied to the creation of shareholder value. CAPP suggests that shareholders, not ratepayers, are the beneficiaries of these components.[7] Does NGTL agree with this proposition?

A.10 No. TCPL does use shareholder value as a measurement tool in its long-term incentive programs. However, NGTL disagrees that the components of the LTIC program result solely in the creation of shareholder value. To the contrary, NGTL believes that ratepayer and shareholder interests are not mutually exclusive. The components of TCPL's LTIC program are designed, to and in fact do, create both ratepayer and shareholder value. More specifically, NGTL believes that shareholder value will not be maximized unless employees concurrently focus on ratepayer interests.

Q.11 CAPP notes in its evidence that the NEB in Decision RH-1-2002 ultimately disallowed 50% of TCPL's forecast 2003 LTIC costs. How does NGTL reconcile the NEB's determination that total compensation costs were reasonable with its decision to disallow 50% of LTIC costs?

A.11 NGTL can't reconcile these two findings. Logically, the findings should be mutually exclusive. If total compensation costs are found to be appropriate, then these costs should be recoverable independent of the component parts or the measurement benchmarks used for those parts. Accordingly, NGTL believes it was inappropriate for the NEB to disallow a portion of TCPL's 2003 LTIC costs.

Q.12 Could the use of performance measures that focus on shareholder value potentially result in employees behaving in a manner that is counter to the interests of ratepayers?

[7] CAPP Written Evidence dated January 9, 2004, page 5, ll.4-10.

A.12 NGTL believes that the structure of TCPL's incentive compensation program does not put TCPL's employees in a situation where they must choose between shareholder and ratepayer interests. NGTL believes that ratepayer and shareholder interests cannot be clearly separated. Both shareholder value and ratepayer value are created and maximized when employees focus on doing the "right things" at the "right time." NGTL believes that the underlying drivers for the creation of shareholder value are consistent or otherwise aligned with the drivers that underlie the creation of ratepayer value. These drivers include operational efficiency, customer service, system reliability, employee and community health and safety, and environmental protection. For example, NGTL measures customer service annually through a survey that gauges customer satisfaction on a range of issues. NGTL strongly believes that excellent customer service drives both ratepayer and shareholder value.

NGTL also believes that focusing on any single value driver will not necessarily result in increased shareholder value nor in satisfying other stakeholders. Rather, it is the focus and attention on the key value drivers in aggregate that is important to effect value for shareholders, ratepayers, and other stakeholders.

Q.13 Does TCPL take steps to ensure that employees understand all of the key value drivers?

A.13 Yes. TCPL's overall compensation program specifically addresses this issue. In particular, the short-term, or annual, incentive program has specific operational, safety, and customer service oriented performance measures that are incorporated into individual employee objectives. Such measures are typically only appropriately measured over a period of one year or less. This practice is consistent with general market practices and specifically the practices of companies in TCPL's comparator group.

TCPL's long-term incentive program is, by definition, designed to reinforce the actions and outcomes targeted through the annual incentive plan on a sustained, long-term basis. NGTL firmly believes that there is a strong correlation between the measures used in TCPL's short-term plan and shareholder value. It is therefore fully appropriate to balance the measures used in the short-term plan with measures that are better suited to a longer time-frame, such as shareholder returns. TCPL's practice in structuring its overall compensation program in this way is, again, consistent with general market practices of companies in its comparator group. It is common market practice to complement a short-term incentive plan that has more discrete measures with a longer-term plan that focuses on the sustained performance of such measures through a higher-level financial measure such as shareholder return.

Q.14 Why does NGTL specifically use total shareholder return (TSR) as a measure of performance in its long-term incentive program?

A.14 NGTL is of the view that TSR, measured over a multi-year period, is the most appropriate measure to determine whether the underlying shareholder and ratepayer value drivers are being achieved on a sustained basis. TSR is an all-encompassing measure that assesses whether employees are doing all of the "right things" at the "right time" over a sustained period.

TSR is a simple and transparent measure that employees can readily understand and follow. It is similarly a simple measure to administer for TCPL.

TSR is also a commonly accepted measure in the market place for the design of long-term incentives. The use of TSR as a measurement tool therefore assists TCPL in ensuring its compensation programs are aligned with general market practices.

III. 2004 PENSION EXPENSES ARE REASONABLE AND PRUDENT

Q.15 What is CAPP's claim about NGTL's forecast 2004 pension conversion expense?

A.15 CAPP accepts in its written evidence that utility management can "… decide on the type of pension plan it offers employees" and also can decide "… to convert employees from the Defined Contribution Plan (DCP) to the Defined Benefit Plan (DCB) and on what terms."[8] NGTL agrees with these propositions.

However, CAPP then suggests that TCPL management has been "generous" in making these decisions and that ratepayers should not pay for "management generosity." Specifically, CAPP states:

> … all costs allocated to NGTL to keep employees whole in the conversion of employee pensions from DCP to DBP should be disallowed. NGTL has specifically identified $2.595 Million of the $25.7 Million total pension liability as being attributable to pension conversion. … The $2.595 Million should be disallowed.[9]

Q.16 What is NGTL's response to CAPP's position on the recovery of the pension conversion costs?

A.16 NGTL disagrees with CAPP's contention that TCPL's management has been "generous" in its pension management decisions and that the 2004 pension conversion expenses, in the amount CAPP specifies or at all, should be disallowed.

First, CAPP has misinterpreted NGTL's forecast 2004 pension expenses attributable to TCPL's conversion of its former DC plan into a DB plan. The 2004 expense attributable to the conversion is $1.2 million, and not $2.595 million as indicated by CAPP.

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8 CAPP Written Evidence dated January 9, 2004, page 7, ll. 5-7.

9 CAPP Written Evidence dated January 9, 2004, page 7, ll. 16-20.

Second, NGTL's forecast 2004 pension expense represents a reasonable cost that was prudently incurred through the conversion of TCPL's former DC plan into a DB plan in 2003. These costs are not the result of "management generosity."

Q.17 How did NGTL determine the forecasted 2004 pension conversion expense?

A.17 The $1.2 million expense is NGTL's allocated annual share of the cost that TCPL incurred to keep former DC plan members whole in converting them to a DB plan. These costs result from crediting former DC plan members with years of service as if they had always been in the defined benefit plan.

More specifically, the $1.2 million is the annual past service cost amortization of the actuarially determined deficit transferred from the DC plan to the DB plan as at January 1, 2003 and measured according to Canadian generally accepted accounting standards. The amount is amortized into pension expense over the expected average remaining service life of employees of 13 years.[10]

Additionally, $6.756 million of the $25.516 million prefunded pension and other post employment benefit (OPEB) liability, as at January 1, 2004, represents an asset in rate base comprised of $7.968 million of funding contributions in 2003 to the DB plan in respect of the former DC plan members less the $1.212 million of past service cost amortization in 2003. The relevant portion of the prefunded pension and OPEB liability is forecast to be $5.544 million at December 31, 2004.

Q.18 Please explain the basis for TCPL's decision to convert its former DC plan.

A.18 Prior to January 1997, TCPL had one employee pension plan, the DB plan. The DC and Combination DB/DC (Combination) plans were introduced by TCPL in January 1997. At this time TCPL employees were given an option to either retain the DB plan or transfer to the DC plan or Combination plan. Effective January 1 2003, TCPL

[10] NGTL also provided information about the expense in its response to information request CAR-NGTL-005(b).

eliminated the DC and Combination plans and moved all existing participants to the DB plan.

In deciding to convert the DC and Combination plans to a DB plan, TCPL management was persuaded by the following factors:

- inequities between the plans. Specifically, over the period of time from 1997 to 2002, the aggregate investment return for DC plan members was 3.0% while the annualized time-weighted rate of return for the DB plan over the same period was 6.1%;
- its desire to secure an adequate retirement income for TCPL's long-term employees;
- its desire to retain essential skills and attract additional employees for the future;
- its desire to minimize administrative costs by operating one plan for all employees;
- the level of DC member investment knowledge;
- the risk for litigation against the company. Specifically, TCPL believed the risk of a class action in the absence of protective legislation to be significant; and
- its regard for the long-term strengths of its employee/employer relationship.

In order to minimize the risk of future litigation from employees, and the costs associated with administering a continuing plan for a closed group of employees who had been in the DC or Combination plans, service was recognized for employees moved to the DB plan on an equal basis to those employees already in the DB plan. If TCPL had retained the DC plan, contribution levels would have had to increase (to at least 10%-11% of salary) to assure reasonable retirement incomes at a level competitive with that of companies in TCPL's comparator group.

Q.19 Is it reasonable for a company to periodically review the effectiveness of its pension plan?

A.19 Yes. A reasonable company monitors and assesses the effectiveness of its pension plan in meeting strategic business objectives. In appropriate circumstances, a company should consider changes to its plan, including switching to a different type of plan.

The circumstances TCPL faced in 2002, as outlined in answer 18, warranted its conversion of the existing DC plan to a DB plan. NGTL believes a reasonable company should not be expected to decide on one type of plan and be required to stay with that plan regardless of any subsequent change in circumstances.

IV. SUMMARY

Q.20 What should the Board conclude from NGTL's Rebuttal Evidence?

A.20 The Board should draw two substantive conclusions from the Rebuttal Evidence.

First, the Board should conclude that CAPP's evidence and positions on LTIC expenses and pension conversion expenses is without merit and should be dismissed.

Second, the Board should conclude that NGTL's forecast 2004 LTIC and pension expenses are reasonable and should be included in NGTL's 2004 revenue requirement.

Q.21 Does this conclude NGTL's Rebuttal Evidence?

A.21 Yes.