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BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE '01 APR 4 AM 11 59

OFFICE OF THE
EXECUTIVE SECRETARY

April 4, 2001

IN RE:	)	
	)	
NASHVILLE GAS COMPANY, a Division of	)	**Docket No. 00-00759**
PIEDMONT NATURAL GAS COMPANY	)	
INCENTIVE PLAN ACCOUNT (IPA) AUDIT	)	

NOTICE OF FILING BY ENERGY AND WATER DIVISION OF THE TENNESSEE REGULATORY AUTHORITY

Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, the Energy and Water Division of the Tennessee Regulatory Authority (hereafter "Energy and Water") hereby gives notice of its filing of the Nashville Gas Company Incentive Plan Account (hereafter "IPA") Audit Report in this docket and would respectfully state as follows:

1. The present docket was opened by the Authority to hear matters arising out of the audit of Nashville Gas Company's (hereafter the "Company") IPA for the year ended June 30, 2000.

2. The Company's IPA filing was received on August 25, 2000, and the Staff completed its audit of same on April 2, 2001.

3. On April 3, 2001, the Energy and Water Division issued its preliminary IPA audit findings to the Company, and on April 4, 2001 the Company responded thereto.

4. The preliminary IPA audit report was modified to reflect the Company's response and a final IPA audit report (the "Report") resulted therefrom. The Report is attached hereto as Exhibit A and is fully incorporated herein by this reference. The Report contains the audit findings of the Energy and Water Division, the Company response thereto and the recommendations of the Energy and Water Division in connection therewith.

5. The Energy and Water Division hereby files its Report with the Tennessee Regulatory Authority for deposit as a public record and approval of the same.

Respectfully Submitted:

Pat Murphy

Pat Murphy
Energy and Water Division
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of April, 2001, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

Mr. K. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

Mr. Bill R. Morris
Director - Rates
Piedmont Natural Gas Company
PO Box 33068
Charlotte, NC 28233

Mr. Paul C. Gibson
Vice President - Rates
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Pat Murphy

Pat Murphy

COMPLIANCE AUDIT REPORT
OF

NASHVILLE GAS COMPANY'S
INCENTIVE PLAN ACCOUNT

Docket No. 00-00759

PREPARED BY

TENNESSEE REGULATORY AUTHORITY

ENERGY AND WATER DIVISION

APRIL, 2001

EXHIBIT A

TENNESSEE REGULATORY AUTHORITY'S
COMPLIANCE AUDIT
of
NASHVILLE GAS COMPANY'S
INCENTIVE PLAN ACCOUNT
Docket No. 00-00759

TABLE OF CONTENTS

I. INTRODUCTION

The subject of this compliance audit is the Performance Incentive Plan (hereafter "Incentive Plan" or "IPA") of Nashville Gas Company (hereafter "Nashville Gas" or the "Company"), a division of Piedmont Natural Gas Company. The objective of the audit was to determine whether the balance in the Incentive Plan Account as of June 30, 2000 was calculated in conformance with the terms of the Incentive Plan and to verify that the factors utilized in the calculations were supported by appropriate source documentation. The IPA consists of two mechanisms, which are more fully described in Section II below.

The following chart summarizes the results of the current period of the Incentive Plan, as presented in the Company's filing:

	Year Ended 6/30/00
Total Actual City Gate Purchases	$ 53,609,675
Total Annual Benchmark	$ 53,828,287
Percentage Actual Purchases to Benchmark	99.59%
Total Incentive Savings from:	
Gas Procurement	$ 271,861
Capacity Management	1,950,692
Total Incentive Savings	$ 2,223,553
Incentive Savings retained by Ratepayers:	
Gas Procurement	$ 152,088
Capacity Management	1,119,941
Total Incentive Savings to Ratepayers	$ 1,272,029
Incentive Savings retained by Company:	
Gas Procurement	$ 120,772
Capacity Management	830,751
Total Incentive Savings to Company	$ 951,523

The results of the audit indicate that during the plan year under review, the Company's calculations were in conformance with the terms of the Incentive Plan. Section III of this report further describes the actual results of the plan year and Section IV details the Staff's findings.

II. <u>BACKGROUND AND DESCRIPTION OF PERFORMANCE INCENTIVE PLAN</u>

On May 31, 1996, the Tennessee Public Service Commission (hereafter the "TPSC"), the predecessor to the Tennessee Regulatory Authority (hereafter the "Authority" or "TRA"), issued an Order in Docket Number 96-00805 approving the Incentive Plan on an experimental basis for Nashville Gas. The specific details of the Incentive Plan were included in Nashville Gas' Service Schedule No. 14 tariff entitled <u>Performance Incentive Plan</u>, which was issued on April 22, 1996, and was effective July 1, 1996. A copy of this tariff is attached to the report as <u>Attachment 1</u>.

The experimental period began July 1, 1996, and ended June 30, 1998. On March 31, 1998, the Company filed an Application for Extension of the Performance Incentive Plan, which would allow the plan to continue on an annual basis. The Authority issued an Order on March 11, 1999, authorizing the Company to continue under a modified Incentive Plan. The Incentive Plan automatically rolls over for an additional plan year on each July 1st, beginning July 1, 1998, and continues until the Incentive Plan is either (a) terminated at the end of a plan year by not less than 90 days notice by Nashville Gas to the Authority or (b) modified, amended or terminated by the Authority.

The Incentive Plan consists of two mechanisms: (1) the Gas Procurement Mechanism, and (2) the Capacity Management Mechanism. Under the Gas Procurement Mechanism, Nashville Gas retains 50% of the savings on gas purchased below 99% of a pre-determined index. Should the Company purchase gas above 101% of the same pre-determined index, the Company is penalized for 50% of the excess. The Capacity Management Mechanism is tied to the Company's total annual demand cost and the sharing ratio is a sliding scale, with Nashville Gas earning a larger percentage with a higher level of cost savings. Interest is accrued on the outstanding monthly balance in the account using the same computation as is provided for in the Authority's Purchased Gas Adjustment Rule 1220-4-7-.03(vii). A more detailed explanation of each mechanism can be found in <u>Attachment 1</u>, the Company's Service Schedule No. 14.

III. ACTUAL PLAN YEAR RESULTS

On August 25, 2000, Nashville Gas submitted a rate adjustment to recover the balance in the Incentive Plan Account as of June 30, 2000. According to the Company filing, the Incentive Plan generated $2,223,553 in total incentive savings. Of this amount, $1,272,029 benefited the ratepayer and $951,523 was retained by Nashville Gas. Adding the -$17,941 over-recovered balance from the prior year and $24,650 in calculated monthly interest due, resulted in an **under-recovered balance** in the account at June 30, 2000 of **$958,231**. To recover this balance, the Company filed a PGA for the TRA Staff's approval to implement a $0.00580 per therm surcharge, effective November 1, 2000.

The Company was able to purchase gas at less than the benchmark during four (4) of the twelve- (12) months in the audit period. However, in only two (2) of those months was the Company able to participate in the savings generated from the Gas Procurement Mechanism. This was due to the total monthly purchases for one month being not only less than the benchmark, but also less than the lower limit of the deadband of 99%. In the other month, the purchases were not below the lower limit of the deadband. However, the Company was eligible to participate in the gain generated by Off System Sales as provided for in its Incentive Plan. In none of the months did the Company's purchases exceed 101% of the benchmark, so there were no losses to be shared. Total actual city gate purchases for the year averaged 99.59% of the total annual benchmark. Of the $272,861 in total savings under the Gas Procurement Mechanism, the Company retained $120,772.

The Capacity Management Mechanism generated a total of $1,950,692 in savings, of which $300,692 was due to off system sales and $1,650,000 was due to capacity release. The Company's total actual demand costs for the year were $12,573,481. Therefore, the Company did not participate in any savings until the savings reached $125,735 (1% of the total demand costs), as provided for in the Incentive Plan. Of the total savings, the Company retained $830,751 and $1,119,941 benefited the ratepayers.

The capacity release portion of the Capacity Management Mechanism generated significantly greater savings this plan year as compared to last year. Last year's savings was $11,510. The $1,650,000 savings for this year was the result of Nashville Gas assigning its pipeline capacity to an "asset manager". The Company provided the following summary of its Gas Asset Management Agreement to the TRA Staff.

> "Under the Gas Asset Management agreement, Nashville Gas assigns its firm pipeline transportation (capacity), storage (excluding local LNG) and supply rights to the "Asset Manager." In return for this assignment, Nashville Gas receives a lump-sum payment from the asset manager for the assignment of these rights.
>
> Nashville Gas retains the right to call on supply from the asset manager for its city gate needs consistent with its rights as they existed prior to their

assignment to the asset manager. The asset manager's lump-sum payment is for the value acquired for utilization of the released assets when they are not needed by Nashville Gas. The lump-sum payment is considered a capacity release transaction and, as such, is accounted for in the Performance Incentive Plan under the Capacity Management Incentive mechanism.

In essence, Nashville Gas and its ratepayers are "guaranteed" the up-front lump-sum payment by the asset manager, as opposed to Nashville Gas releasing capacity and entering into off-system sales transactions with third parties...."

IV. IPA FINDINGS

After review of Company's filing, the Staff noted one finding.

Exception

The Company **understated** its share of Capacity Release savings by **$4,866**. It overstated the Ratepayer's share by the same amount.

Discussion

The Incentive Plan provides for a sliding scale of the sharing percentages between the Company and the Ratepayer. The sharing percentages are based on the Company's total actual demand costs for the plan year as adjusted by any refunds or surcharges from suppliers. For this plan year, the actual costs were $12,573,481. The Company based their sharing percentages on this amount (sharing began when savings reached 1% of the demand costs or $125,735).

However, at the end of the last plan year, a Tennessee Gas Pipeline GSR (Gas Supply Realignment) refund for June 1999 was received after the close of the Incentive Plan year and not known to the Company at the time of the IPA filing. The $423,109 refund credit should have been a prior period adjustment to the total demand cost in this plan year. The effect of the adjustment was to lower the demand costs by this amount. Therefore, the 1% level at which the Company began sharing in the savings was lowered to $121,504. Total savings remained the same. However, the effect was to increase the Company's share by $4,866 and decrease the ratepayers share by the same amount.

Company Response

The Company agrees with this finding.

V. JURISDICTION OF THE TENNESSEE REGULATORY AUTHORITY

Tennessee Code Annotated (hereafter "T.C.A.") gave jurisdiction and control over public utilities to the Tennessee Regulatory Authority. T.C.A. § 65-4-104 states:

> The Authority has general supervisory and regulatory power, jurisdiction, and control over all public utilities, and also over their property, property rights, facilities, and franchises, so far as may be necessary for the purpose of carrying out the provisions of this chapter.

Further, T.C.A. § 65-4-105 grants the same power to the Authority with reference to all public utilities within its jurisdiction as chapters 3 and 5 of Title 65 of the T.C.A. has conferred on the Department of Transportation's oversight of the railroads or the Department of Safety's oversight of transportation companies. By virtue of T.C.A. § 65-3-108, said power includes the right to audit:

> The department is given full power to examine the books and papers of the said companies, and to examine, under oath, the officers, agents, and employees of said companies...to procure the necessary information to intelligently and justly discharge their duties and carry out the provisions of this chapter and chapter 5 of this title.

The Authority's Energy and Water Division is responsible for auditing those companies under the Division's jurisdiction to insure that each company is abiding by the rules and regulations of the TRA. This audit was performed by Pat Murphy of the Energy and Water Division.

ATTACHMENT 1

SERVICE SCHEDULE NO. 14
Performance Incentive Plan

APPLICABILITY
The Performance Incentive Plan (the plan) replaces the reasonableness or prudence review of Nashville Gas Company's (Nashville or Company) gas purchasing activities overseen by the Tennessee Regulatory Authority (Authority). The plan is designed to provide incentives to Nashville in a manner that will produce rewards for its customers and its shareholders and improvements in Nashville's gas procurement activities. Each plan year will begin July 1. The annual provisions and filings herein would apply to this annual period. The Plan will continue until the Plan is either (a) terminated at the end of a plan year by not less than 90 days notice by Nashville to the Authority or (b) the Plan is modified, amended or terminated by the Authority.

OVERVIEW OF STRUCTURE
Nashville's Performance Incentive Plan is comprised of two interrelated components.

- Gas Procurement Incentive Mechanism
- Capacity Management Incentive Mechanism

The Gas Procurement Incentive Mechanism establishes a predefined benchmark index to which Nashville's commodity cost of gas is compared. It also addresses the recovery of gas supply reservation fees, the treatment of off-system sales and wholesale interstate sale for resale transactions, and the use of financial or private contracts in managing gas costs. The net incentive benefits or costs will be shared between the Company's customers and the Company on a 50% / 50% basis.

The Capacity Management Incentive Mechanism is designed to encourage Nashville to actively market off-peak unutilized transportation and storage capacity on upstream pipelines in the secondary market. The net incentive benefits or costs will be shared between the Company's customers and the Company utilizing a graduated sharing formula, with sharing percentages for Nashville ranging between zero and fifty percent.

The Company is subject to a cap on overall incentive gains or losses of $1.6 million annually. In connection with the Performance Incentive Plan, Nashville shall file with the Authority Staff, and update each year a Three Year Supply Plan. Nashville will obtain additional firm capacity and/or gas supply pursuant to such plan.

GAS PROCUREMENT INCENTIVE MECHANISM
The Gas Procurement Incentive Mechanism addresses the following areas:

- Commodity Costs
- Gas Supply Reservation Fees
- Off-System Sales and Sale for Resale Transactions
- Use of Financial Instruments or Other Private Contracts

COMMODITY COSTS

Each month Nashville will compare its *total city gate commodity cost of gas*[1] to a benchmark dollar amount. The benchmark gas cost will be computed by multiplying total actual purchase quantities for the month by a price index. The monthly price index is defined as

$$I = F_f(P_0K_0+P_1K_1+P_cK_c+...P_\propto K_\propto)+F_oO+F_dD; \text{ where}$$

$$F_f+F_o+F_d = 1; \text{ and}$$

I = the monthly city gate commodity gas cost index.

F_f = the fraction of gas supplies purchased in the first-of-the-month market which are transported to the city gate under Nashville's FT service agreements.

P = the *Inside FERC Gas Market Report* price index for the first-of-the-month edition for a geographic pricing region, where subscript 0 denotes Tennessee Gas Pipeline (TGP) Rate Zone 0; subscript 1 denotes TGP Rate Zone 1; subscript C denotes Columbia Gas Transmission (CGT), Louisiana, plus applicable transportation and fuel charges in CGT's FT tariff to Rayne, and subscript $\propto$ denotes new incremental firm services to which Nashville may

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1 Gas purchases under Nashville's existing supply contract on the Tetco system are excluded from the incentive mechanism. Nashville will continue to recover 100 percent of these costs through its PGA with no profit or loss potential. Extension or replacement of such contract shall be subject to the same competitive bidding procedures that will apply to other firm gas supply agreements. In addition, Nashville's gas procurement incentive mechanism will measure storage gas supplies against the benchmark index during the months such quantities are purchased for injection. For purposes of comparing such gas purchase costs against the monthly city gate index price, Nashville will exclude any commodity costs incurred downstream of the city gate to storage so that Nashville's actual costs and the benchmark index are calculated on the same basis.

subscribe in the future.[2] The commodity index prices will be adjusted to include the appropriate pipeline maximum firm transportation (FT) commodity transportation charges and fuel retention to the city gate under Nashville's FT service agreements.

K = the fraction (relative to total maximum daily contract entitlement) of Nashville's total firm transportation capacity under contract in a geographic pricing region, where the subscripts are as above.[3]

F_o = the fraction of gas supplies purchased in the first-of-the-month spot market which are delivered to Nashville's system using transportation arrangements other than Nashville's FT contracts.

O = the weighted average of *Inside FERC Gas Market Report* first-of-the-month price indices, plus applicable maximum IT rates and fuel retention, from the source of the gas to the city gate, where the weights are computed based on actual purchases of gas supplies purchased by Nashville and delivered to Nashville's system using transportation arrangements other than Nashville's FT contracts.

F_d = the fraction of gas supplies purchased in the daily spot market.

D = the weighted average of daily average index commodity prices taken from *Gas Daily* for the appropriate geographic pricing regions, where the weights are computed based on actual purchases made during the month. The commodity index prices will be adjusted to include the appropriate maximum transportation commodity charges and fuel retention to the city gate.

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2 To the extent that Nashville renegotiates existing reservation fee supply contracts or executes new reservation fee supply contracts with commodity pricing provisions at a discount to the first-of-the-month price index, Nashville shall modify the monthly commodity price index to reflect such discount.

3 Because the aggregate maximum daily contract quantities in Nashville's FT contract portfolio vary by month over the course of the year, the weights will be recalculated each month to reflect actual contract demand quantities for such month. The contract weights, and potentially the price indices used, will also vary as Nashville renegotiates existing or adds new FT contracts. As new contracts are negotiated, Nashville shall modify the index to reflect actual contract demand quantities and the commodity price indices appropriate for the supply regions reached by such FT agreements.

If the actual total commodity gas purchase cost in a month is within one percent of the benchmark dollar amount, there will be no incentive gains or losses. If the actual total commodity gas purchase cost varies from the benchmark dollar allowance by more than one percent, the variance in excess of the one percent threshold shall be deemed incentive gains or losses under the plan. Such gains or losses will be shared 50/50 between the Company and the ratepayers.

Gas Supply Reservation Fees

Nashville will continue to recover 100% of gas supply reservation fee costs through its PGA with no profit or loss potential. For new contracts and/or contracts subject to renegotiation during the Plan year, Nashville will solicit bids for gas supply contracts containing a reservation fee.

Off-System Sales And Sale For Resale Transactions

Margin on off-system sales and wholesale sale-for-resale transactions using Nashville's firm transportation and capacity entitlements (the costs of which are recovered from Nashville's ratepayers) shall be credited to the commodity gas cost component of the Gas Procurement Incentive Mechanism and will be shared with ratepayers. Margin on such sales will be defined as the difference between the sales proceeds and the total variable costs incurred by Nashville in connection with the transaction, including transportation and gas costs, taxes, fuel, or other costs. For purposes of gas costs, Nashville will impute such costs for its related supply purchases at the benchmark first-of-the-month or daily index, as appropriate, on the pipeline and in the zone in which the sale takes place. The difference between Nashville's actual costs and such index price is taken into account under the Gas Procurement Incentive Mechanism. As to transportation costs, Nashville will impute such costs up to the transporting pipeline's maximum interruptible transportation (IT) rate. The difference between the maximum IT rate and Nashville's actual transportation commodity costs will be treated as capacity release margin under the Capacity Management Incentive Mechanism. After deducting the total transaction costs from the sales proceeds, any remaining margin will be credited to commodity gas costs and shared on a 50/50 basis with ratepayers.

Use Of Financial Instruments Or Other Private Contracts

To the extent Nashville uses futures contracts, financial derivative products, storage swap arrangements, or other private agreements to hedge, manage or reduce gas costs, any gains or losses will flow through the commodity cost component of the Gas Procurement Incentive Mechanism.

CAPACITY MANAGEMENT INCENTIVE MECHANISM

To the extent Nashville is able to release transportation or storage capacity, or generate transportation or storage margin associated with off-system or wholesale sales-for-resale, the associated cost savings shall be shared by Nashville and customers according to the following sharing formula:

Capacity Management Incentive cost savings as a percent of Nashville's annual transportation and storage demand costs.	**Sharing percentages Nashville/Customers. (Percent)**
Less than or equal to 1 percent	0/100
Greater than 1 percent but less than or equal to 2 percent	10/90
Greater than 2 percent but less than or equal to 3 percent	25/75
Greater than 3 percent	50/50

The sharing percentages shall be determined based on the actual demand costs incurred by Nashville (exclusive of credits for capacity release) for transportation and storage capacity during the plan year, as such costs may be adjusted due to refunds or surcharges from pipeline and storage suppliers. Any incentive gains or losses resulting from adjustments to the sharing percentages caused by refunds or surcharges shall be recorded in the current Incentive Plan Account (IPA).

DETERMINATION OF SHARED SAVINGS

Each month during the term of plan, Nashville will compute any gains or losses in accordance with the plan. If Nashville earns a gain, a separate Incentive Plan Account (IPA) will be debited with such gain. If Nashville incurs a loss, that same IPA will be credited with such loss. During a plan year, Nashville will be limited to overall gains or losses totaling $1.6 million. Interest shall be computed on balances in the IPA using the same interest rate and methods as used in Nashville's Actual Cost Adjustment (ACA) account. The offsetting entries to IPA gains or losses will be recorded to income or expense, as appropriate. At its option, however, Nashville may temporarily record any monthly gains in a non-regulatory deferred credit balance sheet account until results for the entire plan year are available.

Gains or losses accruing to the Company under the Plan will form the basis for a rate increment or decrement to be filed and placed into effect separate from any other rate adjustments to recover or refund such amount over a prospective twelve-month period.

Each year, effective November 1, the rates for all customers, excluding interruptible transportation customers who receive no direct benefit from any gas cost reductions resulting from the plan, will be increased or decreased by a separate rate increment or decrement designed to amortize the collection or refund of the June 30 IPA balance over the succeeding twelve month period. The increment or decrement will be established by dividing the June 30 IPA balance by the appropriate volumetric billing determinants for the twelve months ended June 30. During the twelve month amortization period, the amount collected or refunded each month will be computed by multiplying the billed volumetric determinants for such month by the increment or decrement, as applicable. The product will be credited or debited to the IPA, as appropriate. The balance in the IPA will be tracked as a separate collection mechanism.

FILING WITH THE AUTHORITY

The Company will file calculations of shared savings and shared costs quarterly with the Authority not later than 60 days after the end of each interim fiscal quarter and will file an annual report not later than 60 days following the end of each plan year. Unless the Authority provides written notification to the Company within 180 days of such reports, the Incentive Plan Account shall be deemed in compliance with the provisions of this Service Schedule.

PERIODIC INDEX REVISIONS

Because of changes in the natural gas marketplace, the price indices utilized by the Company, and the composition of the Company's purchased gas portfolio may change. The Company shall, within 30 days of identifying a change to a significant component of the mechanism, provide notice of such change to the Authority. Unless the Authority provides written justification to the Company within 30 days of such notice, the price indices shall be deemed approved as proposed by the Company.

GAS SUPPLY INCENTIVE COMPENSATION PROGRAM

The Company has in place a Gas Supply Incentive Compensation Program (the Program) designed to provide incentive compensation to selected Gas Supply non-executive employees involved in the implementation of the Nashville Incentive Plan and Secondary Marketing Programs in a manner consistent with the benefits achieved for customers and shareholders through improvements in gas procurement and secondary marketing activities. Participants in the program receive incentive compensation as recognition for their contribution to the customers and shareholders of the Company through lower gas costs and gains related thereto. Performance measures are established for the Program each year.

During the time this tariff is in effect, the Company will continue to have in place the Gas Supply Incentive Compensation Program, as detailed to the Authority, as it relates to the Nashville Incentive Plan. The Company will advise the Authority in writing of any changes to the Program, and unless the Company is advised within 60 days, said changes will become effective. No filing for prior approval is required for changes in the performance measures.