GEORGE H MASTERSON
TEL (615) 742-6263
FAX (615) 742-2763
gmasterson@bassberry corn

BASS, BERRY & SIMS PLC
A PROFESSIONAL LIMITED LIABILITY COMPANY
ATTORNEYS AT LAW

AMSOUTH CENTER
315 DEADERICK STREET, SUITE 2700
NASHVILLE, TN 37238-3001
(615) 742-6200

www.bassberry.com

OTHER OFFICES
...VILLE MUSIC RO...
MEMPHIS

RECEIVED
2005 MAY 26 ...
TRA DOCKET ROOM

May 26,2005

VIA HAND-DELIVERY TO:

Chairman Pat Miller
c/o Sharla Dillon, Docket Manager
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. 04-00290.***

Dear Chairman Miller:

Enclosed please find the onginal and thirteen (13) copies of Nashville Gas Company's Response to the Staffs Reply to be filed in the above-referenced docket on behalf of our client, Nashville Gas Company, a division of Piedmont Natural Gas Company, Inc. Also enclosed is an additional copy, which I would appreciate your stamping as "filed," and returnıng to me by way of our courier.

Should you have any questions with respect to this filing, please do not hesitate to contact me.

With kindest regards, I remain

Very truly yours,

George H. Mastersdn

GHM/tn
Enclosures

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
NASHVILLE GAS COMPANY, A	)	
DIVISION OF PIEDMONT NATURAL	)	**DOCKET NO. 04-00290**
GAS COMPANY, INC. INCENTIVE	)	
PLAN ACCOUNT (IPA) AUDIT	)	

NASHVILLE GAS COMPANY'S RESPONSE TO THE STAFF'S REPLY

Nashville Gas Company, a division of Piedmont Natural Gas Company, Inc. ("Nashville Gas" or the 'Company"), respectfully submits the following response to the May 18, 2005 *Staff Reply to Nashville Gas Company's Response to the Utilities Division's Incentive Plan Account Audit Report* ("Staff Reply") in the above-captioned docket. This response is filed to address a new issue raised by Staff's Reply. That issue involves Staff's contention that the maximum ratepayer/shareholder sharing ratio applicable to capacity management savings under Nashville Gas' approved Incentive Plan ("Incentive Plan" or "Plan") is not in conformance with capacity release sharing ratios in effect in the other two states where Piedmont Natural Gas Company, Inc. provides regulated natural gas service. While Staff's Reply accurately identifies the fact that the capacity release sharing ratios applicable to the Company in North and South Carolina differ from the Capacity Management Incentive Mechanism sharing arrangements applicable under the Company's approved Tennessee Incentive Plan, Staff does not disclose or discuss the context of those ratios or the fundamental differences between gas cost recovery mechanisms in the Carolinas and Tennessee that justify such a differential. The purpose of this pleading is to disclose the differences between how gas costs are recovered by the Company in Tennessee and the Carolinas in order to ensure the Authority is fully informed in reaching its decision in this matter

I. THE ALLOCATION OF RISK BETWEEN RATEPAYERS AND THE COMPANY IS FUNDAMENTALLY DIFFERENT IN TENNESSEE THAN IN THE CAROLINAS AND JUSTIFIES A DIFFERENT SHARING RATIO.

Staff's Reply asserts that the maximum sharing ratio in effect under Nashville Gas' approved Incentive Plan in Tennessee is not consistent with the capacity release sharing ratios in effect for the Company in North and South Carolina and that this provides a basis for modification of the Tennessee sharing ratio. This argument is flawed, however, because it presumes that the gas cost recovery mechanisms in effect in North and South Carolina are comparable to the Company's Tennessee Incentive Plan when they are not. To the contrary, there are a number of differences between the Tennessee Incentive Plan and the gas cost recovery mechanisms in place in the Carolinas which support a higher sharing ratio under the Tennessee Plan.

First, under the Tennessee Incentive Plan Nashville Gas bears the risk that it will not be able to beat the Incentive Plan's benchmark parameters. In such event, the Company and its shareholders would be forced to absorb up to 50% of the losses associated with such failure thereby giving the Company substantial downside risk under the Plan. Given the more than $150 million in annual commodity costs incurred to serve Tennessee customers during 2004, this risk to Nashville Gas is significant. In both North Carolina and South Carolina, however, the Company is allowed to recover 100% of its prudently incurred gas costs.[1] Under this standard, so long as the Company is not negligent, it has no downside risk associated with its gas and capacity procurement activities.

Second, the variation in Company's sharing percentages between Tennessee and the Carolinas.are reflective of the risk differential cited above. In the Carolinas, the 25% sharing factor is meant solely to incent the Company to engage in secondary market/capacity release type transactions. These transactions do not present any affirmative risk of loss to the Company or its shareholders. In Tennessee, however, where the Company bears a substantial risk under its Incentive Plan, the maximum sharing factor is higher in order to accommodate that risk. This differential is entirely rational and justified under the circumstances.

Third, and based upon historical performance, the actual sharing percentage of Plan savings between Nashville Gas and its customers is closer to 60/40 in favor of ratepayers rather than the 50/50 ratio cited by Staff. This is reflected by the approximate figure of $17 million in aggregate Plan savings reflected in Staff's Reply, of which approximately $10 million has been returned to Tennessee ratepayers.[2] While Staff is correct that the maximum Plan sharing ratio under the Capacity Management Incentive Mechanism is 50/50 once savings or costs exceed 3% of annual transportation and storage demand costs, the sharing ratios are much less favorable to the Company below the 3% level. Further, any savings under the Capacity Management Incentive Mechanism must be combined with any savings or losses obtained under the Gas Procurement Incentive Mechanism before being credited to the Company and its ratepayers.

Fourth, the Company's sharing percentages under the Tennessee Incentive Plan are both graduated and capped as a means to protect Tennessee ratepayers whereas customers in North Carolina and South Carolina do not have such protections. Under the Tennessee Plan, Nashville Gas' ability to share in savings from capacity release transactions (including asset management transactions) is graduated in nature. Under the Plan, sharing for the Company begins at zero for savings equal to or lesser than 1% of the Company's total annual transportation and storage demand costs, goes to 10% for savings between 1% and 2% of demand costs, increases to 25% for savings between 2% and 3% of annual demand costs and does not reach 50% until savings exceed 3% of total annual demand costs. As a result of the graduated nature of the Company's Incentive Plan, Tennessee customers actually achieve higher savings than Carolina customers at savings levels at or below 4.5% of total annual

---

[1] See N.C. Gen. Stat. § 62-133.4

[2] Year to date 2005 results indicate a Customer/Company sharing ratio of approximately 65/35 under the

demand costs.[3] Further, any savings achieved above $1.6 million in Tennessee are allocated 100% to Tennessee ratepayers whereas the 25% sharing allocations in both North Carolina and South Carolina are open-ended.

In short, the risks to the Company and its shareholders under the Tennessee Incentive Plan are fundamentally different from the risks associated with the gas cost recovery mechanisms in effect in North and South Carolina. Further, the relative benefits to customers and the Company under these plans vary significantly depending on the underlying facts. **As** a general statement, the risk to the Company is materially higher in Tennessee than it is in the Carolinas. Notwithstanding this fact, the Tennessee Plan is more favorable to customers in many circumstances than the mechanisms approved in North and South Carolina. The only time this is not the case is when Plan savings from capacity release type arrangements exceed approximately 4.5%' of annual transportation and storage demand costs and aggregate uncapped savings shared by the Company under the Plan are equal to or less than $1.6 million. Given the variety of results possible under the Tennessee Plan and the gas cost recovery mechanisms in effect in North and South Carolina, Nashville Gas contends that it is a significant under-simplification to conclude that the Tennessee Plan needs to be revised solely on the grounds 'that the maximum sharing percentage available under the Capacity Management Incentive Mechanism of that Plan under prescribed circumstances is higher than the capacity release sharing percentage under existing gas cost recovery mechanisms in effect in North and South Carolina.

II. THE INCENTIVE PLAN RESULTS ABOUT WHICH STAFF IS CONCERNED ARE WITHIN THE EXPRESSLY APPROVED PLAN PARAMETERS.

One troubling aspect of the Staff's position in this docket with respect to the suggestion that sharing percentages may need to be adjusted is that the results about which Staff expresses concern fall squarely within the anticipated (and approved) Plan parameters. In

---

Tennessee Incentive Plan.

essence, the Staff's concerns appear to be a challenge to those parameters rather than a challenge to the Company's compliance with the Plan. These parameters have been thoroughly reviewed and approved by both the TRA and its predecessor in multiple prior proceedings. Staff now appears to contend that these parameters are wrong or at least that the addition of asset management fees may raise a question as to their continuing propriety. These contentions appear to be based on Staff's subjective judgment that the recent levels of savings achieved by the Company under the Plan (even though consistent with the approved Plan) are too high. Where the levels of savings achieved fall squarely within the parameters of Nashville Gas' approved Incentive Plan, however, the Company can only interpret Staff's conclusion as a collateral attack on the substantive terms of the Plan itself. In the absence of evidence that the Plan is operating in a manner contrary to the public interest or that the Plan is operating beyond its approved parameters, then re-examination of the Plan parameters would not appear to be either justified or in the nature of an "audit" issue. If any re-examination occurs, then any modifications must be applied on a prospective basis only.

CONCLUSION

For the reasons set forth above, Nashville Gas respectfully requests that the Authority accept this response to the Staff's Reply and approve the continuation of Nashville Gas' Performance Incentive Plan in accordance with its tariff and/or with the revised Service Schedule No. 316 previously submitted in this Docket.

This the 26th day of May, 2005.

George Masterson

R. Dale Grimes
George Masterson

ATTORNEYS FOR NASHVILLE GAS COMPANY

---

[3] **See attached Table** 1.

OF COUNSEL:

Bass, Berry & Sims PLC
315 Deaderick Street
Suite 2700
Nashville, Tennessee 37238-3001
Telephone: 615-742-6244

James H. Jeffries IV by Bear Worth w/permission

dames H. Jeffries IV

ATTORNEY FOR NASHVILLE GAS COMPANY

OF COUNSEL:

Moore &.Van Allen PLLC
Bank of America Corporate Center
100 N. Tryon Street, Suite 4700
Charlotte, North Carolina 28202-4003
Telephone: 704-331-1079

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of NASHVILLE GAS COMPANY'S RESPONSE TO THE STAFF'S REPLY was served upon the parties in this action by facsimile transmission and/or hand-delivery addressed as follows:

Mr. Randal Gilliam
Staff Attorney
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505

This the 24th day of May, 2005.

George Masterson

TABLE 1

Ratepayer Allocated Savings Comparison for Capacity Release/Capacity Management Transactions

Assuming $10,000,000 in annual Transportation and Storage Demand Charges.

Savings Capacity Transactions	Achieved Release	Through Type	Ratepayer NC/SC	Allocation Shanng	Under Mechanism	Ratepayer Tennessee	Allocation Shanng	Under Mechanism
% of demand costs saved	Savings $	Aggregate Savings $	Ratepayer Shanng	Shanng $	Cumulative $	Ratepayer Shanng	Sharing $	Cumulative $
‘0-1%	$100,000	$100,000	75%	$75,000	$75,000	100%	$100,000	$100,000
1-2%	$100,000	$200.000	75%	$75.000	$150.000	90%	$90.000	$190.000
2-3%	$100,000	$300,000	75%	$75,000	$225,000	75%	$75,000	$265,000
3-4%	$100,000	$400,000	75%	$75,000	$300,000	50%	$50,000	$315,000
4-5%	$100,000	$500,000	75%	$75,000	$375,000	50%	$50,000	$365,000