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OFFICE OF THE
EXECUTIVE SECRETARY

September 1, 1999

Mr. Mark G. Thessin
Vice President - Rates & Regulatory Affairs
810 Crescent Centre Dr, Suite 600
Franklin, TN 37067-6226

Re: 97-01364 - Application of United Cities Gas Company to establish an experimental performance-based ratemaking mechanism

Dear Mr. Thessin,

On June 1, 1999, you sent a letter (and variable pay plan that was effective October 1, 1998) to Mr. David Waddell at the Tennessee Regulatory Authority. The opening paragraph stated:

> "In conformance with the Tennessee Regulatory Authority's (TRA) decision in Phase II of United Cities Gas Company's Performance Base Ratemaking (PBR) program an the tariff effective April 1, 1999 that was filed in compliance with the TRA's decision, the Company hereby submits its incentive/bonus program for non-executive employees in its gas supply department."

You sent another letter on August 2, 1999 clarifying the above filing. The Authority's Phase II order was issued on August 16, 1999. The order states:

> Mr Creamer further found that UCG's existing incentive practices may not be sustainable in the absence of a feedback and reward system that prompts individuals to adopt desired behaviors that support business goals and objectives. The Authority concludes that a feedback and reward system for those employees

involved in the activities detailed in the plan must be in place as long as the Company is operating under a PBR mechanism."

On July 30, 1999, Dan McCormac asked you a question about the filing to try to determine whether UCG's proposal meets the TRA's objective of a feedback and reward system for those employees involved in gas purchasing activities. Mr. McCormac asked how much reward an employee would get if that employee reduced gas costs by $1,000,000 per year (below 98.7% of index) assuming all other operations were at budget. We have received no response to that request.

We also request how much reward an employee would get if that employee reduced gas costs by $1,000,000 per year (below 98.7% of index) assuming all other operations were at budget except that Tennessee Intrastate operations earned 11% on a consolidated equity structure (before the effects of the $1,000,000 gas cost reduction) rather than budget. Also, please repeat the above two calculations based on a projected savings of $2,000,000 per year instead of $1,000,000 per year. Please state the assumed returns on equity (in each state) that are implied by the budgeted earnings factors in the variable pay plan. Neither the letters that you sent to the Authority nor the proposed variable pay plan appear to contain enough details to allow us to make these calculations.

It is probably too late to make any needed changes in the 1998-1999 variable pay plan, but we hope to be able to work with you and the Authority to arrive at a mutually agreeable plan for the October 1, 1999-2000 year that will meet the goals of August 16, 1999 order from the Authority.

Sincerely,

Vance L. Broemel

Vance L. Broemel

cc: Mr. David Waddell, Tennessee Regulatory Authority

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