BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

May 31,2005

IN RE:	)	
	)	
NASHVILLE GAS COMPANY, a Division of	)	**Docket No. 04-00290**
PIEDMONT NATURAL GAS COMPANY	)	
INCENTIVE PLAN ACCOUNT (IPA) AUDIT	)	

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

The Audit Staff of the Utilities Division ("the Staff') submits the comments below in response to Nashville Gas Company's ("Nashville Gas" or "the Company") May 27, 2005 Response to the Staffs Reply, which was filed in this docket on May 18, 2005. This'purpose of this reply is to address certain assertions made by the Company in its response.

DISCUSSION

Nashville Gas Company's response of May 27, 2005 seeks to justify the sharing ratios contained in its Capacity Management Incentive Mechanism, specifically as they relate to the asset management agreement. The response was prompted by the Staffs reference to the Company's sharing arrangements in North and South Carolina.[1] Staff made no attempt in its reply to compare plans among the states. Staff merely pointed out the omission made by the Company when referencing its asset management agreements

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[1] Staff Reply to Nashville Gas Company's Response to the Utilities Division's Incentive Plan Account Audit Report, page 6.

in other states' as support for including the agreement in Tennessee under the current Incentive Plan terms.[3] Staff would point to the fact that other state commissions have evaluated the asset management arrangement and made a determination of Piedmont's proper share of any proceeds realized from these agreements. To date, Tennessee, specifically the TRA, has not examined asset management agreements in the context of Nashville Gas' Incentive Plan and made its own determination. Staffs overall objective is and has been to ensure that customers are treated fairly under the Company's Incentive Plan.

The Company emphasizes that its risk in Tennessee is different from its risk in North and South Carolina. Nashville Gas has reported its risk level under the asset management agreement as anywhere from "no risk" to a "substantial risk", depending upon' which statements by Staff it is attempting to rebut. In Docket 03-00489, the Company stated "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." [Emphasis added][4] In its latest response in this docket, the Company states that "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 nsk." [Emphasis added]'

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[2] Docket 03-00489, Nashville Gas Company's Response to the Energy and Water Division's Incentive Plan Account Audit Reuort, page 8, footnote 10
[3] Nashville Gas Company, Service Schedule No 316, Performance Incentive Plan, pages 5 and 6
[4] Company letter addressed to Chairman Tate, dated June 17,2004, page 3
[5] Nashville Gas Company's Response to the Staffs Reply, page 3

Staff would note that the "substantial risk" the Company refers to is misleading. The nsk descnbed by Nashville Gas is relative to the Gas Procurement Incentive Mechanism, not the Capacity Management Incentive Mechanism. The risk related to the Gas Procurement Incentive Mechanism does not affect the Capacity Management Incentive Mechanism.[6] While the sharing percentages under the Capacity Management Incentive Mechanism are graduated based on the Company's total demand costs, those demand costs are reimbursed 100% by customers under the Actual Cost Adjustment.[7] Therefore, Staff contends that the risk associated with the Gas Procurement Incentive Mechanism is <u>not relevant</u> to the discussion regarding the asset management agreement.

CONCLUSION

It is readily apparent that Nashville Gas has mitigated any risk to the Company under the Capacity Management Incentive Mechanism by outsourcing the capacity management function. The asset management agreement is a transaction that was not contemplated at the time Nashville's Incentive Plan was crafted. The asset management agreement has never been examined by the Authority. The asset management agreement may be treated differently in different jurisdictions. The TRA should have the opportunity to look at the whole picture before rendering its decision regarding the terms

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[6] The <u>Gas Procurement Incentive Mechanism</u> relates to the Company's purchase of the "gas commodity itself' The Company is reimbursed 100% of the gas commodity costs and pipeline demand and capacity costs by its customers under the Actual Cost Adjustment Benchmark parameters based on national commodity indexes have been established to measure any incentive gams or losses. The Company is entitled to keep 50% of any gains (savings) below the benchmark, but is also requıred to share 50% of any losses above the benchmark Hence, the nsk associated wıth this mechanism.
The <u>Capacıty Management Incentive Mechanism</u> relates to the management of an "asset" The capacity, storage, and transportation contracts held by Nashville Gas on the ınterstate pipelines represent marketable assets, that can be released on a temporary basis to other parties for a fee The monıes obtained by release of capacity under the Capacity Management Incentive Mechanism are subject to sharıng between the Company and the customers on a sliding scale The reimbursement received from an asset manager (under the terms of the current plan) increases Nashville's percentage to approachmg 50% and virtually guarantees that the Company wıll reach its cap of $1 6 mıllıon, wıth very little effort

of the Company's Incentive Plan as applied to an asset management agreement. For these reasons, Staff respectfully asks the Authority to address the treatment of these types of agreements in a separate docket.

Respectfully submitted,

Pat Murphy

Pat Murphy
Manager of Energy and Water
Utilities Division

[7] Nashville Gas Company, Service Schedule No. 316, Performance Incentive Plan, page 4

:ERT 'E OF SERVICE

I hereby certify that a copy of the foregoing was served as indicated on the person **or** persons listed below on ay 31 2005

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