Nelson Mullins

Nelson Mullins Riley & Scarborough LLP
Attorneys and Counselors at Law
100 North Tryon Street / 24th Floor / Charlotte, North Carolina 28202-4000
Tel 704.417.3000 Fax. 704.377.4814
www.nelsonmullins.com

James H. Jeffries IV
Partner
Direct Dial: 704 417 3103
Direct Fax: 704 417 3014
Jim.Jeffries@nelsonmullins.com

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ENERGY & WATER DIVISION

August 12, 2004

VIA FEDERAL EXPRESS

The Honorable Pat Miller
Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505

Re: Nashville Gas Company, a Division of Piedmont Natural Gas Company, Inc. Incentive Plan Account (IPA) Audit -- Docket No. 03-00489

Dear Chairman Miller:

On August 5, 2004, the Energy and Water Division ("Staff") of the Tennessee Regulatory Authority Staff ("TRA" or "the Authority") filed its *Staff Reply to Nashville Gas Company's Proposals* in this docket ("Reply"). The purpose of Staff's Reply was to respond to certain proposals made by Nashville Gas Company ("Company") to "remedy weaknesses" in the Company's gas cost Incentive Plan ("Incentive Plan") as directed by the TRA in Notices issued on May 5, 2004 and May 17, 2004. In its Reply, Staff accepts a number of the remedies suggested by Nashville Gas Company; however, Staff continues to pursue three issues relative to the Company's Incentive Plan: (1) Staff oversight of the asset management fee bid process; (2) inclusion of asset management fees under the Company's Incentive Plan; and (3) Staff utilization of an outside consultant to assist in future Incentive Plan audits. Nashville Gas Company disagrees with the Staff's position on several of these issues and has previously discussed the basis of that disagreement in filings made on April 8, 2004 and June 17, 2004. In order to ensure that the record before the TRA is clear and complete, Nashville Gas Company respectfully submits the following summary of its position on each of the three remaining disputed issues identified in Staff's Reply.

STAFF OVERSIGHT OF THE ASSET MANAGEMENT BID PROCESS

Staff proposes that it be permitted to directly observe the opening of asset management bids in order to assure that all bids are given equal consideration. The Company respectfully opposes this proposal for the following reasons:

1. There is no single bid opening utilized by the Company in its RFP process.

Instead, bids are opened as they are received (typically via fax or email) and then responsible Company personnel utilize these bids to attempt to encourage other active and qualified participants to make better offers for the capacity subject to the RFP process in order to reap the maximum benefit for the Company and its ratepayers from that process. In short, the ascertainment of the "best bid" is the result of a multi-day (or multi-week) dynamic process carried out through formal bids, informal telephone discussions, email communications, and ultimately a written asset management contract.

2. There is no material benefit to the Staff's proposal as the Company has already agreed to a transparent process whereby it will annually publish notice of its RFP process and will maintain auditable records of all recipients of its RFPs and their written responses to those RFPs.

3. The Staff's proposal represents an unprecedented and potentially problematic degree of active participation in the Company's day-to-day business processes the need for which has not been demonstrated.

INCLUSION OF ASSET MANAGEMENT FEES UNDER THE COMPANY'S INCENTIVE PLAN

Staff contends that the Company's Incentive Plan tariff does not cover asset management fees paid to Nashville. Based on this conclusion, Staff then asserts that the Company must file for a "change" to its tariff, in a separate docket, in order for the TRA to determine whether such fees should be included in the Company's Incentive Plan. Nashville Gas Company respectfully disagrees with the Staff's analysis on the following grounds.

1. Asset management fees do fall within the scope of the Capacity Management Mechanism set forth in the Company's Incentive Plan tariff inasmuch as they constitute a bulk capacity release and assignment of Company assets with an associated city-gate supply arrangement.

2. Both the TRA and Staff have previously and repeatedly approved the inclusion of asset management fees under the Company's Incentive Plan.

3. Ratepayers have reaped substantial benefits from the inclusion of asset management fees under the Company's Incentive Plan.

It is clear from the Staff's Reply that they intend to continue to contest the inclusion of asset management fees under the Company's Incentive Plan. Nashville Gas Company hereby notifies the TRA of its intention, consistent with the analysis set forth above, to continue to include such fees under its Incentive Plan pending further direction of the Authority on this issue.

STAFF USE OF AN OUTSIDE CONSULTANT FOR INCENTIVE PLAN AUDITS

Staff recommends that it be permitted to utilize an outside consultant to assist in future Incentive Plan audits and that the cost of such consultant be recovered through the Company's Actual Cost Adjustment account. Nashville Gas Company has no strong opinion on this discrete issue and believes that it is fundamentally a staffing matter between the TRA and the Energy and Water Division. The Company will implement the Staff's proposal if it is directed to do so by the TRA.

Notwithstanding this fact, Nashville Gas Company is very concerned about one aspect of the Staff's consultant request – the underlying inference that Staff intends to engage in a re-examination of the substance of the Company's Incentive Plan within the context of its annual IPA "audits." The Company's Incentive Plan was adopted as a form of reduced regulation over gas cost activities of the Company in the place of a more involved and in-depth annual prudence review procedure. The Incentive Plan was carefully designed to ensure that the Company's and the ratepayers' interests were aligned and protected. The Incentive Plan was also the subject of substantial (and relatively recent) scrutiny by the TRA before it was approved. A review of the Plan's performance since approval indicates that it has performed exactly as hoped and that ratepayers (and the Company) have reaped material benefits from the operation of the Plan. On these facts, the Company is highly concerned about the suggestion of the Staff that it intends to engage in an annual re-examination of substantive aspects of the Plan as part of its audit process. In the Company's view, this represents a return to an annual prudence review type proceeding in the total absence of evidence suggesting that this increased degree of regulatory oversight is necessary and in contravention of the underlying premise of the Incentive Plan mechanism. In taking this position, the Company does not intend to suggest that its Incentive Plan is not subject to review and revision by the Authority, just that any such process should be independent of the Incentive Plan audit.

Nashville Gas Company appreciates the Authority's consideration of these points and looks forward to the Authority's further order in this proceeding.

Sincerely,

James H. Jeffries IV

JHJ/srl

c: Mr. Randal Gilliam
Mr. Richard Collier
Mr. Dale Grimes
Mr. David Carpenter