BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained within the Rate Schedules of Northeast Ohio Natural Gas Corporation and Orwell Natural Gas Company.	:	**Case No. 12-0209-GA-GCR** **Case No. 12-0212-GA-GCR**
In the Matter of the Regulations of the Purchased Gas Adjustment Clauses contained within the Rate Schedules of Northeast Ohio Natural Gas Corporation and related matters.	:	**Case No. 12-0309-GA-UEX**
In the Matter of the Uncollectible Expense Rider of Orwell Natural Gas Company.	:	**Case No. 12-0312-GA-UEX**

REPLY BRIEF OF NORTHEAST OHIO NATURAL GAS CORPORATION AND ORWELL NATURAL GAS COMPANY

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I. INTRODUCTION.

The evidentiary record in this proceeding was completed on July 22, 2013. Northeast Ohio Natural Gas Corporation ("NEO" or "Northeast"), Orwell Natural Gas Company ("Orwell")(together the "Companies"), the Staff of the Public Utilities Commission of Ohio (the "Staff"), and the Office of the Ohio Consumers' Counsel (the "OCC") filed Post-Hearing Briefs on August 19, 2013. In accordance with the schedule established by the Attorney Examiner, the Companies submit their Reply Brief for consideration of the Public Utilities Commission of Ohio ("PUCO" or "Commission"). The Companies Reply Brief identifies the legal, factual and policy defects persistent throughout the positions advanced by the OCC and the Staff in their Post-Hearing Briefs.[1]

II. LAW AND ARGUMENT.

A. The Companies' Natural Gas Procurement Policy for Intrastate Gas Reasonably Ensures Reliable Service at Optimal Prices.

The Staff's entire analysis of whether the Companies' GCR rates were reasonable hinges on whether the Companies paid more for intrastate gas than it paid for interstate gas. The record demonstrates that the Companies' purchases for intrastate gas were less expensive than the Companies' purchase of interstate gas. The OCC's analysis of the reasonableness of the rates is based solely on the results of the RFP, which is irrelevant because the RFP was not issued until after the Audit Period. Both the OCC and the Staff attempt to argue that the Companies' rates are not reasonable because they purchased from a JDOGM, an affiliated marketer, but argument is unsound because the fact that the Companies purchased gas from JDOGM has no bearing on whether the GCR rates were reasonable. Likewise, examination of the Companies' procurement policies, while relevant to the proceeding, does not in itself establish that the *price* paid for intrastate gas was unreasonable. These are two separate issues that both the Staff and the OCC intertwine in an attempt to bolster their unsupportable position that the Companies' GCR rates were unreasonably priced.

i. <u>The Companies' paid less for intrastate gas than they did for interstate gas.</u>

The Staff claims that the Companies' intrastate gas purchase prices were unreasonable for one reason: because the Companies paid more for intrastate gas than

[1] Any failure by the Companies to specifically address a proposal by the OCC or Staff should not be construed as agreement with such proposals.

they paid for interstate gas purchases. (Staff Brief at 2, 6, 7). However, neither the Staff nor the OCC provided any evidence to support this claim.[2] The Staff and the OCC's summary conclusions that the Companies' intrastate purchases were more expensive than the Companies' interstate purchases should be given no weight absent evidentiary support. On the other hand, Dr. Overcast's Schedule 1 to his Direct Pre-filed Testimony methodically demonstrates – using NEO's and Orwell's actual purchase volumes and prices – that, on average, the Companies paid substantially less for intrastate gas than interstate gas during the audit period.[3]

NEO and Orwell did not need to rebut the unsupported testimony of Mr. Sarver that intrastate gas costs less than interstate gas because the evidence that Mr. Sarver submitted to demonstrate that Schedule 1 of Dr. Overcast's testimony is "inaccurate and drastically inflates the true costs of interstate gas" is factually wrong, and, in fact, cannot be relied upon by the Commission. The adjustments made by Mr. Sarver consisted of eliminating the DEO transportation cost from interstate service and also eliminating the TCO fixed charges from the cost of interstate service. Mr. Sarver's assertions are incorrect and ignore the physical realities of the delivery system.

With respect to DEO, it is physically impossible for gas to flow from local production in one system to the other because the gas flow is under pressure coming into the system. There is no physical or virtual backhaul capability on DEO. Further, there is no local production gas under the JDOG contracts that is connected to the DEO

[2] The Audit Report provides no support for this claim, other than reiterating the conclusion.

[3] The Companies do not dispute that there were isolated months where the Companies paid more for intrastate gas than interstate gas. However, over the course of the audit period, the evidence plainly shows that the Companies paid significantly less over that period for intrastate gas. To "cherry-pick" certain months where the Companies paid more for interstate gas is an exception to prove a rule, and ignores the overall cost savings that Companies realized by purchasing local production instead of interstate gas.

system. Thus, all of the DEO's charges are directly related to the interstate gas as shown in Schedule 1 of Dr. Overcast's testimony. Since charges under this schedule tie out to the actual DEO charges in the audit, it is mathematically impossible for any of the DEO costs to be attributed to JDOG local production costs. Mr. Sarver is therefore wrong in his conclusion that the DEO transport costs are incurred to deliver local gas to either Orwell or NEO. These costs are a necessary part of the cost of interstate service that must be used in the comparison of local production costs to interstate costs.

Mr. Sarver also incorrectly claims that the fixed costs of TCO are incurred to move local gas to Orwell and NEO. This claim is incorrect on a number of grounds. First, as Mr. Sarver correctly notes, local production gas is not "firm" gas supply. The TCO contract is a firm capacity contract designed to provide design day delivery capacity to the system. It would be irrational and imprudent to buy firm pipeline capacity to deliver a non-firm gas supply. There is no evidence that the TCO capacity is unneeded or imprudent as part of the portfolio of assets required by the Companies to provide reliable service under design day conditions. Second, as shown by the pipeline schematic it is impossible for the local production to flow into TCO because it would be flowing upstream on the delivery pipelines and that is not physically possible. Further, to the extent that JDOG were to ship local production on TCO from some other location or interconnection, the costs associated with that shipment are already included in the delivered city gate price as shown in the audit workpapers used by Dr. Overcast to prepare Schedule 1. There are no TCO charges associated with JDOG local production.

It is incorrect for Mr. Sarver to arbitrarily exclude these costs from the delivered cost of interstate gas because there is no evidence to support his conclusion that these costs are incurred for local production gas delivery. Apparently, Mr. Sarver removed these costs so that local production gas costs during the audit period appeared greater than interstate costs. Without a demonstration that local production gas costs were greater than the cost of interstate supplies, there is no basis for concluding that intrastate supplies require an adjustment that Mr. Sarver proposed in his analysis to reduce intrastate gas costs. Absent the conclusion that the intrastate gas costs exceed interstate gas costs, the proposed adjustment becomes arbitrary and capricious. It is merely based on the unsupported suspicion that JDOGM makes too much money. All of these adjustments must be therefore rejected by the Commission and the Company's expenditures for intrastate gas must be found just and reasonable. The Companies have satisfied their burden of proof to provide facts demonstrating that their gas procurement policies are prudent and provide consumers with reliable service at fair, just, and reasonable rates.

ii. The results of the RFP did not affect the Companies' GCR rates during the Audit Period

The OCC and the Staff argue that the RFP process and result were uncompetitive, and the OCC misguidedly uses that conclusion to argue that RFP resulted in unjust and unreasonable rates during the Audit Period. (OCC Brief 10). While it is inappropriate to evaluate the RFP at all in this GCR Case because the RFP was issued after the Audit Period concluded and because it is not ripe for review (see Companies Brief 33-34), it is simply wrong to suggest that the rates that went into effect as a result of the RFP had any relation to the Companies' GCR rates during the Audit

Period. (OCC Brief 10). The Companies' reporting period for the current audit (as determined by the Staff, not the Commission) ended in May and June of 2012 for NEO and Orwell, respectively. The Companies' RFP was not issued until October 2012. Consequently, the OCC's Brief is severely flawed because the only evidence the OCC presents that the Companies' rates were unreasonable is on page 10 where the OCC evaluates the resulting rates of the RFP.

B. The Staff Failed to Rebut the Presumption that the Companies' Gas Purchases Were Prudent, and therefore, the Staff's Proposed Disallowance Should be Rejected.

The Staff and the OCC have failed to provide any real evidence that the Companies prices were unreasonable. Conversely, the Companies proved by the preponderance of the evidence, through Dr. Overcast's testimony, that the Companies' purchases were reasonable and prudent based on the current market conditions during the audit period. In response, the Staff and the OCC have failed to make any showing that the Companies' intrastate purchases were unreasonable, and the Staff and the OCC certainly did not rebut the presumption that the Companies' purchases were prudent to justify their proposed disallowances.

i. <u>The Staff's Methodology for Repricing Is Inappropriate and Unreasonable.</u>

With respect to the Staff's methodology for repricing, the Companies stand on their arguments presented in the Companies' Post-hearing Brief and emphasize that the Staff has provided no supportable explanation for the value or significance of the "weighted difference." (Companies' Brief 22-29). To this point, the Staff states (without any evidentiary support):

> Staff determined the basis associated with units of local production sold on each system by subtracting the average price JDOG

> Marketing paid to local producers from the average NYMEX price. While accounting for the location of specific producer, transportation costs, processing fees and shrinkage related to each of the three categories, Staff was able to determine premium amounts payable to JDOG Marketing that are reasonable.... (Staff Brief 12).

This is the first time that the Staff has called the weighted difference a "basis," and even so, it is still not reconcilable with the Staff Alternative Premium NYMEX Plus. Additionally, the Staff states that it accounted for location of producers, transportation costs, processing fees and shrinkage when determining the Staff Alternative Premium NYMEX Plus; however there is absolutely no support in the record for this proposition. The Audit Report and Mr. Sarver's testimony completely fail to explain the weighted difference and its connection to the Staff Alternative Premium NYMEX Plus. This appears to be an attempt by the Staff to retroactively account for a serious deficiency in its repricing; however, it is unsupported in the record, and therefore, the methodology must be rejected.

ii. <u>Staff's Methodology Was Admittedly Flawed and Based on Non-Regulated Marketers' Profit Margins, Which Requires the Commission to Order a *De Facto* Cap on Unregulated Marketers' Profits.</u>

During the Audit, the Staff asked the Companies to turn-over all of the intrastate gas purchase contracts entered into between JDOGM and intrastate producers, which contracts were produced by the Companies in the prior GCR case. (Staff Brief 11). The Companies are *not parties* to the requested contracts, and while the Companies have no interest in relitigating the last GCR case, suffice it to say, the Staff objected to the Companies' business dealings with their unregulated affiliated marketer, JDOGM. In the current audit, the Staff has requested that the Companies produce documents that belong to their affiliate – *the same affiliate that Staff adamantly wants to operate at arms-length with the Companies.* However, the contracts were not produced to the Staff because the Companies are not in possession of their affiliated marketer's contracts. Staff now objects that the Companies have heeded the Staff's recommendations from the prior audit, and have implied that the Companies are being less than forthcoming in the course of the audit.[4] Apparently, the Staff's vision is so narrowly focused on "winning the case" that the Staff twisted this fact against the Companies without even contemplating that *the Companies should not have JDOGM's contracts if the parties are dealing at arm's length.*

The Staff was apparently unfazed by the lack of this critical component of the Staff's methodology, and the Staff decided to pursue its methodology using outdated JDOGM contracts that do not reflect current prices or market conditions. Essentially, the Staff has admitted that their methodology is severely flawed because their methodology would be more accurate if they had access to the JDOGM's current contracts, but, as explained below, the Staff cannot access those contracts because the PUCO does not regulate JDOGM.

This proceeding is not a JDOGM investigation. JDOGM's contracts with local producers are irrelevant to the outcome of this case. The focus of the Commission's inquiry should solely be on the Companies' prices charged to customers in relation to the price the Companies pay for gas. The Staff should examine the prices that the Companies paid JDOGM for gas; not the prices that JDOGM paid for gas. The Staff has not authority to determine profits for an unregulated company. The Staff's audit

[4] While the Staff is clearly disappointed that they do not have the authority under the law to require an unregulated entity to produce its gas purchasing contracts, the Staff provided no evidence that it attempted to contact a representative of JDOGM to request the contracts.

report relating to the Companies' intrastate purchases is almost exclusively based off of JDOGM's perceived premiums. However, with respect to the Companies' actual purchases beginning in August 2011, the Audit Report states:

> Staff believes that [JDOGM's] calculation of the ceiling prices ***reduced costs paid by NEO***, but JDOG[M] earned higher premiums by selling local production as if it were purchased in the interstate market, delivered on TCO through Cobra customers.

(Audit Report 13)(*Emphasis added*). It is important to note that any purchase the Companies made prior to August 2011 occurred prior to the Commission's issuance of the October 23, 2011 Opinion and Order in the prior GCR case. The above quote reveals the Staff's misperception of the issue in the case. The Staff clearly found that NEO's purchase price was reduced in August 2011 (and going forward), but the Staff found that the purchases were still unreasonable because JDOGM's profits allegedly increased during this time period.

The Commission can determine whether the price the Companies paid for gas is reasonable or not without making an inquiry into JDOGM's profit margins. The profit margins of an unregulated marketer are not necessary for consideration in the Companies' GCR proceeding. If they were, the Staff would have been given the authority to require all natural gas marketers to produce their contracts with local producers in GCR hearings. The determination of whether the prices the Companies paid for gas were reasonable can and should be made by examining the then-current market for interstate and intrastate gas in Ohio. Indeed, Mr. Sarver acknowledged that the Columbia TCO and Dominion indexes were acceptable indicators for market prices of intrastate gas in this state.

Moreover, it is against public policy in Ohio to base the Companies' GCR rate on an unregulated gas marketer's profit margins. If the Commission bases its examination of the Companies' GCR rate on JDOGM's profit margins, as the Staff suggests, the Commission would be, in effect, regulating unregulated entities. While the marketers retain their profits from the transactions with the Companies, the Commission's acceptance of the Staff's proposed methodology would necessitate a finding that the *gas marketers* made too much money. The Staff's methodology forces the Commission to interfere with the unregulated side of the natural gas market by finding, as the Staff's methodology requires, that the margin between the marketer's purchase price for gas and sale price for gas is too great, which requires an adjustment to the Utility's GCR rate. Basing the Commission's decision on marketers' prices is a *de facto* cap on marketers' profits, which is clearly outside the jurisdiction of the PUCO.

C. The OCC Failed to Rebut the Presumption that the Companies' Gas Purchases Were Prudent, and therefore, the OCC's Proposed Disallowance Should be Rejected.

i. <u>The OCC's methodology for repricing is Inappropriate and Unreasonable.</u>

The Companies stand on the arguments presented in their Post-Hearing Brief with respect to the OCC's flawed repricing methodology. (Companies' Brief 29-34).

ii. <u>The OCC's request to disallow all of Cobra's Pipeline processing fees is inappropriate and unreasonable.</u>

The Staff and the OCC have brought to light the possibility that Cobra Pipeline ("Cobra") has been charging NEO for processing fees on the Churchtown system for gas that was not processed on Cobra's pipeline. The Companies take this issue very seriously. If Cobra was charging NEO a $0.25 processing fee for volumes of gas that were never processed, and NEO paid that fee based on rates recovered through its GCR customers, NEO's customers on the Churchtown system should be made whole, in accordance with law.

Cobra's tariff states: "Processing and compression charge shall only apply when gas received by Company at the Receipt Point has a heat content in excess 1,130 Btu per cubic foot and is processed through a processing plant on Company's system." When questioned on cross-examination, Mr. Whelan stated that he did not know whether the Companies were being charged processing fees by Cobra for volumes that were not actually processed. (Cross-examination of Martin K. Whelan 51:20-25)("Whelan Cross"). Later in his testimony, Mr. Whelan stated that none of the gas that NEO's customers receive has been treated by Cobra's processing facility. (Whelan Cross 102:22 – 103:2). On Re-Cross Examination, Mr. Whelan stated that some Cobra bills were incorrect but he could not confirm that all of Cobra's processing charges were incorrect. (Whelan Cross 166:14 – 167:2). Mr. Whelan stated that he would need to review all of the invoices to determine whether the Companies' were overcharged. (Whelan Cross 166:17-18). Based on this inconsistent testimony, it is evident that the record is not clear with respect to volumes of NEO gas on Cobra's pipeline that was processed.

The GCR hearing is not the appropriate proceeding to determine whether a separate regulated entity overcharged NEO for processing fees. The processing fee is a component of Cobra Pipeline's PUCO-approved tariff. Northeast's recovery of this processing fee is a pass-through based on Cobra's invoices. The processing charge is unrelated to any of the Companies' procurement policies. In order to get NEO's natural gas where it needs to go on NEO's systems, NEO must move gas through the Cobra pipeline. NEO does not have access to Cobra's internal systems and processing plants. If there was an overcharge, it was Cobra's error; not NEO's. Accordingly, Cobra must be involved in a proceeding determining whether Cobra overcharged NEO.

Also related to Cobra's Tariff, the OCC avers that Companies should be negotiating with Cobra to violate their tariff. When Cobra processes gas, Cobra removes the wet gases such as propane and butane out of the natural gas. (Whelan Cross 97:5-8). The volume of wet gases removed is replaced with natural gas. (Whelan Cross 97:12-18). It is generally accepted that currently butane and propane are more valuable than natural gas. (Whelan Cross 98:1-2). The OCC criticizes the Companies for not being reimbursed for the difference in price between the wet gas removed and the replaced natural gas; however Mr. Whelan explained that this process was pursuant to Cobra's tariff, which permits the pipeline to process gas. (Whelan Cross 98:10-15). The Companies cannot process gas and sell wet gas because the Companies do not have a processing plant. (Whelan Cross 99:15-21). Moreover, Mr. Whelan testified that the Companies did look into whether they could process gas themselves, but they determined that it was not feasible because the gas flows were not consistent enough. (Whelan Cross 100:3-6). The OCC's criticism also ignores the fact that if Cobra were required to reimburse its users for all separated natural gas liquids, Cobra might well charge users more to transport gas than it currently charges. Prices are not set in a vacuum. Finally, the OCC's argument fails to account for the ever-changing gas markets, and the possibility that natural gas will become more expensive than wet gases. If that happens, the Companies will receive the benefit from Cobra's tariff provision.

iii. The OCC's request to disallow all of JDOGM's fees for interstate gas purchases is inappropriate and unreasonable.

The OCC argues that all of JDOGM's fees for interstate gas purchases should be disallowed by the Commission. The OCC wrongly claims that the Companies paid JDOGM $647,906.06 in fees *for interstate purchases*. (OCC Brief 23). The OCC cited the Companies' Responses to Interrogatories Nos. 23 and 24 to the OCC's First Amended Discovery Requests to determine the amount paid to JDOGM for interstate purchases. (OCC Exhibit 6). The OCC's request for disallowance of $647,906.06 is highly misleading because the interrogatories ask "[w]hat were the *total* fees paid" by NEO and Orwell "for the audit period for services provided by JDOG[M]," during the NEO and Orwell Audit? (OCC Exhibit 6). Thus, the response included fees paid to JDOGM for services related to interstate purchases, intrastate purchases, and any other service that JDOGM provided for the Companies.

Also in support of the OCC's argument, the OCC claims that Mike Zapitello was the only employee of JDOGM working on behalf of the Companies. (OCC Brief 23). This conclusion is unsupportable. The Companies had only one contact at JDOGM, Mike Zapitello; but that does not prove that he was the only person at JDOGM working on behalf of the Companies. The OCC based this information on OCC Exhibit 6, which is a copy of all of the Companies' Discovery Responses to the OCC. Interrogatory 23 of the Companies' Responses to the OCC's First Amended Discovery Requests asked the Companies to identify the individuals at JDOGM who were involved in the procurement of natural gas for the Companies during the Audit Periods. (OCC Ex. 6). The

Companies' response explained that the Companies did not know the operations of JDOGM and that any response would be speculative:

> Objection, in addition to the General Objections, the Companies object to the Interrogatory because it requires the Companies to speculate because JDOG[M] is a separate entity that operates under separate control from the Companies and its complete employee list and corresponding duties are not necessarily known to the Companies. Without waiving these objections, the Companies state: Mike Zappitello.

(OCC Ex. 6). Again, the OCC misconstrued the Companies' discovery responses in order to prejudice the Companies.

It is clear that the OCC's and the Staff's analysis of JDOGM lacked any objectivity. As evidence of lack of internal controls in the Companies, the OCC and the Staff repeatedly assert that the Companies and GSNC did nothing to review JDOGM's purchases of natural gas for the Companies. These assertions are false. The Staff and the OCC's arguments lack credibility because they twist every action taken by the Companies as evidence of wrongdoing. Any instance where the Companies reviewed, supported, or evaluated JDOGM's services, the Staff and the OCC claim that the Companies were performing JDOGM's services. For example, NEO provided JDOGM with information related to the Companies' local production needs. (Whelan Cross 88:15-19). Mr. Whelan explained to the OCC that JDOGM provided services to the Companies and the Companies provided oversight and recommendations to JDOG:

> Q: So [JDOG] didn't do any independent analysis; they simply took the information you gave them and then went out and contracted for volumes of gas to meet your requirements, correct?
>
> A: No.
>
> Q. No?

A: They would send us what they felt we needed for the month and prior to the month. We would review it and say "we think you should do this" or "we think you should do that" and make a recommendation.

(Whelan Cross 88:21 – 89:6). The OCC and the Staff argue that assisting in the purchases of gas so that purchase volumes are more accurate *is a bad thing* because it makes JDOGM redundant. However, the flip side of that coin is that the Companies are doing exactly what the OCC and Staff wants them to do: ensuring that JDOGM's is providing effective service by also examining purchasing needs.

The OCC's request to disallow the entirety of JDOGM's fees is unreasonable, and the Commission should reject the proposal.

D. The Staff's and the OCC's request for wide-ranging management and performance audits at the cost of the Companies is unreasonable and violates Ohio law.

The Companies do not dispute that the Commission has the authority under R.C. 4905.302(C)(4) to conduct a Commission Order Investigation ("COI") of NEO and Orwell related to the Companies' management or performance. Because NEO and Orwell have less than 15,000 customers, the Commission must issue an order "setting forth the reasons showing good cause . . . and the specific matters to be audited, investigated, or subjected to hearing." R.C. 4905.302(C)(5).

Revised Code section 4905.302(C)(2) narrowly defines the scope of a management or performance audit:

> Any such management or performance audit and any such hearing *shall be strictly limited* to the gas or natural gas company's gas or natural gas production and purchasing policies. No such management or performance audit and no such hearing shall extend in scope beyond matters that are necessary to determine the following:

(a) That the gas or natural gas company's purchasing policies are designed to meet the company's service requirements;

(b) That the gas or natural gas company's procurement planning is sufficient to reasonably ensure reliable service at optimal prices and consistent with the company's long-term strategic supply plan;

(c) That the gas or natural gas company has reviewed existing and potential supply sources;

There are no exceptions to this law. To the extent that the Staff and the OCC request that the Commission order a COI with a scope greater than the enumerated matters in R.C. 4905.302(C)(2), the Staff and the OCC's requests must be denied.[5]

In their pre-filed testimony, both the OCC and the Staff requested that the cost of the proposed management and performance audits be borne by the shareholders of the Companies. The Staff did not discuss or make a recommendation related to this in the Staff's Post-Hearing Brief. On page 42 of the OCC's Brief, the OCC recommends that the Companies' shareholders pay for any COI ordered by the Commission "consistent with the PUCO Staff recommendations in this case." While it is unclear what the parties' positions are now regarding the cost of a potential COI, the law in Ohio is absolutely clear on this issue. R.C. 4905.302(C)(3) provides that "unless otherwise ordered by the commission for good cause shown . . .:(b) Except as provided in section 4905.10 of the Revised Code, the commission shall not impose upon such company any fee, expense, or cost of such audit or other investigation or any related hearing under this section."

[5] To the extent that the OCC and the Staff have spent inordinate time at the hearing and in their briefs addressing issues that are customarily involved in a management or performance audit, these arguments should be rejected as improper for a GCR hearing. The Staff and the OCC have strayed far beyond on the scope of GCR hearing in their Post-Hearing Briefs, and much of this irrelevant and prejudicial information would not even be permitted in scope of a management and performance audit.

The Staff and the OCC have not shown good cause for the Commission to impose the cost of a management or performance audit. The Staff failed to raise the issue in its Post-Hearing Brief, and the OCC stated that it supported the Staff's recommendation. Additionally, the OCC cites the Columbia COI Case as support for the Companies paying for a COI; however that case is not analogous to the instant proceedings. In the Columbia COI Case, the proceeding was a management and performance audit, not a financial audit for a GCR. The utility's shareholders were not paying for the COI. Rather, the Commission instructed the utility's shareholders to pay for the corrective action as a result of the order in the COI case. The Columbia COI Case does not stand for the proposition that there was good cause for the utility's shareholders to pay for a management and performance audit. The Staff and the OCC have failed to demonstrate good cause for the Companies' to pay for a proposed management and performance audit.

E. The RFP Reasonably Ensures Reliable Service at Optimal Prices.

Without waiving their positions that the RFP process occurred outside of the current audit period and that resulting contracts are not ripe for review (Companies' Brief 34-35), the Companies have demonstrated that the issuance of the RFP was a competitive process.

i. The RFP process was fair and competitive.

The Companies stand on their argument set forth on pages 35-42 of their Post-Hearing Brief regarding the fairness and competitiveness of the Companies' RFP Process. As discussed in section I. A. ii above, The OCC has claimed that the resulting rates of the RFP were not competitive and led to unreasonably high GCR rates during the Audit Period. This is argument is baseless. The RFP was issued after the Audit Period concluded, and therefore, the resulting rates could not be incorporated into the current GCR calculations. Furthermore, according to the Staff Audit, the OCC's argument is wrong. In the context of discussing the Companies' intrastate purchases, the Audit Report states: "Staff believes that local production purchases delivered directly into the companies' systems should continue to be priced above NYMEX as it currently is, but without the large premium paid to JDOG[M]. A more representative premium of the service provided by JDOG would be in the five to ten cent range, *comparable with the fees contained in the JDOG bid proposal.*" (Audit Report 22)(*Emphasis added*). Consequently, the most contentious issue in this proceeding – whether affiliated marketer is earning too high of profits on their fees – has been eliminated moving forward as a result of the reasonable fee arranged with JDOGM resulting from the RFP.

ii. <u>The Staff and the OCC Have Fully Litigated the Reasonableness of the Stipulation in the Prior Audit, and Therefore, the Doctrines of Res Judicata and Collateral Estoppel Preclude Relitigation of Issues in the Prior Audit.</u>

In Ohio, "[t]he doctrine of res judicata encompasses the two related concepts of claim preclusion, also known as res judicata or estoppel by judgment, and issue preclusion, also known as collateral estoppel." *O'Nesti v. DeBartolo Realty Corp.*, 113 Ohio St.3d 59, 2007-Ohio-1102, 862 N.E.2d 803, ¶ 6. With regard to claim preclusion, the doctrine of res judicata prevents subsequent actions, by the same parties or their privies, based upon any claim arising out of a transaction that was the subject matter of a previous action." *Id.* The previous action is conclusive for all claims that were or that could have been litigated in the first action. *See Holzemer v. Urbanski*, 86 Ohio St. 3d

129, 133, 712 N.E.2d 713 (1999). Thus, a prior adjudication serves to settle all issues between parties that could have been raised and decided along with those that were decided. *Charles A. Burton, Inc. v. Durkee*, 51 Ohio App. 3d 166, 555 N.E. 2d, 969, 974 (Ct. App.). Issue preclusion, or collateral estoppel, precludes "the relitigation, in a second action, of an issue that had been actually and necessarily litigated and determined in a prior action that was based on a different cause of action." *State ex rel Davis v. Pub. Emps. Retirement Bd.*, 120 Ohio St.3d 386, 2008-Ohio-6254, 899 N.E.2d 975, ¶25.

The principles of res judicata apply to quasi-judicial administrative proceedings. *Office of Consumers' Counsel v. Publ Util. Comm.* 16 Ohio St. 3d 9, 475 N.E. 2d 782 (1985). An administrative proceeding is quasi-judicial for purposes of res judicata if "the parties have had an ample opportunity to litigate the issues involved in the proceeding." *Set Prods., Inc. v. Bainbridge Twp. Bd. of Zoning Appeals*, 31 Ohio St.3d 260, 263, 31 OBR 463, 510 NE.2d 373, quoting *Superior's Brand v. Lindley*, 62 Ohio St.2d 133, 16 O.O.3d 150, 403 N.E.2d 996. A judgment entered by agreement is the same as if adjudicated on the merits means of litigation and is enforceable for res judicata purposes. *Packer, Thomas & Co. v. Eyster*, 126 Ohio App. 3d 109, 118 (Ohio Ct. App., Mahoning County 1998); *Kashnier v. Donelly* (1991), 81 Ohio App. 3d 154, 156, 610 N.E.2d 519. Accordingly, res judicata applies in the same way to an approved settlement at the PUCO as it would in a prior court proceeding.

Pursuant to O.A.C. 4901:1-30, the Staff, the OCC and the Companies entered into a Stipulation in the prior audit on, which was filed with the Commission on August 18, 2011 in Docket Nos. 10-209-GA-GCR, 10-212-GA-GCR, 10-309,GA-UEX, 10-312-

GA-UEX. The Commission modified and adopted the Stipulation on October 26, 2011. The Stipulation was comprehensive, and its purpose was to "resolve all issues pertaining to Northeast and Orwell" in the prior audit hearing. (Stipulation at 1). Pursuant to the Stipulation, the Companies and their affiliated natural gas company Brainard Natural Gas Corporation ("Brainard") were to terminate their existing contracts for "purchases of local production and the arrangement of purchases of natural gas in the interstate market . . . upon the entry of the Commission's Order adopting this Stipulation and Recommendation." (Stipulation at 6).

In connection with the RFP, the Stipulation between the parties filed in the prior audit case states in pertinent part:

> e. Gas Natural Service Company will coordinate with Staff and the OCC in designing and implementing the request for proposal(s) ("RFP") and the selection criteria that identifies in detail all services to be provided by the successful bidder. OCC shall have the right to fully participate in the RFP process to the extent it determines necessary in order to assure the Northeast and Orwell GCR customers are protected from the potential harm from onerous contract terms procuring their natural gas requirements and/or managing their capacity and storage assets. The request for proposal process shall lead to the receipt of competitive bids to manage the interstate transportation and storage capacity assets of the Companies and procure the gas requirements of the Companies' GCR customers and Brainard's GCR customers in the local and interstate markets. It is agreed that bids received from competitive bidders will be provided to Gas Natural Service Company, the Companies and Brainard, Staff and the OCC contemporaneously. Gas Natural Service Company will select the successful bidder in consultation with Brainard, Northeast, and Orwell. It is the intention of the Signatory Parties that the competitive bidding process will be completed by November 11, 2011.
>
> f. Marketers who are affiliated with or related parties to the Companies and Brainard shall be accorded the opportunity to participate in the competitive bidding process

> on the identical terms and access to information as non-affiliated marketers.

(Stipulation)(*Emphasis added*).

The Staff and the OCC now claim that the RFP process was uncompetitive and request that Commission reject the contracts that resulted from the RFP. The Staff and the OCC make these arguments based on issues that were resolved or could have been resolved in the prior audit hearing, which was fully adjudicated on the merits. A brief summary of the Staff's and the OCC's criticisms of the Companies' RFP process are as follows:

- The inclusion of JDOGM in the bidding process had a chilling effect by scaring off potential bidders. (OCC Brief 10).
- The RFP failed to provide adequate background data. (OCC Brief 28).
- The issuance of the RFP was delayed. (Staff Brief 18).
- Only six of fifteen potential bidders were prequalified. (OCC Brief 28).
- A single response to an RFP is not competitive. (Staff Brief 20).
- The RFP failed to provide necessary historical data. (OCC Brief 28).

The doctrine of res judicata prohibits the relitigation of the issues raised by the OCC and the Staff. The Stipulation in the prior audit set out the parameters that the same parties agreed to with respect to the set-up and issuance of the RFP. Section f. clearly allows JDOGM to participate in the RFP. The issue has been adjudicated on the merits, and the OCC's attempt to now relitigate whether JDOGM can participate in the RFP is precluded by the doctrine of res judicata.

Additionally, the doctrine of res judicata precludes the relitigation of all issues between parties that could have been raised and decided along with those that were decided. *Charles A. Burton, Inc. v. Durkee*, 51 Ohio App. 3d 166, 555 N.E. 2d, 969, 974 (Ct. App.). The requirement that the Companies develop an RFP was stipulated to in the last GCR case. Section e. of the Stipulation defines the legally agreed to terms of the RFP process. If the Staff and the OCC wanted to add more requirements to the upcoming RFP process, such as the criteria in the bullet-points above, the OCC and the Staff should have raised those issues in the last GCR case where the establishment of the RFP was litigated. The OCC and the Staff should not have another bite of the apple in order to incorporate additional requirements into the RFP process. These arguments are precluded by the doctrine of res judicata.

F. The Staff and the OCC's Request to Order Management Performance Audits for Non-Party Utilities Violates Due Process Under the United States and Ohio Constitution.

The Staff and the OCC recommended that the Commission open a Commission Ordered Investigation into the management practices of NEO, Orwell, and their affiliated regulated companies Brainard Natural Gas Company, Cobra Pipeline, and Orwell Trumbull Pipeline. With regard to this recommendation, the Staff states that it "does not take this step lightly. This is, in fact, an unprecedented recommendation." (Staff Brief 16). The Staff and the OCC's recommendations are most likely unprecedented because they are unlawful and offend every notion of due process for NEO's and Orwell's affiliated companies.

i. <u>Ordering a management performance audits of non-party utilities constitutes a violation of the non-parties' due process rights.</u>

To impose an order requiring management performance and forensic audits of non-party affiliates – at their cost – arising from a hearing where they were not named as parties, not given notice of or the opportunity to participate any hearings or briefing, not given the opportunity to present or cross-examine witnesses, and not permitted to present evidence in their defense would violate the due process rights of the non-party affiliates guaranteed by the United States and Ohio constitutions. The Fourteenth Amendment of the United States Constitution provides that state governments may not "deprive any person of life, liberty, or property, without due process of the law. The Ohio Constitution guarantees "due course of law" which is virtually the same as the Due Process Clause of the Fourteenth Amendment of the United States Constitution. Section 16, Article I of the Ohio Constitution.[6] *In re Hua,* 62 Ohio St.3d 227, 258, 405 N.E.2d 255 (Ohio 1980).

The United States Supreme Court has established that the "deprivation of life, liberty or property by adjudication (must) be preceded by notice and opportunity for hearing appropriate to the nature of the case." *Hua* at 258, citing *Mullane v. Central Hanover Trust Co.*, 339 U.S. 306, 313, 70 S.Ct. 652, 94 L.Ed. 865 (1950). "'The formality and procedural requisites for the hearing can vary, depending upon the importance of the interests involved and the nature of the subsequent proceedings.'" *Id.* quoting *Boddie v. Connecticut*, 401 U.S. 371, 378, 91 S.Ct. 780, 786, 28 L.Ed.2d 113 (1971). In cases where important decisions affecting substantial rights turn upon controverted issues of fact, the "due process" right to an adjudicatory hearing would be meaningless unless the parties whose rights may be affected are allowed full opportunity to present their own evidence, to confront and cross-examine adverse witnesses, and to present oral argument in support of their respective positions.

[6] Because the "due course of law" provision of the Ohio Constitution is virtually the same as the "due process" clause of the Fourteenth Amendment, Ohio courts often look to the opinions of the United States Supreme Court decided under the Fourteenth Amendment in defining the rights guaranteed under Article I of the Ohio Constitution. *State ex rel. Heller v. Miller*, 61 Ohio St.2d 6, 399 N.E.2d 66 (1980).

Goldberg v. Kelly, 397 U.S. 254, 267-271, 90 S.Ct. 1011, 1020-1022, 25 L.Ed.2d 287 (1970).

There is no question that these due process requirements apply to decisions by the Commissions and the hearings conducted before them. For example, in *Vectren Energy Delivery of Ohio, Inc., v. Public Utilities Commission of Ohio,* 113 Ohio St.3d 180, 2006-Ohio-1386 at ¶ 53, 863 N.E.2d 599 ("*Vectren*"), the Ohio Supreme Court held that that the Commission did not violate a gas provider's due process rights during a gas-cost-recovery proceeding where the provider had received, among other things, a full hearing before the committee and actual notice of the same. The provider was permitted to present evidence to the Commission, including calling its own witnesses, cross-examining other parties' witnesses and filing exhibits, and was "able to argue its position through the filing of post hearing briefs and challenge the PUCO's findings through an application for rehearing." *Id.*

Unlike the gas provider in *Vectren*, Brainard Natural Gas Company, Cobra Pipeline, and Orwell Trumbull Pipeline have not been afforded due process. Certainly, at a minimum, non-parties to a gas-cost-recovery proceeding being subjected to orders of the Commission should be entitled to notice of and participation in any hearings. However, the Companies' non-party affiliates have had no notice of the hearings on the issues, no opportunity to present evidence, and no opportunity to participate in this briefing. Likely, this is because the Commission has no power to issue an order granting equitable relief against an entity that is not a party and over an entity it does not have personal jurisdiction. *See Columbus Homes Ltd. v. S.A.R. Constr. Co.,* 10th Dist. No. 06AP-759, 2007-Ohio-1702 (holding that a court cannot enter an order enjoining a non-party without giving them notice and an opportunity to be heard). Accordingly, the OCC's and the Staff's recommendation that the PUCO order a COI of the Companies' non-party affiliates – at their cost – should be rejected by the Commission because the Commission's order would violate the non-party affiliates' due process rights.

ii. The non-party utilities are not responsible for the actions of NEO or Orwell and cannot be held liable or otherwise punished for the actions of those entities.

If Commission wants to order management performance and forensic audits for the non-party affiliates, it must demonstrate an independent legal basis for any such order for each non-party affiliate. RC § 4905.302(C)(3) requires the Commission or an interested party to show *good cause* before requiring natural gas companies to submit to an audit. If good cause is shown, the cost of the audit is not to be imposed upon the company. RC § 4905.302(C)(4). Despite these clear standards, the OCC and Staff have failed to allege even the most basic facts that would demonstrate that the non-party affiliates should be subject to costly audits; instead, Staff and the OCC focus their briefs entirely on the alleged actions of NEO and Orwell. (OCC Brief 39-54; Staff Brief 16-42). None of these allegations implicate the non-party affiliates beyond the fact that some of the non-party affiliates share officers and/or shareholders with NEO and Orwell. The OCC and Staff have failed demonstrate the "good cause" necessary to require the requested audits and any such order would have the improper result of holding the non-party affiliates to be guilty by association in contravention of the Ohio Revised Code.

Even if the Commission had jurisdiction over the non-party affiliates to order management performance and forensic audits of the non-party affiliates' operations without evidence of good cause – which it does not -- it would be improper for the Commission to hold the non-party affiliates responsible for the alleged misdeeds or actions of their sister companies under Ohio law. It is well established that, absent piercing of the corporate veil, a parent company or corporation is not liable for the acts of its subsidiaries. *U.S. v. Bestfoods,* 524 U.S. 51, 61 118 S.Ct. 1876, 141 L.Ed.2d 43 (1998); *Belvedere Condominium Unit Owners' Assn. v. R.E. Roark Cos., Inc.* (1993), 67 Ohio St.3d 274, 617 N.E.2d 1075, *Dombroski v. WellPoint, Inc.,* 119 Ohio St.3d 506, 2008-Ohio-4827, 895 N.E.2d 538.

Similarly, sister corporations are separate entities not liable for the acts of the other. *Minno v. Pro-Fab, Inc. 121 Ohio St. 3d*, 905 N.E.2d 613, 2009-Ohio-1247, ¶ 11-12. This is true even where the corporations have common shareholders or are controlled by the same or substantially the same owners. *Id.* at ¶ 12 ("the common shareholder ownership of sister corporations does not provide one sister corporation with the inherent ability to exercise control over the other. Any wrongful act committed by one sister corporation might have been instigated by the corporation's owners, but it could not have been instigated by the corporation's sister").

Thus, the fact that the non-party affiliates share officers and directors with Orwell and NEO is irrelevant. Separate legal identities of related corporations must be respected even where directors and officers serve in various capacities in multiple entities. *CSAHA/UHHS Canton, Inv. v. Aultman Health Foundation,* 5th Dist. No 2012CA00303, 2012-Ohio-897, ¶ 110. The actions of NEO and Orwell alone are not enough to implicate the non-party affiliates or provide the good cause necessary to subject them to costly and time consuming audits. The OCC's and the Staff's recommendation must be rejected.

G. The OCC's Requested Penalties Are Inappropriate for Consideration in a GCR Proceeding.

The OCC has requested a number of penalties for alleged violations of various sections of the Ohio Revised Code by Orwell and NEO. The OCC first requests that a penalty of "no less than $60,000" be assessed against Orwell for its alleged violations of R.C. §§ 4905.30, 4905.32, 4905.35 and 4905.54. (OCC Brief 30-32). Second, the OCC requests a forfeiture of no less than $130,000 for the Companies' alleged failure to terminate certain contracts as required by a previous PUCO order in violation of R.C. 4905.54. (OCC Brief 33-34). Third, the OCC alleges that certain actions by NEO resulted in unreasonable rates for customers and discriminatory behavior in favor of an affiliate in violation of R.C. 4905.22 and 4905.35 and seeks a penalty of no less than $10,000. (OCC Brief 34-36). Fourth, the OCC alleges that NEO violated R.C. 4905.35 by allegedly failing to enforce certain contract terms with its affiliates, resulting in unreasonable rates and constituting discriminatory behavior and seeks a penalty of no less than $10,000. (OCC Brief 36-37). Lastly, the OCC seeks an additional $10,000 for the Companies' allegedly discriminatory payment practices favoring affiliates in violation of R.C. 4905.35. OCC Brief at 37-39. In sum, the OCC is seeking at least $220,000 in forfeitures from NEO and Orwell in a GCR proceeding without notice and without providing NEO or Orwell an opportunity to dispute the allegations.

i. <u>This GCR case is an inappropriate forum for the PUCO to assess forfeitures against NEO and Orwell.</u>

The Revised Code and the Commission's Rules do not contemplate the assessment of forfeiture in a GCR proceeding. Section 4905.54 of the Revised Code provides the Commission with the power to "assess a forfeiture of not more than ten thousand dollars for each violation or failure against a public utility...that after due notice fails to comply with an order, direction or requirement of the commission that was officially promulgated."

The procedural framework for GCR cases is set forth in section 4905.302. Specifically, R.C. 4905.302(C) provides that the Commission establish rules for the purchased gas adjustment clause, including investigative procedures, including periodic reports, audits, and hearings to examine the accuracy of the gas costs reflected in the company's GCR rates. Commission rules specify how these audits and hearings are to be conducted. *See* O.A.C. § 4901:1-14-07.

Neither the Commission's rules nor R.C. 4905.302(C) provide for GCR cases to be anything other than a vehicle for analyzing NEO and Orwell's gas utility procurement policies and practices. This framework specifically limits the scope of the Commission's inquiry and analysis. Despite these clear limitations on the purpose and scope of GCR proceedings, the OCC has improperly attempted to transform these proceedings into an enforcement mechanism for assessing forfeitures on NEO and Orwell. Nothing in the Ohio Revised Code or the Commission's rules provides for forfeiture in a GCR case under R.C. 4905.54. Accordingly, the OCC's attempt to assess penalties upon the Companies should be rejected.

ii. <u>NEO and Orwell have not had notice of or the opportunity to defend themselves against the violations alleged by the OCC.</u>

The violations of Ohio Revised Code that the OCC alleges give rise to the penalties requested have nothing to do with and are entirely separate issues than those contemplated by the commencement the GCR case. All but one of the penalties sought by the OCC are based on the alleged violations of entirely separate sections of the Ohio Revised Code than the GCR provisions. For example, in its first request for a penalty, the OCC argues that Orwell has violated R.C. 4905.30 (which requires that printed schedules of rates be filed with the Commission), R.C.4905.32 (requiring that only rates on file with the Commission be collected), R.C. 4905.35 (prohibiting utilities from making or giving any undue or unreasonable preference or advantage to any person), and R.C. 4905.54 (forfeiture for the violation of Commission order). All of these sections are separate and independent from the GCR case or the inquiry conducted therein.

Due process considerations in the Fourteenth Amendment of the United States Constitution and Section 16, Article I of the Ohio require that NEO and Orwell be provided with notice of these alleged violations and be provided the opportunity to present their own evidence in their defense and to confront and cross-examine adverse witnesses, and support their positions before being deprived of a property right via fines and penalties. *See Vectren Energy Delivery of Ohio, Inc., v. Public Utilities Commission of Ohio, 113 Ohio St.3d 180, 2006-Ohio-1386 at ¶ 53, 863 N.E.2d 599.* Additionally, the OCC must establish the elements of each of these violations prior to a penalty being assessed. The fact that a GCR case is pending did not provide NEO and Orwell with notice of claims of violations unrelated to the GCR proceedings.

In addition to the numerous violations of the Ohio Revised Code outlined by the OCC, the OCC twice claims that the Companies have acted in contravention to a Commission order in violation of Section 4905.54 for alleged action (or inaction) following the October 26, 2011 Opinion and Stipulation reached in the 2010 GCR case. First, the OCC claims that Orwell failed to terminate its residential transportation program in violation of the Order and Opinion arising from the 2010 case.[7] (OCC Brief 31). Second, the OCC claims that the same October 26, 2011 Opinion and the relevant Stipulation required NEO and Orwell to terminate their affiliate gas supply contracts and that NEO and Orwell failed to do so for 13 months after the order was promulgated. (OCC Brief 34).[8]

If the OCC believes that NEO and Orwell are in violation of the non-GCR sections of the Ohio Revised Code, the Commission's Rules or a Commission order, the OCC can raise those issues in the appropriate docket and provide the Companies with notice of the allegations against them. [9] By doing so, NEO and Orwell would be provided the with an opportunity to put on a defense, rather than being left to guess which violations, penalties, and forfeitures the OCC would seek until the OCC filed their initial post-hearing brief. The OCC has not and cannot demonstrate that the requested penalties are warranted. Even if they could, the Companies have a right to notice of the

[7] With respect to the OCC's first allegation on pages 30-33, the OCC concedes that Orwell did not actually violate an order of the Commission but rather an order that the Commission "could have" made in the 2010 GCR case. OCC Brief at 31. At a minimum, R.C. 4905.54 only permits assessment of forfeiture where a utility has violated "an order, director, or requirement of the commission that was *officially promulgated.*" The OCC admits no such order exists and this argument should be disregarded.

[8] The parties also stipulated that no forfeiture actions would be brought against NEO and Orwell under R.C. 4905.22 or 4905.54 with respect to certain specified contracts. *See* 2010 Stipulation and Order § II(A)(3)(h). The OCC makes no distinction among which contractual relationships it alleges violated the October 26, 2011 Opinion and Stipulation and ignores this agreement.

[9] To the extent that the OCC believes the Companies violated the October 26, 2011 Opinion and the terms of the Stipulation, the OCC is free to raise those issues in that case. The case pending before the commission is a separate GCR proceeding; it is not a mechanism for enforcement of the Commission's previous orders.

claims alleged and an opportunity to defend themselves – an opportunity not afforded in this or any other GCR proceeding.

III. CONCLUSION.

As demonstrated in the Companies' Post-Hearing Brief and Reply Brief, the record in this proceeding demonstrates that the Companies' natural gas purchases during the Audit Period have been and are based on prudent and reasonable gas supply policies and practices. For the foregoing reasons and the reasons provided in the Companies' Post-Hearing Brief, the Companies urge the Commission to reject the OCC's and the Staff's proposed disallowances and their repricing methodology. Additionally, the Companies urge the Commission to deny the Staff's and the OCC's request to order a management and performance audit of the Companies and their regulated affiliates at the cost of their shareholders.

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