BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

July 15, 2004

IN RE:	)	
	)	
APPLICATION OF NASHVILLE GAS COMPANY, A DIVISION OF PIEDMONT NATURAL GAS COMPANY, INC. FOR AN ADJUSTMENT OF ITS RATES AND CHARGES, THE APPROVAL OF REVISED TARIFFS AND THE APPROVAL OF REVISED SERVICE REGULATIONS	)	**DOCKET NO. 03-00313**

ORDER APPROVING RATE INCREASE AND RATE DESIGN AND APPROVING RATES FILED BY NASHVILLE GAS COMPANY

This matter came before Director Pat Miller, Director Sara Kyle, and Director Ron Jones, of the Tennessee Regulatory Authority ("Authority" or "TRA"), the voting panel assigned to this docket, at a regularly scheduled Authority Conference held on September 22, 2003, for consideration of the *Application of Nashville Gas Company, a Division of Piedmont Natural Gas Company, Inc. for an Adjustment of its Rates and Charges, For Approval of Revised Tariffs and Approval of Revised Service Regulations* ("*Application*") filed on April 29, 2003. As more fully described herein, and for the reasons set forth below, the panel voted unanimously to grant the request of Nashville Gas Company ("NGC" or the "Company") to increase its rates. Additionally, a majority of the panel voted to approve a rate design implementing the increased rates.

<u>BACKGROUND</u>

<u>NGC's *Application*</u>

NGC filed its *Application* together with a proposed tariff for a rate increase on April 29, 2003. In the *Application*, NGC requested that it be allowed to earn an overall rate of return of ten and twenty-three one hundredths percent (10.23%) and a twelve and six-tenths percent (12.6%) return on equity during the attrition year ending October 31, 2004. The Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate" or the "CAPD") filed a petition to intervene on May 14, 2003. In support of its *Application*, NGC filed sworn testimony, together with exhibits, of the following witnesses: Thomas E. Skains, President and Chief Executive Officer of Piedmont Natural Gas Company; Chuck Fleenor, Vice President of Planning and Rates of Piedmont Natural Gas Company; Bill R. Morris, Director of Corporate Planning and Corporate Development of Piedmont Natural Gas Company; David Carpenter, Director of Rates of Piedmont Natural Gas Company; and Donald A. Murry, Economist with C. H. Guernsey & Company, Oklahoma City, Oklahoma.

NGC's *Application* was considered at a regularly scheduled Authority Conference held on June 2, 2003, at which time the panel voted unanimously to suspend NGC's proposed tariff, convene a contested case, grant the intervention of the Consumer Advocate, and appoint Director Pat Miller as the Hearing Officer in this proceeding for the purpose of preparing this matter for hearing. The Hearing Officer conducted a Status Conference on June 17, 2003 and thereafter, by way of an order issued on June 18, 2003, established a procedural schedule for discovery and the filing of testimony and set this matter for hearing on September 9 and 10, 2003.

On June 26, 2003 NGC filed a letter revising and amending the Service Regulations previously filed as part of their *Application*. On August 1, 2003 Associated Valley Industries, Inc. ("AVI") filed a petition to intervene. On August 7, 2003 NGC filed a request to modify the procedural schedule without modifying the hearing dates set by the Hearing Officer's June 18, 2003 order. On August 8, 2003 the Hearing Officer issued an order modifying the procedural schedule as requested and maintaining the September 9 and 10, 2003 hearing dates. A separate Notice of the September 9 and 10, 2003 hearing dates was also issued on August 8, 2003. On August 13, 2003 the Hearing Officer issued an order granting AVI's petition to intervene.[1] Thereafter NGC and the Consumer Advocate conducted discovery in the form of interrogatories and requests for production of documents pursuant to the Hearing Officer's procedural schedule.

A Status Conference was held on September 8, 2003. During the Status Conference, counsel for NGC and the Consumer Advocate confirmed that they had reached a tentative settlement of the case and were in the process of reducing the settlement to a written agreement. Thereafter counsel for the parties requested that the Hearing begin at 3:00 p.m. the next day rather than at 9:00 a.m. as originally scheduled. The Hearing Officer granted the parties' request and rescheduled the Hearing to begin at 3:00 p.m. on September 9, 2003.

The Hearing

This matter came before the panel of Directors for Hearing on September 9, 2003. Participating in the Hearing were the following parties and their respective attorneys:

[1] AVI was served copies of all filings in this docket but did not actively participate in this docket

> **Nashville Gas Company, a Division of Piedmont Natural Gas Company, Inc.** – R. Dale Grimes, Esq., Bass, Berry & Sims, PLC, AmSouth Center, Suite 2700, 315 Deaderick Street, Nashville, Tennessee 37238 and James H. Jeffries IV, Esq. and Jerry Amos, Esq., Nelson, Mullins, Riley & Scarborough, L.L.P., Bank of America Corporate Center, Suite 2400, 100 North Tryon Street, Charlotte, North Carolina 28202;
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> **Consumer Advocate and Protection Division** – Timothy C. Phillips, Esq. and Joe A. Shirley, Esq., Office of the Attorney General, P.O. Box 20207, Nashville, Tennessee 37202.

AVI did not participate in the Hearing.

During the Hearing counsel for the parties submitted the *Stipulation*, reflecting the settlement agreement of the parties, for the consideration of the panel. The *Stipulation* was also filed in the docket file on September 9, 2003. The *Stipulation* contained the following language:

> The parties to this settlement have engaged in substantial discovery and have undertaken extensive discussions to resolve all known disputed issues in this case. In addition, the Staff of the Authority has engaged in discovery. As a result of the information obtained during discovery and the discussions between the Company and the CAPD, the parties to this stipulation have agreed to adjustments to revenues, expenses, net operating income, net operating income for return, rate base and return on rate base. These adjustments reduce the Company's additional revenue requirements from $18,315,475 to $10,300,000. The Staff of the Tennessee Regulatory Authority has identified certain adjustments which the parties agree are included in the $10,300,000 settlement amount.
>
> The parties agree that the adjustments referred to [above] include the following: (a) reduction to correct meter reading errors in the test period; (b) increase to include uncollectibles expense; (c) reduction to correct accumulated depreciation; (d) increase to include gas odorant costs; (e) decrease to remove certain consulting fees; (f) increase to reflect additional coverage and cost of directors and officers liability insurance; (g) decrease to reduce pension expense to reflect updated pension contributions; (h) increase to recognize new rate for state excise taxes; (i) decrease to reflect lower carrying charges for gas inventory; (j) decrease to eliminate short-term incentive bonus; and (k) decrease to eliminate GTI funding. The elimination of GTI funding from expenses in this case is not intended to prevent the Company from making contributions to GTI.

> The parties were unable to reach an agreement as to various capital structure, cost of capital and rate of return issues; however, the parties agree that the increase of $10,300,000 results in reasonable rates.
>
> The parties to this settlement jointly recommend to the Authority that the Authority issue an order authorizing the Company: (a) to increase its rates to produce additional revenues of $10,300,000 effective November 1, 2003; (b) to implement the revised rates attached hereto as Schedule I effective November 1, 2003; (c) to use the fixed gas costs set forth on Schedule II attached hereto in future true-ups of gas costs under the Company's Purchase Gas Adjustment (PGA); (d) to use the "R" values, base load factors and heat factors set forth on Schedule III attached hereto in future rate adjustments under the Company's Weather Normalization Adjustment (WNA); (e) to implement the revised tariffs attached hereto as Schedule IV effective November 1, 2003; and (f) to implement, effective November 1, 2003, the revised Service Regulations filed with the Authority on April 29, 2003, as amended by letter filing of June 26, 2003.
>
> The parties hereto agree that the revised rates and tariffs agreed to herein are fair and reasonable to all customer classes and will provide the Company with a reasonable opportunity to recover the agreed upon additional operating revenue requirement and a reasonable rate of return on investment. The parties further agree as follows: (a) the Company's rate base is $259,859,927; (b) the Company's existing rates will permit it to earn an operating income of $15,602,432; (c) to earn a reasonable return on its investment, the Company should be permitted to earn an operating income of $21,880,206; (d) unless changed, the Company's existing rates will cause the Company to have an operating income deficiency of $6,277,774; (e) the gross revenue conversion factor is 1.640709; (f) the revenue deficiency is $10,300,000 ($6,277,774 x 1.640709); and (g) the fair rate of return on investment is within the range of 8.0% to 9.0%.

At the outset of the Hearing, the attorneys for the parties each expressed their respective clients' support for the *Stipulation*. After hearing from the parties, the Directors voted unanimously to continue the Hearing until September 22, 2003 at which time the panel would deliberate the merits of the *Stipulation* following the regularly scheduled Authority Conference.

After the September 9, 2003 Hearing, and prior to the resumption of the Hearing on September 22, 2003, the Consumer Advocate and NGC filed responses to data requests regarding the *Stipulation* issued by the Authority.[2]

The panel reconvened on September 22, 2003 and deliberated the merits of the *Stipulation*. Thereafter the panel voted unanimously to approve the requested rate increase as modified by the *Stipulation*. A majority of the Directors voted to approve the rate design set forth in the *Stipulation*.[3]

Criteria For Establishing Just And Reasonable Rates

The Authority considers Applications for a rate increase, filed pursuant to Tenn. Code Ann. § 65-5-203, in light of the following criteria:

1. The investment or rate base upon which the utility should be permitted to earn a fair rate of return;
2. The proper level of revenues for the utility;
3. The proper level of expenses for the utility; and
4. The rate of return the utility should earn.

[2] *See* Letter from William H Novak, Chief, Energy and Water Division to R Dale Grimes, Esq , Counsel for Piedmont Natural Gas Company, Mr Bill Morris, Director of Corporate Planning & Development; and Timothy Phillips, Esq , Assistant Attorney General, Office of the Attorney General, Consumer Advocate Division (September 11, 2003). Letter from Ron Jones, Director, Tennessee Regulatory Authority to R Dale Grimes, Esq., Counsel for Piedmont Natural Gas Company; Mr Bill Morris, Director of Corporate Planning & Development, and Timothy Phillips, Esq., Assistant Attorney General, Office of the Attorney General, Consumer Advocate Division (September 12, 2003). *Response to TRA Data Request Dated September 11, 2003* (September 15, 2003). *Response to TRA Data Request Dated September 12, 2003* (September 16, 2003) Letter from James H Jeffries IV to Pat Miller, Director, Tennessee Regulatory Authority (September 16, 2003). Letter from James H Jeffries IV to Ron Jones, Director, Tennessee Regulatory Authority (September 16, 2003) (There are two letters from James H. Jeffries IV addressed to Director Ron Jones and filed on September 16, 2003 responding to separate data requests)

[3] Director Jones declined to vote with the majority with regard to the rate design portion of the *Stipulation* Director Jones could not find any basis in the *Stipulation* for dividing the residential class into two different classes that did not exist prior to the filing of the *Stipulation* or with one class bearing more of the demand reallocation than another and no part of the demand reallocation being placed on special contract customers *See* Transcript of Proceedings, p 71 (September 22, 2003)

Findings and Conclusions

After reviewing the record, including all exhibits, the TRA makes the following findings and conclusions.

Test Period

The objective of selecting a test period is to obtain financial data and adjust it as necessary to reflect the inter-relationship of revenues, expenses and investment expected to occur in the immediate future. In this case, the Company selected the twelve months ended December 31, 2002, as the historical test period and made two levels of adjustments. The first adjustment normalizes the test year and the second adjusts the normalized year to arrive at the forecast for the attrition year, which is the twelve months ending October 31, 2004. The *Stipulation* between the parties as to this issue is adopted. The TRA therefore finds that this attrition period will allow the Company the opportunity to earn a fair rate of return on its investment.

Rate Base

The parties stipulated as to a rate base for the attrition year in the amount of $259,859,927, as detailed below. The TRA finds that the rate base in this case has been adjusted to reflect the investment and expenses of the Company for the attrition year test period and therefore is proper and should give the Company the opportunity to earn a fair rate of return on its investment to which it is entitled.

Additions:	
Utility Plant in Service	$468,507,509
Construction Work in Progress	6,536,531
Working Capital	12,201,210
Total Additions	**$487,245,250**

Deductions:	
Accumulated Depreciation	$199,411,506
Accumulated Deferred Income Taxes	23,313,096
Customer Advances for Construction	187,175
Contributions in Aid of Construction	4,473,546
Total Deductions	**$227,385,323**
Rate Base	**$259,859,927**

Revenues and Expenses

The parties have stipulated to certain facts which were obtained by their review and investigation of the Company's books and records for the purposes of this case. The parties agree that the net operating income at present rates of the Company for the attrition period is $15,602,433 as detailed below. The TRA finds that the net operating income in this case has been adjusted to reflect the appropriate attrition period level of revenues and expenses necessary for continued utility operations.

Revenues:	
Sales and Transportation of Gas	$195,481,680
Less Gas Cost	115,869,340
Net Sale and Transportation of Gas	$79,612,340
Other Revenues	1,814,896
Total Net Revenues	**$81,427,236**
Expenses:	
Salaries and Wages	$17,721,485
Distribution Expense	5,062,890
Uncollectible Accounts Expense	850,872
Customer Relations Expense	657,174
Administrative and General Expense	10,526,781
Interest on Customer Deposits	232,103
Miscellaneous Expense	38,184
Depreciation & Amortization Expense	18,232,156
Taxes Other Than Income	8,938,625
State Excise Tax	678,624
Federal Income Tax	3,233,982
Total Expenses	**$66,172,876**
Allowance for Funds Used During Construction	$348,073
Net Operating Income	**$15,602,433**

Fair Rate of Return

In reaching a decision on a rate of return, the Authority must conduct an in-depth analysis and give proper consideration to numerous factors, such as capital structure, cost of capital and changes which can reasonably be anticipated in the foreseeable future. The Authority has the obligation to make this determination based upon the controlling legal standard set forth in the landmark cases of *Bluefield Water Works and Improvement Company v. Public Service Commission of the State of West Virginia*[4] and *Federal Power Commission v. Hope Natural Gas Company,*[5] which have been specifically relied upon by the Tennessee Supreme Court.[6]

In the *Bluefield* case, the United States Supreme Court stated:

> 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 risk and uncertainties; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable 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.[7]

Later, in the *Hope* case, the United States Supreme Court refined these guidelines, holding that:

> 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

[4] *Bluefield Water Works and Improvement Company v Public Service Commission of the State of West Virginia,* 262 U.S. 679, 43 S Ct 675 (1923)
[5] *Federal Power Commission v Hope Natural Gas Company,* 320 U S 591, 64 S. Ct. 281 (1944)
[6] *Southern Bell Telephone & Telegraph Co v Public Service Commission,* 304 S W 2d 640, 647 (Tenn 1957)
[7] *Bluefield Water Works and Improvement Company v Public Service Commission of the State of West Virginia,* 262 U S 679, 692-93, 43 S Ct 675, 679 (1923)

> 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.[8]

The parties for this case, and this case only, have agreed on a capital structure and cost that produces an overall rate of return for the Company of 8.42% without providing detail as to the specific structural components of this return. The TRA finds that this return is fair and reasonable and meets the tests of the *Bluefield* and *Hope* cases.

Revenue Deficiency

Based upon the rate base, net operating income, and fair rate of return agreed to by the parties, the revenue deficiency for this case is calculated to be $10,300,000 as shown below. This revenue deficiency calculation was agreed to by each of the parties. The TRA finds that the Company needs additional annual revenues in the amount of $10,300,000 in order to earn a fair return on its investment during the attrition year.

Rate Base	$259,859,927
Fair Rate of Return	8.42%
Required Net Operating Income	**$21,880,207**
Current Net Operating Income	15,602,433
Net Operating Income Deficiency	$6,277,774
Revenue Conversion Factor	1.640709
Net Revenue Deficiency	**$10,300,000**

[8] *Federal Power Commission v Hope Natural Gas Company*, 320 U.S. 591, 603, 64 S. Ct. 281, 288 (1944)

Rate Design

The parties stipulated to a rate design that will produce additional revenues of approximately $10,300,000 as shown on **Attachment A** to this Order. Based upon a review of the rate design set forth in **Attachment A**, the testimony and exhibits of the parties that were filed in this matter prior to the filing of the stipulated rate design, and the record as a whole, a majority of the panel finds that this rate design is just and reasonable and meets the standards set out in Tenn. Code Ann. § 65-5-203(a).

	Present Net Revenues	**Rate Increase %**	**Rate Increase**
Residential	$51,021,291	16.51%	$7,229,179
Commercial	28,974,173	5.44%	1,494,901
Industrial	8,820,079	18.62%	1,384,350
Special Contract	752,415	0.00%	0
Sale for Resale	169,200	6.19%	9,867
Other	2,129,609	10.92%	209,635
Total	**$91,866,767**	**12.67%**	**$10,327,932**
Revenue Deficiency			10,300,000
Difference			**$27,932**

Tariff and Service Regulation Changes

The parties have also stipulated to changes other than rates in the Company's tariff. Specifically, the parties have agreed on language to segment residential customers into one of two categories: a Standard Rate or low base usage category, and a Value Rate or high base load usage category. In addition, the parties have also agreed on language to segment commercial customers into one of four categories: a Low Usage Standard Rate, a Low Usage Value Rate, a Medium Usage Standard Rate and a Medium Usage Value Rate. These changes are also outlined in **Attachment A** to this Order.

In addition, the parties have agreed on tariff language to change the reconnection fee from a year-round rate of $50 to a seasonal design of $85 for reconnections during the time period from September through January and $55 for reconnections during the time period from February through August.

Finally, the parties have agreed on language for changes in the Company's service line policy. Under the current service line policy, the Company will extend its service lines for one hundred (100) feet from the main to the customer's premise at no additional charge if the customer agrees to use natural gas for one major appliance, and install an additional fifty (50) feet at no cost for each additional natural gas appliance. The new language eliminates the provision of installing an additional fifty (50) feet and replaces it with language stating that the additional service line will be installed at no cost only if the anticipated load from the additional appliance provides a reasonable return to the Company.

The Authority finds that these tariff changes are just and reasonable and meet the standards set out in Tenn.Code Ann. § 65-5-203(a).

<u>Fixed Demand Cost Reallocation</u>

Although not part of the base rates established in this case, the parties have stipulated to an allocation of fixed demand costs that the Company will recover through the purchased gas adjustment ("PGA") process as shown on **Attachment A** to this Order. The TRA finds that this fixed demand cost allocation is just and reasonable and meets the standards set out in Tenn. Code Ann. § 65-5-203(a).

Weather Normalization Adjustment

The parties have stipulated to use the "R" values, base load factors, and heat factors as set out below in future rate adjustments under the Company's Weather Normalization Adjustment.[9] The TRA finds that these factors are just and reasonable and meet the standards set out in Tenn. Code Ann. § 65-5-203(a).

	"R" Value ($/Therm)	Heat Sensitivity Factor (Therms/DDD)	Base Factor (Therms/month)
Residential:			
Standard Rate	$0.32000	$0.15957	$3.915640
Value Rate	0.32000	0.21337	23.086530
Commercial:			
Rate 302			
All Usage	0.35400	0.79247	0.675169
Rate 332			
First 2,000 Therms	0.35400	0.51840	486.221100
Over 2,000 Therms	0.35400	0.51840	486.221100
Rate 352			
All Usage	0.35400	17.6718	2229.587600
Rate 362			
First 5,000 Therms	0.35400	5.36775	6229.705300
Over 5,000 Therms	0.35400	5.36775	6229.705300

[9] These values and factors are defined in Service Schedule No 315 of the Weather Normalization Adjustment Rider in NGC's tariff which is on file with the Authority

IT IS THEREFORE ORDERED THAT:

1. The *Application of Nashville Gas Company, a Division of Piedmont Natural Gas Company, Inc. for an Adjustment of its Rates and Charges, For Approval of Revised Tariffs and Approval of Revised Service Regulations,* as modified by the *Stipulation,* is approved based on the Authority's determination that a rate increase is warranted and that NGC is entitled to a rate increase of $10,300,000.

2. The rate design set forth in **Attachment A** to this Order shall be used to allocate the approved $10,300,000 rate increase.

3. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration with the Authority within fifteen (15) days from the date of this Order.

4. Any party aggrieved by the Authority's decision in this matter has the right of judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty (60) days from the date of this Order.

Pat Miller, Director

Sara Kyle, Director

Ron Jones, Director[10]

[10] Director Jones voted with the panel on the issue of the rate increase but did not vote with the majority on the issue of rate design

ATTACHMENT A

	Base Rate	Demand Rate
Residential		
Value Tariff (Rate 301)		
Winter Monthly Customer Charge	$13.0000	
Summer Monthly Customer Charge	10.0000	
Winter Volumetric Charge (per Therm)	0.3200	$0.02200
Summer Volumetric Charge (per Therm)	0.2700	0.01002
Standard Tariff (Rate 321)		
Winter Monthly Customer Charge	$13.0000	
Summer Monthly Customer Charge	10.0000	
Winter Volumetric Charge (per Therm)	0.3200	$0.05994
Summer Volumetric Charge (per Therm)	0.2700	0.01001
Commerical		
SGS Value Tariff (Rate 332)		
Monthly Customer Charge	$29.0000	
Winter – 1st 2000 Therms	0.3540	$0.02200
Winter – Over 2000 Therms	0.3540	0.01100
Summer – 1st 2000 Therms	0.3030	0.01500
Summer – Over 2000 Therms	0.3030	0.00750
SGS Standard Tariff (Rate 302)		
Monthly Customer Charge	$29.0000	
Winter Volumetric Charge (per Therm)	0.3540	$0.05994
Summer Volumetric Charge (per Therm)	0.3030	0.01000
MGS Value Tariff (Rate 362)		
Monthly Customer Charge	$75.0000	
Winter – 1st 5000 Therms	0.3540	$0.02200
Winter – Over 5000 Therms	0.3540	0.01100
Summer – 1st 5000 Therms	0.3030	0.01500
Summer – Over 5000 Therms	0.3030	0.00750
MGS Standard Tariff (Rate 352)		
Monthly Customer Charge	$75.0000	
Winter Volumetric Charge (per Therm)	0.3540	$0.02200
Summer Volumetric Charge (per Therm)	0.3030	0.01100

	Base Rate	Demand Rate
Industrial		
Industrial Sales (Rate 303)		
Customer Charge	$300.0000	
Demand Charge	8.0000	$0.54409
1st 15000 Therms	0.9742	0.00300
Next 25000 Therms	0.8953	0.00200
Next 50000 Therms	0.6450	0.00120
Over 90000 Therms	0.2764	0.00000
Industrial Transportation (Rate 313)		
Customer Charge	$300.0000	
Demand Charge	8.0000	$0.54409
1st 15000 Therms	0.9742	0.00300
Next 25000 Therms	0.8953	0.00200
Next 50000 Therms	0.6450	0.00120
Over 90000 Therms	0.2764	0.00000
Interruptible Sales (Rate 304)		
Customer Charge	$300.0000	
1st 15000 Therms	0.9742	$0.04500
Next 25000 Therms	0.8953	0.02000
Next 50000 Therms	0.6450	0.01500
Over 90000 Therms	0.2764	0.01000
Interruptible Transportation (Rate 314)		
Customer Charge	$300.0000	
1st 15000 Therms	0.9742	$0.00300
Next 25000 Therms	0.8953	0.00200
Next 50000 Therms	0.6450	0.00120
Over 90000 Therms	0.2764	0.00000
Special Contract	Set by Order	$0.09200
Sale for Resale (Rate 310)		
Demand	$8.0000	$0.54409
Commodity	0.9000	0.00171