Nelson
Mullins

Nelson Mullins Riley & Scarborough LLP
Attorneys and Counselors at Law
100 North Tryon Street / 24th Floor / Charlotte, North Carolina 28202-4000
Tel 704 417 3000 Fax 704 377 4814
www nelsonmullins com

James H Jeffries IV
Partner
Direct Dial 704 417 3103
Direct Fax 704 417 3014
Jim Jeffries@nelsonmullins com

June 17, 2004

VIA HAND-DELIVERY

The Honorable Deborah Taylor Tate
Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505

Re Nashville Gas Company, a Division of Piedmont Natural Gas Company, Inc
Incentive Plan Account (IPA) Audit -- Docket No. 03-00489

Dear Chairman Tate

By Notices of Filing issued on May 5, 2004 and May 17, 2004 in the above-captioned proceeding, the Tennessee Regulatory Authority ("Authority") directed Nashville Gas Company ("Nashville Gas" or "Company") to file, on or before June 17, 2004, a proposal to remedy weaknesses in the IPA practices identified as Findings #1 and #2 in the Staff's IPA Audit report ("Staff Report") as well as information relating to certain other specified issues raised in the Staff Report.

Since the date of these notices, Nashville Gas has carefully examined the concerns identified in the Staff Report and has met with representatives of the Staff in order to better understand Staff's concerns As a result of this process, Nashville Gas hereby makes the following proposals to modify the way in which it executes its Incentive Plan, in order to address concerns raised by Staff in this proceeding.

ASSET MANAGEMENT REQUEST FOR PROPOSAL PROCESS

In its report, Staff raised several concerns about the processes utilized by Nashville Gas in its "Request for Proposal" or "RFP" process with respect to Asset Management arrangements. Specifically, these concerns related to the Company's failure to archive the lists of parties that received RFPs during the review period, the Company's acceptance of verbal bids, and the Company's use of a non-public RFP process As a result of these concerns, Staff asked to be given some degree of direct supervisory authority over the RFP process going forward. In its April 8, 2004 *Response to the Energy and Water Division's Incentive Plan Account Audit Report* ("Response"), Nashville Gas explained the reasons underlying its review period RFP practices and asserted that there was no evidence of any ratepayer harm or improper activity by the Company associated with the Staff's audit concerns or any need for direct Staff supervision over the RFP process. Nashville Gas continues to believe that this is the case. In further examining the issues raised by Staff, however, Nashville Gas has concluded that certain modifications to its internal processes can and should be taken in order to improve the transparency of its RFP processes on a going forward basis

First, Nashville Gas will immediately implement an archival process designed to ensure that lists of all future Asset Management RFP recipients are maintained for subsequent audit and review by the Staff.

Second, on a going forward basis, Nashville Gas will require that all Asset Management bids be documented in writing, either before or after they are made, in order to ensure that the Staff has a complete audit trail of the RFP bid process.

Third, on a going forward basis, Nashville Gas will publish an annual notice in Gas Daily, or a similar national industry publication, informing the public of the fact that Nashville Gas periodically engages in Asset Management transactions for its Tennessee capacity pursuant to an RFP process and providing notice of who to contact at the Company to seek participation in that process

These changes are calculated to address the concerns raised by Staff in their Report in a direct and efficient manner In light of these modifications to the Company's Asset Management RFP processes, Nashville Gas does not believe that any direct Staff supervision over its RFP process is appropriate or necessary in this instance for the reasons set forth in Nashville Gas' April 8, 2004 Response.

RECORDS RETENTION

The Staff Report also noted, with respect to its concerns over RFP documentation, that Nashville Gas was obligated to comply with the NARUC document retention standards Nashville Gas has reviewed this assertion and agrees with Staff's conclusion Accordingly, Nashville Gas will hereafter comply with the NARUC document retention standards

WHOLESALE PRICE INDEX RELIABILITY

The Staff Report questioned the reliability of existing wholesale price indices based on concerns over the potential for price manipulation and a recent history of problems with those indices. In its Response, Nashville Gas acknowledged that the reliability of these indices had been a subject of both industry and regulatory concern for the last several years but that both the industry as a whole and the Federal Energy Regulatory Commission ("FERC") in particular were actively involved in regulating those indices to ensure the integrity of the prices reported This regulatory activity by FERC has continued since the date of Nashville Gas' April 8, 2004 Response to include issuance of a FERC Staff Report on price index reliability and an Order on Rehearing by FERC on its regulations adopted to ensure the integrity of reporting to these indices Based upon FERC's active and ongoing regulation of price reporting to these indices, Nashville Gas recommends that the TRA not take any action on this subject at this time but continue to monitor FERC's activities and the state of the market in general Based on conversations with Staff, it is Nashville Gas' understanding that Staff does not disagree with this approach

RESERVE CAPACITY MARGIN

The Staff Report raised an issue regarding the reasonable level of "excess capacity" maintained by Nashville Gas as part of its supply and capacity portfolio In its April 8, 2004 Response, Nashville Gas explained the derivation of its current supply and capacity arrangements and indicated that the Company was actually short of long-term firm interstate pipeline capacity needed to serve its Tennessee customers and was in the process of procuring additional capacity. In further considering Staff's concerns, Nashville Gas believes that it would be appropriate to share more information with Staff regarding the Company's calculation of its gas supply and capacity needs, including its reserve capacity margin calculation, on a regular basis In order to accomplish this goal, Nashville Gas will hereafter provide Staff with information utilized by the Company to determine its current and future needs in conjunction with the annual three year supply plan review process Based on conversations with Staff, Nashville Gas believes that this approach is acceptable to Staff.

INCLUSION OF ASSET MANAGEMENT FEES UNDER THE INCENTIVE PLAN

The Staff Report also questioned whether Asset Management fees should be included under the Incentive Plan Account. Nashville Gas has carefully reviewed this contention and concludes that these fees should be included in the Incentive Plan Account. As is set out in greater detail in the Company's April 8, 2004 Response, Asset Management fees fall within the description of savings properly included in the Incentive Plan Account, have been treated as such by both the Authority and Staff for several years, and represent a substantial benefit to ratepayers. Further, and contrary to Staff's assumptions, the Company has not been relieved of any of its material duties with respect to the day-to-day and month-to-month management of its capacity, including capacity available for release, as a result of Asset Management arrangements. In short, the inclusion of Asset Management fees as savings under the Incentive Plan Account is consistent with the purpose of the plan, has been highly beneficial to ratepayers, and presents no risk of any kind to ratepayers or the Company In light of these facts, Nashville Gas respectfully contends that there is no rational basis to change the treatment of these fees in this proceeding To the extent that Staff's concern is that Nashville Gas' Incentive Plan tariff does not contain an express reference to "Asset Management fees", Nashville Gas would be willing to clarify its tariff to include such a reference if such action is deemed appropriate by the Authority

UTILIZATION OF OUTSIDE CONSULTANT

Finally, the Staff Report asserted that due to the complexity of Incentive Plan Audits, a consultant should be hired to assist with those audits In its April 8, 2004 Response, the Company questioned whether such additional expertise is necessary if the audit is properly limited to the purpose of determining whether the Incentive Plan Account balance is correctly calculated. In further conversations with Staff, they have clarified that they are short on the manpower needed to conduct Incentive Plan Account audits and that their intention in the Staff Report was to propose that the costs of such a consultant be funded through an adjustment through the ACA account rather than from the Company. Nashville Gas has considered Staff's recommendation and has the following comments First, Nashville Gas has no direct knowledge of the Staff's ability to meet the demands of Incentive Plan Account audits without outside help, although the Company continues to believe that the scope of those audits should be fairly narrow. Second, even if the Staff's request is fully justified, Nashville Gas has no way to unilaterally implement the Staff's suggestion to fund outside consultants through the ACA.

Only the Authority can order such a mechanism and Nashville views this suggestion as a matter between Staff and the Authority Finally, and in light of the persistently high price of natural gas, Nashville Gas does have some concerns over any changes in practice which would result in a net increase to the price paid for natural gas service by end-users in Tennessee.

Thank you for your consideration of this response If you have any further questions regarding Nashville Gas' position on these matters, you may reach me at the number shown above.

Please accept the original and 14 copies of this letter for filing and return one file-stamped copy to me in the enclosed envelope

Sincerely,

James H. Jeffries IV
by RDG

James H Jeffries IV

JHJ/srl

c: Mr Randal Gilliam
Mr Richard Collier
Mr Dale Grimes
Mr David Carpenter