

RECEIVED

2009 APR -3 PM 1:47

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

T.R.A. DOCKET ROOM

April 3, 2009

IN RE:)
)
PIEDMONT NATURAL GAS COMPANY) **Docket No. 08-00164**
INCENTIVE PLAN ACCOUNT (IPA) AUDIT)

**NOTICE OF FILING BY UTILITIES DIVISION OF
THE TENNESSEE REGULATORY AUTHORITY**


Pursuant to Tenn. Code Ann. §§ 65-4-104, 65-4-111 and 65-3-108, the Utilities Division of the Tennessee Regulatory Authority hereby gives notice of its filing of the Piedmont Natural 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 Piedmont Natural Gas Company's (hereafter the "Company") IPA for the year ended June 30, 2008.
2. The Company's IPA filing was received on September 4, 2008, and the Audit Staff (hereafter the "Staff") completed its audit of same on April 1, 2009. There were no material audit findings.
3. As provided for in the Company's Service Schedule No. 316 (Performance Incentive Plan), Staff notified Piedmont of its intent to extend the 180-day audit deadline

by forty-eight (48) days to April 20, 2009, to allow Staff time to review Company responses to outstanding data requests.

4. The Utilities Division hereby files its Report attached as Exhibit A with the Tennessee Regulatory Authority for deposit as a public record and approval of the findings and recommendations contained therein.

Respectfully Submitted:


Pat Murphy, Manager
Utilities Division of the
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of April 2009, 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:

Eddie Roberson
Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

Mr. David Carpenter
Director-Rates
Piedmont Natural Gas Company
P.O. Box 33068
Charlotte, NC 28233

Ms. Jenny Furr
Manager – Regulatory Reporting
Piedmont Natural Gas Company
PO Box 33068
Charlotte, NC 28233

James H. Jeffries IV Esq.
Attorney at Law
Moore & Van Allen PLLC
Suite 4700
100 North Tryon Street
Charlotte, NC 28202-4003

Timothy Phillips
Senior Counsel
Office of the Attorney General
Consumer Advocate and Protection Division
P.O. Box 20207
Nashville, TN 37202-0207


Pat Murphy

COMPLIANCE AUDIT REPORT
OF

PIEDMONT NATURAL GAS COMPANY'S
INCENTIVE PLAN ACCOUNT

Docket No. 08-00164

PREPARED BY

TENNESSEE REGULATORY AUTHORITY

UTILITIES DIVISION

APRIL 2009

EXHIBIT A

**TENNESSEE REGULATORY AUTHORITY'S
COMPLIANCE AUDIT
of
PIEDMONT NATURAL GAS COMPANY'S
INCENTIVE PLAN ACCOUNT
Docket No. 08-00164**

TABLE OF CONTENTS

I. INTRODUCTION AND AUDIT OPINION	1
II. BACKGROUND AND DESCRIPTION OF PERFORMANCE INCENTIVE PLAN	2
III. ACTUAL PLAN YEAR RESULTS	4
IV. AUDIT SCOPE	5
V. INCENTIVE PLAN (IPA) FINDINGS	6
VI. AUDIT CONCLUSIONS AND RECOMMENDATIONS	8
VII. JURISDICTION OF TENNESSEE REGULATORY AUTHORITY	9
SERVICE SCHEDULE NO. 316	ATTACHMENT 1

I. INTRODUCTION AND AUDIT OPINION

The subject of this compliance audit is the Performance Incentive Plan (hereafter “Incentive Plan” or “IPA”) of Piedmont Natural Gas¹ (hereafter “Piedmont” or the “Company”). The TRA Audit Staff’s (“Staff”) objective in this audit was to determine whether the balance in the Incentive Plan Account as of June 30, 2008 was calculated in conformance with all terms and conditions of the Company’s Incentive Plan² and to verify that the factors utilized in the calculations were supported by appropriate source documentation. The IPA addresses sharing incentives with respect to the Company’s gas procurement and capacity management activities, which are more fully described in Section II. After reviewing the Company’s filing, Staff found no material errors. Staff therefore concludes that, during the plan year under review, the Company correctly calculated the benefits accruing to Piedmont and the ratepayer under the plan.

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

	<u>Plan Year Ended 6/30/08</u>
Total Actual City Gate Purchases	\$ <u>152,561,543</u>
Total Annual Benchmark	\$ <u>154,271,272</u>
Percentage Actual Purchases to Benchmark	98.89%
Total Incentive Savings (Losses) from:	
Gas Procurement	\$ 1,709,730
Capacity Management	<u>3,989,640</u>
<u>Total Incentive Savings</u>	\$ <u>5,699,370</u>
Incentive Savings (Losses) Retained by Ratepayers (75%):	
Gas Procurement	\$ 1,282,297
Capacity Management	<u>2,992,230</u>
<u>Total Incentive Savings to Ratepayers</u>	\$ <u>4,274,527</u>
Incentive Savings (Losses) Retained by Company (25%):³	
Gas Procurement	\$ 427,432
Capacity Management	<u>997,410</u>
<u>Total Incentive Savings to Company</u>	\$ <u>1,424,842</u>

¹ On January 23, 2008, the TRA received a letter advising that beginning in March 2008, the name of Nashville Gas Company, a Division of Piedmont Natural Gas, would be changed to Piedmont Natural Gas.

² Service Schedule No. 316, Performance Incentive Plan. (See Attachment I)

³ Piedmont is subject to a cap on overall gains or losses of \$1.6 million annually.

II. BACKGROUND AND DESCRIPTION OF PERFORMANCE INCENTIVE PLAN

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 96-00805 approving the Incentive Plan on an experimental basis for Nashville Gas Company. The specific details of the Incentive Plan were included in Nashville Gas' Service Schedule No. 14 tariff⁴ entitled Performance Incentive Plan, which was issued on April 22, 1996, and was effective July 1, 1996.

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 consisted of two mechanisms: (1) the Gas Procurement Incentive Mechanism, and (2) the Capacity Management Incentive Mechanism. Under the Gas Procurement Incentive Mechanism, Nashville Gas retained 50% of the savings on gas purchased below 99% of a pre-determined benchmark. If the Company purchased gas above 101% of the same pre-determined benchmark, the Company was penalized for 50% of the excess. The Capacity Management Incentive Mechanism was tied to the Company's total annual demand cost and the sharing ratio was a sliding scale, with Nashville Gas earning a larger percentage with a higher level of cost savings. Interest was accrued on the outstanding monthly balance in the IPA account using the same computation as is provided for in the Authority's Purchased Gas Adjustment Rule 1220-4-7-.03(vii). Total annual savings accruing to Nashville was capped at \$1.6 million.

At a regularly scheduled Authority Conference held on June 13, 2005, the panel of Directors in Docket No. 04-00290⁵ voted to open a new docket to consider issues associated with the Company's inclusion of asset management fees in its Incentive Plan. A contested case was convened in Docket No. 05-00165 on June 27, 2005. On July 7, 2005, the Consumer Advocate and Protection Division of the Attorney General's Office ("CAD") petitioned to intervene. On June 5, 2007, after extensive discussions and negotiations, the Company, CAD and TRA Audit Staff filed a joint request for approval of a proposed Settlement Agreement ("Agreement"). At the August 20, 2007 and September 24, 2007 Authority Conferences, the parties gave an oral presentation of the Agreement before the panel and answered questions. At the October 22, 2007 Authority Conference, the majority of the panel approved the Agreement as filed by the parties.

The new Service Schedule No. 316 ("new tariff") became effective July 1, 2006. This tariff replaces the old Service Schedule No. 316 ("old tariff"). The modifications and improvements to the IPA tariff include the following:

1. Eliminating varying sharing bands under the commodity and capacity management mechanisms and replacing with a straight 75%-customer/ 25%-Company sharing ratio;
2. Maintaining the overall annual incentive cap of \$1.6 million available to Piedmont;

⁴ Service Schedule No. 14 was subsequently changed to Service Schedule No. 316 in Docket No. 03-00313.

⁵ Docket No. 04-00290 contains the TRA Staff audit report of the Company's IPA for the plan year ended June 30, 2004.

3. Expanding the tariff language to expressly include asset management fees and other forms of compensation related to capacity management;
4. Adopting RFP procedures for selection of a non-affiliate asset manager;
5. Implementing a triennial review of the IPA process by an outside consultant beginning in the fall of 2008;
6. Clarifying the benchmark formula for commodity purchases to include new deliveries from Midwestern Gas Transmission; and
7. Modifying and clarifying the provisions under which hedging costs are recoverable in the Actual Cost Adjustment (“ACA”).

The audit period under review is the second reporting period governed by the new IPA tariff and the first year that includes the procurement of an outside consultant under the triennial review provision.

III. ACTUAL PLAN YEAR RESULTS

On September 4, 2008, Piedmont filed its annual IPA report. According to the Company filing, the Incentive Plan generated \$5,699,370 in total incentive savings. Of this amount, \$4,274,527 benefited the ratepayer and **\$1,424,842** was retained by Piedmont. Adding the under-recovered balance from the previous audit period and accrued interest on the monthly balances, and subtracting the surcharges recovered from customers during the audit period, resulted in an **under-recovered balance** in the IPA Account at June 30, 2008 of **\$408,488**. The Company filed a tariff effective January 1, 2009 to begin surcharging the balance in the IPA Account.

SUMMARY OF THE IPA ACCOUNT:

	<u>Piedmont Filing</u>
Un-recovered IPA Account Balance at 6/30/07	\$ 1,056,119
Plus Gas Procurement Savings Accruing to Piedmont	427,432
Plus Capacity Mgt. Savings Accruing to Piedmont	997,410
Minus Amount Recovered from Customers (7/1/07-6/30/08)	<u>2,123,009</u>
Equals IPA Balance Before Interest	\$ 357,952
Plus Interest Calculated on Monthly Balances	<u>50,536</u>
Equals IPA Account Balance at 6/30/08	<u>\$408,488</u>

IV. AUDIT SCOPE

The IPA audit is a compliance audit of the Company's Incentive Plan account.⁶ The audit goal is to verify that the Company's calculations of incentive gains and losses are materially correct,⁷ and that the Company is in compliance with all terms of its tariff and following all Authority orders and directives with respect to its calculation of the IPA account balance. Also included in this audit was the Company's PGA tariff filing to implement a customer surcharge to recover the balance in the IPA Account, effective January 1, 2009.

To accomplish the audit goal, Staff reviewed the Company's tariff, gas supply invoices, pipeline tariffs, supplemental schedules and other source documentation provided by Nashville Gas, and industry publications to verify the indexes used to calculate the benchmarks, as well as prior Staff audits and Authority Orders. Where needed, Staff issued data requests to the Company to obtain additional information to clarify the filing.

The Authority's Utilities Division is responsible for auditing those companies under the Authority'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 Utilities Division.

⁶ Service Schedule No. 316 Performance Incentive Plan.

⁷ The audit goal is not to guarantee that the Company's results are 100% correct. Where it is appropriate, Staff utilizes sampling techniques to determine whether the Company's calculations are materially correct. Material discrepancies would dictate a broadening of the scope of Staff's review.

V. INCENTIVE PLAN (IPA) FINDINGS

Staff reviewed the purchasing activities and capacity management activities of Piedmont to determine whether the Company correctly calculated the amount of gains and losses under its Incentive Plan and whether it complied fully with the terms of its tariff. Staff's audit revealed no material findings with respect to the Company's mathematical calculations. Therefore, Staff issues no monetary findings in this audit.

Staff also reviewed the Company's compliance with other terms contained in its Incentive Plan:

Three Year Supply Plan

The tariff states that "Nashville shall file with the Authority Staff, and update each year, a Three Year Supply Plan."⁸ Staff verified that Piedmont filed this supply plan with the Authority Staff on December 3, 2008.

Hedging Activities

The tariff states that "Costs related to hedging transactions may be recovered through the ACA account; provided, however, that such costs recovered through the ACA account shall not exceed one percent (1%) of total annual gas costs."⁹ Due to a late filing of the Company's January 1, 2007 – December 31, 2007 ACA filing, Staff has not yet completed the audit. This period includes six (6) months of the current incentive audit period. Staff will report on the results of 2007 in the next Incentive Plan audit report.

Gas Supply Incentive Compensation Program

The tariff states that "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."¹⁰ Through a data request to the Company, Staff confirmed that this program is still in place.

RFP Procedures for Selection of Non-affiliate Asset Managers

The tariff contains detailed procedures that the Company must follow in the selection of its non-affiliate asset manager, which were effective upon approval of the Agreement by the Authority (October 22, 2007). At the December 3, 2008 meeting between the Company, the Consumer Advocate Division, and the Authority Staff, during which the annual Three-Year Supply Plan was presented, the Company stated that it did not employ the services of an asset manager during the 2007-2008 incentive year. This decision was based on the uncertainty regarding pending FERC regulations relating to asset management relationships. FERC issued its rulemaking Order No. 712 on June 19, 2008. In lieu of an asset management agreement, Piedmont entered into two capacity release transactions with Eagle Energy. These agreements resulted in \$3,131,128 in incentive dollars to be shared between Piedmont and its customers.

⁸ Service Schedule No. 316, Performance Incentive Plan, page 1.

⁹ Service Schedule No. 316, Performance Incentive Plan, page 4.

¹⁰ Ibid.

Triennial Review by Outside Consultant

The tariff provides for a comprehensive review of the transactions and activities related to the Incentive Plan once every three years by an independent outside consultant, with the first review commencing in the fall of 2008. That process is currently under way. The Company, the Consumer Advocate and the Authority Staff have communicated on several occasions on the selection of the consultant. A list of agreed upon consultants has been established and an RFP has been drafted and approved by the three parties. The RFP was issued on March 27, 2009, with a requested response date of April 20, 2009.

VI. AUDIT CONCLUSIONS AND RECOMMENDATIONS

As a result of this audit, Staff determined that Piedmont Natural Gas has correctly calculated its share of savings under its Service Schedule No. 316 Performance Incentive Plan for the plan year ended June 30, 2008. The balance in the IPA Account as of June 30, 2008 is \$408,488. This balance will serve as the beginning balance for the next year's calculations.

The tariff provides for a comprehensive review of the transactions and activities related to the Incentive Plan by an independent consultant once every three (3) years, with the first triennial review to be conducted in the fall of 2008. The selection process for this review is currently under way.

Staff has no further recommendations at this time.

VII. 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.

ATTACHMENT 1

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

707000-5 1 2-16

IN RE:

**REVIEW OF NASHVILLE GAS
COMPANY'S IPA RELATING TO
ASSET MANAGEMENT FEES**

)
)
)
)
)

DOCKET NO. 05-00165

PROPOSED SETTLEMENT AGREEMENT

Nashville Gas Company (Nashville Gas), a division of Piedmont Natural Gas Company, Inc. (Piedmont or Company), the Audit Staff of the Tennessee Regulatory Authority (TRA Audit Staff), and Robert E. Cooper, Jr., the Tennessee Attorney General and Reporter, through the Consumer Advocate and Protection Division (Consumer Advocate or CAD) (collectively, the "Parties") hereby stipulate and agree as follows:

1. The Company conducts its natural gas distribution business in the State of Tennessee through its operating division, Nashville Gas. Nashville Gas' natural gas distribution business is subject to regulation and supervision by the Tennessee Regulatory Authority (Authority) pursuant to Chapters 4 and 5 of Title 65 of the Tennessee Code Annotated.

2. Nashville Gas has its principal offices at 665 Mainstream Drive, Nashville, Tennessee, and it is engaged in the business of furnishing natural gas to customers located in Davidson County and portions of the counties of Cheatham, Dickson, Robertson, Rutherford, Sumner, Trousdale, Williamson and Wilson and in certain incorporated towns and cities located therein.

3. On June 13, 2005, the panel of Directors assigned to TRA Docket No. 04-00290, *In re: Audit of Nashville Gas Company's Incentive Plan Account for the Plan Year Ended June 30, 2004*, ordered a new docket to be opened to consider issues associated with the Company's inclusion of asset management fees in the Incentive Plan Account (IPA). As a result, this Docket was opened on June 27, 2005, and the panel of Directors assigned to this Docket voted to convene a contested case proceeding.

4. On July 7, 2005, the CAD filed a Petition to Intervene in this Docket. By order entered on July 19, 2005, the CAD's intervention was granted.

5. The Parties have engaged in substantial discovery and have undertaken extensive discussions to resolve the disputed issues in this Docket. As a result of the information obtained during discovery and discussions among the Parties, the Parties have agreed to settle the issues pending in this Docket by stipulating to the following:

A. Effective as of July 1, 2006, the Company's Performance Incentive Plan (Service Schedule No. 316) presently in effect will be withdrawn in its entirety and replaced with the Performance Incentive Plan provided in the attached Exhibit A, which is incorporated fully herein by reference.

B. Beginning in 2008, triennial reviews will be conducted by an independent consultant pursuant to the provisions provided in the attached Exhibit B, which is incorporated fully herein by reference.

C. Effective upon approval of the Proposed Settlement Agreement by the Authority, the Company's selection of asset managers will be governed by the procedures set forth in the attached Exhibit C, which is incorporated fully herein by reference.

6. The Parties jointly recommend to the Authority that the Authority issue an order adopting this stipulation in its entirety without modification.

7. It is expressly agreed by the Parties that this stipulation shall be void and of no effect whatsoever if the Authority does not accept this Proposed Settlement Agreement in its exact form as the full and final settlement of the issues in this Docket. Any proposed modifications by the Authority shall require the written approval of the Parties before becoming effective and binding on the Parties.

8. This stipulation is the product of compromise negotiations, and no provision of this stipulation shall be binding on the Parties unless the Authority accepts the entire stipulation without modification.

9. By agreeing to this stipulation, no Party waives any right to continue litigating this matter should the stipulation be rejected, in whole or in part.

10. No provision of this stipulation shall be deemed an admission of any Party.

11. The Parties agree to support this stipulation in any proceeding before the Authority in this Docket; however, the Parties further agree and request the Authority to order that the settlement of any issue pursuant to this stipulation shall not be cited by the Parties or any other entity as binding precedent in any other proceeding before the Authority.

12. The provisions of this stipulation do not necessarily reflect the positions asserted by any Party, and no Party to this stipulation waives the right to assert any position in any future proceeding.

13. This stipulation is contingent upon implementation effective as of July 1, 2006.

14. The Parties agree to implement this stipulation in good faith and with due diligence.

The foregoing is agreed and stipulated to this 31st day of May, 2007.

PIEDMONT NATURAL GAS COMPANY, INC.

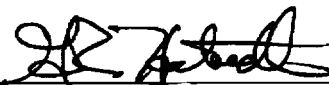
By: _____



Jane Lewis-Raymond
Vice President and General Counsel
Piedmont Natural Gas Company, Inc.
P. O. Box 33068
Charlotte, North Carolina 28233

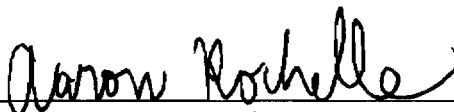
AUDIT STAFF OF THE TENNESSEE REGULATORY AUTHORITY

By: _____



Gary Hotvedt
Counsel

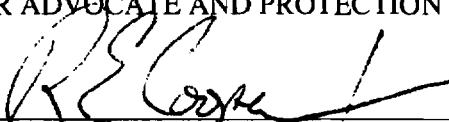
By: _____



Aaron Rochelle
Counsel
460 James Robertson Parkway
Nashville, Tennessee 37243

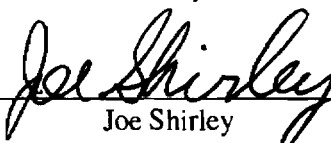
OFFICE OF THE ATTORNEY GENERAL AND REPORTER
CONSUMER ADVOCATE AND PROTECTION DIVISION

By: _____



Robert E. Cooper, Jr.
Attorney General and Reporter

By: _____



Joe Shirley
Assistant Attorney General
P.O. Box 20207
Nashville, Tennessee 37202-0207

EXHIBIT A

SERVICE SCHEDULE NO. 316

Performance Incentive Plan

Applicability

The Performance Incentive Plan (the Plan) replaces the annual reasonableness or prudence review of Nashville Gas Company's (Nashville or Company) gas purchasing activities overseen by the Tennessee Regulatory Authority (Authority or TRA). The Plan does not preclude the Authority from conducting an independent investigation into or examination of any aspect of the Plan or Nashville's conduct thereunder. The Plan is designed to provide incentives to Nashville in a manner that will produce rewards for its customers and its stockholders and improvements in the Company's gas procurement and capacity management 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 on a prospective basis.

Overview of Structure

The Plan 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 and the treatment of off-system sales and wholesale interstate sale for resale transactions. The net incentive benefits or costs will be shared between the Company's customers and the Company on a 75%-customers / 25%- stockholders basis for the Plan year commencing on July 1, 2006.

The Plan also is designed to encourage Nashville to actively market off-peak unutilized transportation and storage capacity on pipelines in the secondary market. It also addresses the sharing of asset management fees paid by asset managers, and other forms of compensation received by the Company for the release and/or utilization of Nashville's transportation and storage assets by third-parties. Nashville shall notify the TRA Staff and the Consumer Advocate and Protection Division of the Office of the Attorney General (CAD) of all "other forms of compensation" prior to inclusion of such compensation in the Plan. The net incentive benefits or costs of such activities will be shared between the Company's customers and the Company utilizing a 75%-customers / 25%-stockholders formula commencing on July 1, 2006.

Every three years the Company's activities under the Plan will be reviewed comprehensively by an independent consultant. The first triennial review shall occur in the autumn of 2008. The scope of the review may include all transactions and activities related to the Performance Incentive Plan, including, but not limited to, natural gas procurement, capacity management, storage, hedging, reserve margins, and off-system sales.

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 supply a copy to the Consumer Advocate and Protection Division of the Tennessee Attorney General (CAD), and update each year, a Three Year Supply Plan. Nashville will obtain firm capacity and/or gas supply pursuant to such plan.

Commodity Costs

Each month Nashville will compare its *total city gate commodity and 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:

$$I = F_f(P_0K_0 + P_1K_1 + P_CK_C + \dots + P_\alpha K_\alpha) + F_OO + F_dD; \text{ where} \\ F_f + F_O + F_d = 1; \text{ and}$$

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 α denotes new incremental firm services to which Nashville may subscribe in the future.² The indices used for calculating Midwestern capacity shall be those produced by Natural Gas Intelligence for monthly purchases and Gas Daily for daily purchases. 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.³

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.⁴

¹ Gas purchases associated with service provided under Texas Eastern Transmission Company Rate Schedule SCT shall be 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, the Plan 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.

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 Capacity released for a month shall be excluded from the benchmark calculation for that month, excluding capacity released under an agreement where the Company maintains city gate delivery rights for the released capacity during such month.

⁴ 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. Citygate benchmark calculations shall be computed utilizing Nashville's Design Day delivery requirements (deliveries required on a peak day).

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 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 transportation commodity charges and fuel retention to the city gate.

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 Plan 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 Plan. After deducting the total transaction costs from the sales proceeds, any remaining margin will be credited to commodity gas costs and shared with customers on a 75%- customer / 25%-stockholders basis.

Capacity Management

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 and/or asset management fees, or other forms of compensation associated with such activities, shall be shared by Nashville and customers according to the following sharing formula: 75%-customers / 25%-stockholders. Nashville shall notify the TRA Staff and the Consumer Advocate and Protection Division of the Office of the Attorney General (CAD) of all "other forms of compensation" prior to inclusion of such compensation in the Plan.

Hedging Activities

The Company may engage in hedging transactions⁵ within the PGA/ACA mechanism. Costs related to hedging transactions may be recovered through the ACA account; provided, however, that such costs recovered through the ACA account shall not exceed one percent (1%) of total annual gas costs. Costs related to hedging transactions recoverable through the ACA account shall be defined as all direct, transaction related costs arising from Nashville's prudent efforts to stabilize or hedge its commodity gas costs including, without limitation, brokerage fees, margin requirements, and the costs of financial instruments. All monthly gains and losses shall be (credited)/debited to the ACA account.

Determination of Shared Savings

Each month during the term of the 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. The Company is subject to a cap on overall incentive gains or losses of \$1.6 million annually.

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. Subject to approval by the TRA, the Company may also propose to refund positive IPA balances on an intra-year basis by making direct bill credits to all customers (except interruptible transportation customers) where such direct bill credit would be beneficial to customers.

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

⁵ Hedging transactions, as used herein, shall include but not be limited to futures contracts, financial derivative products, storage swap arrangements, or other private agreements to hedge, manage or reduce gas costs.

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 the annual reports, the Incentive Plan Account shall be deemed in compliance with the provisions of this Service Schedule. The Authority Staff may expand the time for consideration of the annual reports by up to an additional sixty (60) days upon written notification to the Company or longer by mutual agreement or upon a showing of good cause.

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 sixty (60) 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 sixty (60) 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. The Authority may expand the time for consideration of such changes upon written notification to the Company. No filing for prior approval is required for changes in the performance measures.

Triennial Review

A comprehensive review of the transactions and activities related to the Performance Incentive Plan shall be conducted by an independent consultant once every three years. The initial triennial review shall be conducted in the autumn of 2008 and subsequent triennial reviews shall be conducted every third year thereafter. The TRA Staff, the CAD, and Nashville shall make an effort to maintain a list of no less than five (5) mutually agreeable independent consultants or consulting firms qualified to conduct the aforementioned review. Any dispute concerning whether an independent consultant shall be added to the list shall be resolved by the TRA Staff, after consultation with Nashville and the CAD. For each review, the TRA Staff shall select three (3) prospective independent consultants from that list. Each such consultant shall possess the expertise necessary to conduct the review. The TRA Staff shall provide the list of prospective independent consultants to the Company and the CAD via e-mail. The Company and the CAD shall have the right, but not the obligation, to strike one (1) of the prospective

independent consultants from the list by identifying the stricken consultant in writing to the TRA Staff within thirty (30) days from the date the list is e-mailed. The TRA Staff shall select the independent consultant from those remaining on the list after the Company's and the CAD's rights to strike have expired. The cost of the review shall be reasonable in relation to its scope. Any and all relationships between the independent consultant and the Company, the TRA Staff, and/or the CAD shall be disclosed, and the independent consultant shall have had no prior relationship with either the Company, the TRA Staff, or the CAD for at least the preceding five (5) years unless the Company, the TRA Staff and the CAD agree in writing to waive this requirement. The TRA Staff, the CAD and the Company may consult amongst themselves during the selection process; provided, however, that all such communications between the parties shall be disclosed to any party not involved in such communication so that each party may participate fully in the selection process.

The scope of the triennial reviews may include all transactions and activities related either directly or indirectly to the Performance Incentive Plan as conducted by the Company or its affiliates, including, but not limited to, the following areas of transactions and activities: (a) natural gas procurement; (b) capacity management; (c) storage; (d) hedging; (e) reserve margins; and (f) off-system sales. The scope of each triennial review shall include a review of each of the foregoing matters as well as such additional matters as may be reasonably identified by the Company, the TRA Staff, or the CAD relative to the operation or results of the Performance Incentive Plan.

The Company, the TRA Staff, or the CAD may present documents and information to the independent consultant for the independent consultant's review and consideration. Copies of all such documents and information shall be presented simultaneously to the independent consultant and all other parties.

The independent consultant shall make findings of fact, as well as identify and describe areas of concern and improvement, if any, that in the consultant's opinion warrant further consideration; however, the independent consultant shall not propose changes to the structure of the Performance Incentive Plan itself. The independent consultant shall complete and issue a written report of its findings and conclusions by July 1 of the year immediately following the triennial review. The report deadline may be waived by the written consent of the TRA Staff, the Company, and the CAD.

The independent consultant shall not propose changes to the structure of the Performance Incentive Plan itself; however, the TRA Staff, the Company, or the CAD may use the report of the independent consultant as grounds for making recommendations or proposed changes to the Authority, and the TRA Staff, the Company, or the CAD may support or oppose such recommendations or proposed changes. Any proposed changes to the structure of the Performance Incentive Plan resulting from the initial triennial review or subsequent triennial reviews, whether adopted by agreement or pursuant to a ruling of the Authority, shall be implemented on a prospective basis only beginning with the incentive plan year immediately following such agreement or ruling.

The cost of the triennial reviews shall be paid initially by the Company and recovered through the ACA account. The TRA Staff may continue its annual audits of the IPA and the ACA account, and the triennial reviews shall not in any way limit the scope of such annual audits. The CAD retains all of its statutory rights, and the triennial reviews shall not in any way affect such rights.

EXHIBIT B

Independent Review of Performance Incentive Plan

The Company, the TRA Audit Staff, and the CAD stipulate and agree that a comprehensive review of the transactions and activities related to the Performance Incentive Plan shall be conducted by an independent consultant once every three years pursuant to the following provisions:

1. The initial triennial review shall be conducted in the autumn of 2008 and subsequent triennial reviews shall be conducted every third year thereafter.

2. The TRA Staff, the CAD, and the Company shall make an effort to maintain a list of no less than five (5) mutually agreeable independent consultants or consulting firms qualified to conduct the aforementioned review. Any dispute concerning whether an independent consultant shall be added to the list shall be resolved by the TRA Staff, after consultation with the Company and the CAD. For each review, the TRA Staff shall select three (3) prospective independent consultants from that list. Each such consultant shall possess the expertise necessary to conduct the review. The TRA Staff shall provide the list of prospective independent consultants to the Company and the CAD via e-mail. The Company and the CAD shall have the right, but not the obligation, to strike one (1) of the prospective independent consultants from the list by identifying the stricken consultant in writing to the TRA Staff within thirty (30) days from the date the list is e-mailed. The TRA Staff shall select the independent consultant from those remaining on the list after the Company's and the CAD's rights to strike have expired. The cost of the review shall be reasonable in relation to its scope. Any and all relationships between the independent consultant and the Company, the TRA Staff, and/or the CAD shall be disclosed, and the independent consultant shall have had no prior relationship with either the Company, the TRA Staff, or the CAD for at least the preceding five (5) years unless the Company, the TRA Staff and the CAD agree in writing to waive this requirement. The TRA Staff, the CAD and the Company may consult amongst themselves during the selection process; provided, however, that all such communications between the parties shall be disclosed to any party not involved in such communication so that each party may participate fully in the selection process.

3. The scope of the triennial reviews may include all transactions and activities related either directly or indirectly to the Performance Incentive Plan as conducted by the Company or its affiliates, including, but not limited to, the following areas of transactions and activities: (a) natural gas procurement; (b) capacity management; (c) storage; (d) hedging; (e) reserve margins; and (f) off-system sales. The scope of the triennial reviews may be comprehensive, including, but not limited to, review of the acquisition and utilization of all storage, capacity, transportation, and commodity assets and services.

4. The scope of each triennial review shall include a review of each of the foregoing matters, as well as such additional matters as may be reasonably identified by the Company, the TRA Staff, or the CAD relative to the operation or results of the Performance Incentive Plan.

5. Notwithstanding provision number 4, above, the scope of the initial triennial review shall include, but may not be limited to, the following:

A. The independent consultant shall identify Piedmont's city gates for Nashville (the points and measuring stations at which Piedmont receives natural gas from each pipeline transmission company) and identify the meters measuring the amount of gas flowing into Piedmont's system in Nashville.

B. For each day of the review period and for each city gate, Piedmont shall provide the independent consultant with records Piedmont has received from the pipeline, as well as records in Piedmont's possession, where such records identify and otherwise display the daily amount of gas flowing into each Piedmont city gate in Nashville. Within this amount, any gas flowing into Piedmont's system for firm transportation customers on Rate Schedule 313, interruptible transportation customers on Rate Schedule 314, and industrial interruptible customers on Rate Schedule 304 shall be identified so that the remaining amount shall be presumed to be the gas flowing to meet customers' needs in the following rate classes:

Residential Value Rate Schedule 301
Residential Standard Rate Schedule 321
Small General Standard Rate Schedule 302
Small General Value Rate Schedule 332
Medium General Standard Rate Schedule 352
Medium. General Value Rate Schedule 362
Industrial Firm Rate Schedule 303.

C. The independent consultant shall examine the levels of peak and non-peak, as well as design day and non-design day, firm capacity under Piedmont's pipeline contracts and assess whether such capacity levels are reasonably appropriate in light of both actual and projected demand requirements.

D. The independent consultant shall compare the transportation commodity costs charged to customers with such costs charged under Piedmont's pipeline contracts and report such costs charged to customers and such costs charged under Piedmont's pipeline contracts.

E. The independent consultant shall examine and report on (1) how Piedmont forecasts its design day demand and its peak day demand; (2) Piedmont's forecast of peak demand for Nashville; and (3) actual peak demand as metered at Nashville's city gates.

F. Where Piedmont has firm transportation contracts provided under different tariffs from the same pipeline, the independent consultant shall examine and report on the transportation commodity costs for each such tariff as well as the relationship between such tariff transportation commodity costs and the transportation commodity costs billed to Nashville ratepayers.

G. The independent consultant shall examine and report on:

- (1) The cost of year-round firm transportation and seasonal firm transportation that Piedmont is using to meet peak demand; and
- (2) The potential cost of meeting peak demand with more seasonal firm transportation and less year-round firm transportation; and
- (3) The potential cost of meeting peak demand with more year-round firm transportation and less seasonal firm transportation.

H. The independent consultant shall examine and report on how Piedmont's forecasts of peak demand include the effects of energy conservation and improved efficiency for natural gas appliances that are mandated by federal legislation.

I. For each month of the review period, Piedmont shall provide the independent consultant with the number of therms billed to each rate schedule:

Residential Value Rate Schedule 301
Residential Standard Rate Schedule 321
Small General Standard Rate Schedule 302
Small General Value Rate Schedule 332
Medium General Standard Rate Schedule 352
Medium General Value Rate Schedule 362
Industrial Firm Rate Schedule 303
Firm Transportation Rate Schedule 313
Interruptible Transportation Rate Schedule 314
Industrial Interruptible Rate Schedule 304
Resale Service Rate Schedule 310

6. The Company, the TRA Staff, or the CAD may present documents and information to the independent consultant for the independent consultant's review and consideration. Copies of all such documents and information shall be presented simultaneously to the independent consultant and all other parties.

7. The independent consultant shall make findings of fact, as well as identify and describe areas of concern and improvement, if any, that in the consultant's opinion warrant further consideration; however, the independent consultant shall not propose changes to the structure of the Performance Incentive Plan itself.

8. The independent consultant shall complete and issue a written report of its findings and conclusions by July 1 of the year immediately following the triennial review. The report deadline may be waived by the written consent of all the Parties.

9. The independent consultant shall not propose changes to the structure of the Performance Incentive Plan itself; however, any Party may use the report of the independent consultant as grounds for making recommendations or proposed changes to the Authority, and any other Party may support or oppose such recommendations or proposed changes.

10. Any proposed changes to the structure of the Performance Incentive Plan resulting from the initial triennial review or subsequent triennial reviews, whether adopted by agreement of the Parties or pursuant to a ruling of the Authority, shall be implemented on a prospective basis only beginning with the incentive plan year immediately following such agreement or ruling.

11. The cost of the triennial reviews shall be paid initially by the Company and recovered through the ACA account.

12. The TRA Staff may continue its annual audits of the IPA and the ACA account and the triennial reviews shall not in any way limit the scope of such annual audits. The CAD retains all of its statutory rights, and the triennial reviews shall not in any way affect such rights.

EXHIBIT C

RFP Procedures for Selection of Non-affiliate Asset Managers

The Company, the TRA Audit Staff, and the CAD stipulate and agree that effective upon approval of the Proposed Settlement Agreement by the Authority, the Company's selection of non-affiliate asset managers shall be governed by the following procedures:

1. In each instance in which the Company intends to engage in asset management type transactions for assets regulated by the Tennessee Regulatory Authority, the Company shall develop a written request for proposal (RFP) defining the Company's assets to be managed and detailing the Company's minimum service requirements. The RFP shall also describe the content requirements of the bid proposals and shall include procedures for submission of the bid proposals, and evaluation of the bid proposals.

2. The RFP shall be noticed/advertised for a minimum period of thirty (30) days through a systematic notification process that may include contacting potential asset managers, including past bidders and other approved asset managers, and publication in trade journals as reasonably available. The thirty (30)-day minimum notice/advertisement period may be shortened by the written consent of the TRA Staff.

3. The procedures for submission of bid proposals shall require all initial and follow-up bid proposals to be submitted in writing. The Company shall not accept initial bid proposals that are not written. Following receipt of initial bid proposals, and on a non-discriminatory basis, the Company may solicit more favorable follow-up bid proposals from those submitting initial bid proposals in an effort to obtain the most favorable terms for the transaction consistent with the factors identified in paragraph 4 below.

4. All bid proposals shall be evaluated as they are received. The criteria for choosing the winning bid proposal, including any initial or follow-up bid proposals, shall include, at a minimum, the following categories: (a) the total value of the bid proposal; (b) the ability to perform the RFP requirements; (c) asset manager qualifications and experience; and (d) the financial stability and strength of the asset manager. The winning bid proposal shall be the one with the best combination of attributes based on the evaluation criteria; provided, however, that if the winning bid proposal is lower in amount than any other initial or follow-up bid proposal(s), the Company shall explain in writing why it rejected each higher bid proposal in favor of the lower winning bid proposal. The Company shall maintain records demonstrating its compliance with the evaluation and selection procedures.

5. Beginning with asset management agreements executed after approval of the Proposed Settlement Agreement by the Authority, the incumbent asset manager shall not be granted the right to match a winning bid proposal. In the absence of a currently existing contract right to match, if the incumbent asset manager desires to continue its asset management relationship with the Company after expiration of its asset management agreement, it shall submit a written bid proposal in accordance with the Company's RFP procedures and it shall be evaluated pursuant to the procedures for evaluation of the bid proposals.

6. The Company may develop additional procedures for selection of asset managers as it deems necessary and appropriate so long as such procedures are consistent with the agreed-upon procedures described herein.

7. The Company shall maintain all RFP documents and records for at least four years and such documents and records shall be subject to the review and examination of the TRA Staff, the CAD, and the independent consultant selected to conduct the triennial review set forth in Exhibit B of this stipulation.

8. The Company agrees to comply with all applicable anti-trust laws in its procurement of asset management services.