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April 6, 2010

Via Hand Delivery

Chairman Sara Kyle
c/o Sharla Dillon
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

Re: ***Piedmont Natural Gas Company, Inc.'s Actual Cost Adjustment Account Filing for the Twelve Months Ended December 31, 2005***
Docket No. 09-00093

electronically filed 4/6/10 at 1:40pm

Dear Chairman Kyle:

Enclosed please find an original and five (5) copies of Piedmont Natural Gas Company, Inc.'s Request for Declaratory Interpretation. This document has also been filed by way of email, sent today to the Tennessee Regulatory Authority Docket Manager, Sharla Dillon.

Should you have any questions concerning the enclosed, please do not hesitate to contact me.

With kindest regards, I remain

Very truly yours,

R. Dale Grimes

RDG/smb
Enclosure

8537572.1

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
PIEDMONT NATURAL GAS COMPANY, INC.'S	)	
ACTUAL COST ADJUSTMENT ACCOUNT	)	Docket No. 09-00093
FILING FOR THE TWELVE MONTHS ENDED	)	
DECEMBER 31, 2008	)	

REQUEST FOR DECLARATORY INTERPRETATION

Piedmont Natural Gas Company, Inc. ("Piedmont" or the "Company"), through counsel, respectfully requests that the Tennessee Regulatory Authority (the "Authority") enter a declaratory ruling interpreting Piedmont's Service Schedule No. 316, Performance Incentive Plan, as allowing Piedmont, for purposes of applying the 1% cap of the total annual gas costs on hedging costs only: (a) to allocate hedging costs to the year for which the underlying hedges provide protection rather than the year in which such costs are incurred; and (b) to utilize the Performance Incentive Plan annual period (July – June) rather than the ACA annual period (January – December) for calculating total annual gas costs. In support of this Request, Piedmont respectfully shows unto the Authority as follows:

BASIS OF THE NEED FOR DECLARATORY INTERPRETATION

1. Piedmont's authorization to engage in hedging transactions is established under its Service Schedule No. 316, Performance Incentive Plan. Piedmont engages in such transactions on behalf of its customers and in an effort to reduce the volatility of wholesale gas costs paid by Tennessee sales customers. Piedmont makes no profit on hedging transactions irrespective of the results thereof.

2. The current form of Service Schedule No. 316 was adopted as the result of a settlement between Piedmont, the TRA Staff, and the Consumer Advocate and Protection Division of the Tennessee Attorney General ("CAPD") in prior TRA Docket No. 05-00165. This

service schedule establishes the parameters under which Piedmont is able to hedge on behalf of its customers, and to recover the costs of its hedging activities, as well as recover any gains and losses of hedging transactions. In pertinent part, Service Schedule No. 316 provides:

> The Company may engage in hedging transactions 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 the Company'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."

Notably, Service Schedule No. 316 does not specifically delineate: (1) the methodology for calculating the one percent cap on hedging cost recovery; or (2) the annual period to be used for establishing annual gas costs. Piedmont's request herein seeks to obtain Authority assistance in providing greater certainty around these mechanisms and eliminate the potential for any unintended consequences.

3. Despite the good faith negotiations and agreements of Piedmont, the TRA Staff, and the CAPD in Docket No. 05-00165 that resulted in the inclusion of this language in Service Schedule No. 316, it is now apparent, as reflected by the positions of Audit Staff and Piedmont under Finding No. 2 of Audit Staff's 2008 ACA Audit Report, that Piedmont and Audit Staff have a disagreement regarding the interpretation and application of this language – or at least that they have taken different approaches to the application of the hedging provisions of Service Schedule No. 316 in this proceeding. This disagreement is based upon varying interpretations of what the tariff allows and is not necessarily a disagreement about what the intent of the hedging plan was. In order for Piedmont to move forward with hedging under its Service Schedule No. 316 and for Audit Staff to be able to properly audit those activities with certainty that it is applying the correct methodology, it is appropriate for the Authority to provide guidance to resolve the interpretative difference between Staff and Piedmont with respect to application of

the hedging provisions of Service Schedule No. 316 so the plan can operate as it was intended to operate. This guidance is needed irrespective of the Authority's determination with regard to Finding No. 2 of the Staff's 2008 ACA Audit Report and is the relief sought by Piedmont by this Request for Declaratory Interpretation.

4. In considering Piedmont's request herein it is important to take note of several critical contextual background facts. These are:

A. That Audit Staff's 2008 ACA Audit Report in this proceeding represents the first full audit of the accounting of Piedmont's hedging activities since the provisions of Piedmont's Performance Incentive Plan regarding hedging were modified pursuant to the settlement, and subsequent Commission order approving settlement, in Docket No. 05-00165;

B. That even though Piedmont's ability to engage in hedging transactions is established and controlled by its Performance Incentive Plan, the accounting for and recovery of hedging costs and hedging gains/losses is made through the ACA mechanism. This is true because the actual costs and the gains/losses resulting from discrete hedging transactions, unlike other activities conducted and engaged in under the Performance Incentive Plan, are not shared between Piedmont and its customers;[1] and

C. That Piedmont's ACA has a plan year of January 1 through December 31 of every year while the plan year for activities undertaken under Piedmont's Performance Incentive Plan is June 1 through July 31.

5. In its 2008 ACA Audit Report, Staff concluded that Piedmont exceeded the one percent (1%) hedging cost cap with respect to non-margin related hedging costs during the ACA review period. This finding was based on Staff's restrictive interpretation of the language of

[1] Hedging is engaged in solely for the benefit of Piedmont's customers in order to try to reduce volatility in wholesale gas costs. Piedmont has no potential economic "upside" from engaging in hedging transactions.

Service Schedule No. 316. Under Staff's interpretation, the recovery of hedging costs is restricted to the ACA plan year (January through December) in which such costs were actually incurred without regard to the period covered by the hedge or the fact that hedging is actually conducted by Piedmont on a Performance Incentive Plan year (July through June) basis as was the intent of the Plan.

6. Piedmont understands Staff's interpretation of Service Schedule No. 316 and when viewed solely from the perspective and for the purpose of an economic audit of Piedmont's ACA account for the calendar year, Staff's approach is a plausible reading of the Service Schedule. Piedmont believes that its interpretation is equally plausible, however, and makes more sense from a practical perspective. Piedmont's interpretation is also consistent with that of Exeter Associates, the outside consultant hired to review Piedmont's Performance Incentive Plan mechanism.

7. As is explained below, when viewed from the perspective of an actual operational hedging plan, Audit Staff's interpretation is unworkable. In fact, if Audit Staff's interpretation were to be applied going forward, Piedmont would be effectively unable to engage in meaningful hedging on behalf of its customers and its hedging plan mechanism would be rendered ineffective, all for reasons fully explained below.

8. Piedmont has discussed the difference in interpretations of Service Schedule No. 316 language with Audit Staff and believes that Audit Staff fully comprehends the practical difficulties posed by their interpretation of Service Schedule No. 316. Nonetheless, Audit Staff appears to feel compelled to maintain their interpretation of the tariff absent clarifying guidance from the TRA. Piedmont disagrees with Audit Staff's interpretation of the hedging provisions of Service Schedule No. 316 (for the reasons discussed below and in Piedmont's response to Finding No. 2 of the 2008 Audit Report) but Piedmont does not question Audit Staff's good faith in reaching their interpretation.

RATIONALE OF AND JUSTIFICATION FOR PIEDMONT'S INTERPRETATION OF SERVICE SCHEDULE NO. 316

9. During the 2008 ACA year covered by Staff's audit which consisted of January 1, 2008 through December 31, 2008, Piedmont engaged in hedging transactions which provided price protection to its Tennessee customers for up to 24 months from the date of the hedging transaction engaged in. These hedges, which individually targeted and provided protection for wholesale gas costs for specific future months, many of which were beyond the 2008 ACA period, were undertaken as a result of the operation of Piedmont's Hedging Plan. That Plan uses the same approach to hedging for future periods as Piedmont uses in two other states. The Plan was also designed and is managed with the assistance of a national consulting firm that specializes in such plans, and indicated during 2008 that by historic standards futures prices for natural gas out to a period of 24 months were highly favorable. Responding to those market signals and in conformance with its hedging plan, Piedmont engaged in hedges to cover wholesale gas prices for specific future months, a large number of which were beyond the 2008 ACA plan year.

10. The need to incur hedging costs associated with future periods is an inherent aspect of any meaningful hedging plan given that the purpose of hedging is to provide price protection for a future period. As a practical matter, it is not possible to obtain such protection if the period of such hedges is artificially constrained to a single ACA year because it would mean that hedges for November and December could not be placed until the preceding January at the earliest. More significantly, it would mean that hedges for January could not be placed at all (because the ACA plan year does not start until January 1 and you cannot hedge for January once the month starts). Hedges for February and March also could not be placed until January 1, severely limiting the time available and effective ability to obtain meaningful price protection for those months.

11. In light of these facts, and in order to manage an effective plan, Piedmont utilizes a target year approach to placing hedges and incurring hedging costs. This approach involves calculating the total annual gas costs for the most recent audited Incentive Plan year[2] and then applies that known cap to Piedmont's hedging activities for the next Incentive Plan year. Piedmont then allocates the costs of hedges to the year in which the hedges provide protection in order to match the period covered by the hedge with the costs of that hedge. This approach allows for the calculation of the 1% cap on the basis of a known and audited annual gas cost figure and allows Piedmont to engage in hedging while ensuring that the one percent cap is never exceeded during the Incentive Plan year. Piedmont also believes this approach is consistent with the language of Service Schedule No. 316 which does not specify either: (1) which annual period is to be used to calculate total annual gas costs, (2) whether an ACA year or an Incentive Plan year should be used; or (3) whether hedging costs should be allocated to the year the hedge is entered into or the year for which it is effective.

12. Piedmont submits that its target year approach is a rational method for implementing the language and intent of the Settlement in Docket No. 05-00165 and Service Schedule No. 316 and facilitates an effective hedging program that would otherwise be impeded by Audit Staff's approach.

13. Piedmont does not believe that Audit Staff has any substantive objection to Piedmont's approach to hedging or this requested clarification. Instead, Staff's objection is based on the limiting nature of their interpretation of the tariff. Accordingly, Piedmont requests that the Authority enter a declaratory interpretation authorizing and approving Piedmont's methodology for allocating and accounting for hedging costs and the calculation of a 1% cap on total annual gas costs as described above. This declaratory order will simply serve to avoid

[2] Piedmont hedges on the basis of an Incentive Plan year period in order not to split a winter heating season.

potential unintended consequences of an overly restrictive interpretation of the tariff which conflicts with the intended operation of the Plan.

WHEREFORE, Piedmont Natural Gas Company, Inc., respectfully requests that the Authority enter a declaratory interpretation approving the calculation methodology for total annual gas costs, hedging costs, and the 1% cap on hedging costs described above and utilized by Piedmont in order to resolve uncertainty regarding the application of Service Schedule No. 316.

Respectfully submitted this 6 day of April, 2010.

Piedmont Natural Gas Company, Inc.

R. D. Grimes

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STATE OF NORTH CAROLINA

COUNTY OF MECKLENBURG

VERIFICATION

David R. Carpenter, being duly sworn, deposes and says that he is Managing Director, Regulatory Affairs of Piedmont Natural Gas Company, Inc.; that as such, he has read the foregoing Petition and knows the contents thereof; that the same are true of his own knowledge except as to those matters stated on information and belief and as to those he believes them to be true.

David R. Carpenter

Mecklenburg County, North Carolina
Signed and sworn to before me this day by David R. Carpenter

Date: 4-6-10

Lee E. Howard, Notary Public

Lee E. Howard

(Official Seal)

LEE E. HOWARD NOTARY PUBLIC MECKLENBURG COUNTY, N.C.

My commission expires: MY COMMISSION EXPIRES 10-29-10