

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

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February 5, 2010

IN RE:	)	
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PIEDMONT NATURAL GAS COMPANY	)	Docket No. 09-00125
INCENTIVE PLAN ACCOUNT (IPA) AUDIT	)	

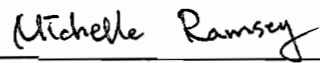
**NOTICE OF FILING BY UTILITIES DIVISION OF
THE TENNESSEE REGULATORY AUTHORITY**

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, 2009.
2. The Company's IPA filing was received on August 31, 2009, and the Audit Staff (hereafter the "Staff") completed its audit of same on February 1, 2010.
3. On February 2, 2010, the Utilities Division submitted its preliminary IPA audit findings to the Company via e-mail. The Company responded on February 5, 2010 via e-mail and this response has been incorporated into the final report.

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:



Michelle Ramsey, Utilities Consultant
Utilities Division of the
Tennessee Regulatory Authority

CERTIFICATE OF SERVICE

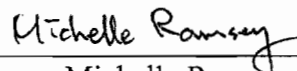
I hereby certify that on this 5th day of February 2010, a true and exact copy of the foregoing has been either hand-delivered or delivered via U.S. Mail, postage pre-paid, to the following persons:

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Chairman
Tennessee Regulatory Authority
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Michelle Ramsey

COMPLIANCE AUDIT REPORT
OF

PIEDMONT NATURAL GAS COMPANY'S
INCENTIVE PLAN ACCOUNT

Docket No. 09-00125

PREPARED BY

TENNESSEE REGULATORY AUTHORITY

UTILITIES DIVISION

February 2010

EXHIBIT A

**TENNESSEE REGULATORY AUTHORITY'S
COMPLIANCE AUDIT
of
PIEDMONT NATURAL GAS COMPANY'S
INCENTIVE PLAN ACCOUNT
Docket No. 09-00125**

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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, 2009 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 three (3) errors. The Staff concludes that, except for the findings noted in Section VI, during the plan year under review the Company correctly calculated the benefits accruing to Piedmont and the ratepayers under the Incentive Plan.

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 an 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 tariff³ entitled Performance Incentive Plan, which was issued on April 22, 1996, and became 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. 04-00290⁴ voted to open a new docket to consider issues associated with the

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 1)

³ Service Schedule No. 14 was subsequently changed to Service Schedule No. 316 in Docket No. 03-00313.

⁴ Docket No. 04-00290 contains the TRA Staff audit report of the Company’s IPA for the plan year ended June 30, 2004.

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 ("CAPD") petitioned to intervene. On June 5, 2007, after extensive discussions and negotiations, the Company, CAPD 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 oral presentations 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 Old 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;
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 third reporting period governed by the New Tariff. During the period, an RFP was issued according to the terms of the triennial review provision. Three consulting firms were invited to respond to the RFP. After considering the three proposals, Exeter Associates, Inc. was awarded the contract. The final audit report will be filed in Docket No. 05-00165.

III. 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.

IV. AUDIT SCOPE

The IPA audit is a compliance audit of the Company's Incentive Plan Account.⁵ The audit goal is to verify that the Company's calculations of incentive gains and losses are materially correct,⁶ 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 filing⁷ to implement a customer surcharge to recover the balance in the IPA Account at June 30, 2009, effective December 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 Piedmont, 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 Michelle Ramsey and Tiffany Underwood of the Utilities Division.

V. ACTUAL PLAN YEAR RESULTS

On August 31, 2009, Piedmont filed its annual IPA report. According to the Company filing, the Incentive Plan generated \$6,345,216 in total incentive savings. Of this amount, \$4,758,912 benefited the ratepayer and **\$1,586,304** 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, 2009 of **\$992,426**.

⁵ Service Schedule No. 316 Performance Incentive Plan.

⁶ 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.

⁷ Tariff Filing No. 2009-0323.

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

		Plan Year Ended 6/30/09
Total Actual City Gate Purchases	\$	<u>130,420,712</u>
Total Annual Benchmark	\$	<u>131,443,301</u>
Percentage Actual Purchases to Benchmark		99.22%
Total Incentive Savings (Losses) from:		
Gas Procurement	\$	1,022,590
Capacity Management		<u>5,322,626</u>
<u>Total Incentive Savings</u>	\$	<u>6,345,216</u>
Incentive Savings (Losses) Retained by Ratepayers (75%):		
Gas Procurement	\$	766,943
Capacity Management		<u>3,991,969</u>
<u>Total Incentive Savings to Ratepayers</u>	\$	<u>4,758,912</u>
Incentive Savings (Losses) Retained by Company (25%):⁸		
Gas Procurement	\$	255,648
Capacity Management		<u>1,330,656</u>
<u>Total Incentive Savings to Company</u>	\$	<u>1,586,304</u>

⁸ Piedmont is subject to a cap on overall gains or losses of \$1.6 million annually.

VI. 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 accrued under its Incentive Plan and whether it complied fully with the terms of its tariff. Staff's audit revealed three (3) findings, which represent a decrease of \$53,441.56 in the Company's reported under-recovered balance in the Incentive Plan Account as of June 30, 2009.⁹ The correct ending balance in the IPA account is **\$938,984.86 under-recovery**. A summary of the IPA account as filed by the Company and as adjusted by the Staff is shown below, followed by a description of the findings.

SUMMARY OF THE IPA ACCOUNT:

	Company	Staff	Difference (Findings)
Un-recovered IPA Account Balance at 6/30/08	\$408,488.42	\$408,488.42	\$0.00
Plus Gas Procurement Savings Accruing to Piedmont	255,647.61	255,647.61	0.00
Plus Capacity Mgt. Savings Accruing to Piedmont	1,330,656.50	1,278,799.00	(51,857.50)
Minus Amt. Recovered from Customers (12mtd 6/30/09)	<u>1,038,985.60</u>	<u>1,038,985.60</u>	<u>0.00</u>
Equals IPA Balance Before Interest	\$955,806.92	\$903,949.43	(\$51,857.50)
Plus Interest Calculated on Monthly Balances	<u>36,619.50</u>	<u>35,035.43</u>	<u>(1,584.07)</u>
Equals IPA Account Balance at 6/30/09	<u>\$992,426.42</u>	<u>\$938,984.86</u>	<u>(\$53,441.56)</u>

SUMMARY OF FINDINGS:

			See page
FINDING #1	Capacity Release amount	\$ (51,857.50)	Over-recovery 6
FINDING #2	Interest	(1,584.07)	Over-recovery 7
FINDING #3	Contractual Capacity	<u>No \$\$ effect</u>	8
Net Result		<u>\$ (53,441.56)</u>	Over-recovery

⁹ On October 30, 2009, Piedmont filed a tariff (2009-0323) to implement a surcharge to recover the balance in its Incentive Plan Account as of June 30, 2009.

FINDING #1:

Exception

The Company overstated its Capacity Release amount.

Discussion

The Company made two errors in the calculation of the October 2008 capacity release amount. The North Carolina capacity release amount of \$90,830 was incorrectly allocated to Tennessee. In addition, the Company overstated the capacity release amount by \$116,600.

The staff made a net adjustment of \$207,430 to the capacity release amount. This amount is shared 75% to the customer and 25% to the Company as per the terms of the tariff. The result of this finding is a **decrease in the Company's reported share of capacity release gains** of \$51,857.50.

Company Response

The Company is in agreement with the above Audit Staff findings in the amount of \$51,857.50 and will adjust its records accordingly.

FINDING #2:

Exception

The Company overstated the amount of interest due from customers in the IPA filing.

Discussion

Staff recalculated interest based upon audit finding #1 above. The result of this finding is a **decrease to reported interest due from customers of \$1,584.07.**

Company Response

The Company is in agreement with the above Audit Staff findings in the amount of \$1,584.07 and will adjust its records accordingly.

FINDING #3:

Exception

The Company understated its Contractual Capacity.

Discussion

Each month's benchmark price index is calculated to determine the amount of Incentive Savings from Gas Procurement activities. The monthly Contractual Capacity amount is one of the factors needed to calculate benchmark price index.

In October 2008, the Company did not include Contractual Capacity on the additional 20,000 dts of Midwestern East Side-Columbia IT, 28,204dts of Tennessee Zone1 – 500 Leg and 23,461dts of Tennessee Zone 1 – 800 Leg. However, this finding did not result in a material difference in the benchmark index and therefore did not result in a dollar amount effect on Incentive Savings from Gas Procurement.

Company Response

The Company is in agreement with the above Audit Staff findings.

VII. AUDIT CONCLUSIONS AND RECOMMENDATIONS

Piedmont Natural Gas, **except for** the findings noted, has correctly calculated its share of savings under its Service Schedule No. 316 Performance Incentive Plan for the plan year ended June 30, 2009. Based on the Company's filing and the audit adjustments by Staff, the net balance in the IPA Account as of June 30, 2009 should be \$938,984.86. This balance will serve as the beginning balance for next year's calculations. **Staff recommends approval of the Company's adjusted IPA Account balances.**

The tariff states that "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." [emphasis added]¹⁰ Staff points out that the Company made the PGA/Tariff filing to establish a new Incentive Plan Account (IPA) Factor and requested that this filing take effect on December 1, 2009. Staff recommends that the Authority direct the Company to file on time in its future tariff filings as per the terms of the tariff.

During the course of this audit, there were numerous data requests and telephonic meetings between Staff and Company personnel to obtain additional information and clarification of the filing. Between now and the next filing, at the earliest convenient time, Staff intends to schedule a meeting with Piedmont personnel to discuss a list of documentation items that the Company will be requested to file concurrent with future annual IPA audit filings. Including this minimum documentation at the time of filing will result in a more efficient use of Staff's time and eliminate a lot of data requests.

¹⁰ Service Schedule No. 316, Performance Incentive Plan, page 4.

ATTACHMENT 1

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:

$$I = F_f(P_0K_0 + P_1K_1 + P_cK_c + \dots P_aK_a) + F_oO + F_dD; \text{ where} \\ F_f + F_o + F_d = 1; \text{ and}$$

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.