BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Complaint of Orwell Natural Gas Company,	:	Case No. 14-1654-GA-CSS
Complainant,	:	
vs.	:	
Orwell-Trumbull Pipeline Company, LLC,	:	Case No. 15-637-GA-CSS
Respondent.	:	

REPLY BRIEF
SUBMITTED ON THE BEHALF OF THE STAFF OF THE PUBLIC UTILITIES COMMISSION OF OHIO

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INTRODUCTION

On November 20, 2008, Orwell-Trumbull Pipeline Company (OTP) filed an application for approval of a transportation service agreement between it and Brainard Gas Corporation and Orwell Natural Gas Company (Orwell or ONG). That agreement was entered into on July 1, 2008 ("2008 OTP-Orwell Arrangement"). OCC Exhibit 2, Attachment GS-5 (Slone Direct). The Public Utilities Commission of Ohio (Commission) reviewed the contract and found that it was reasonable and in the public interest, approving it by Entry dated December 19, 2008. *In the Matter of the Application of Orwell Trumbull Pipeline Company, LLC for Approval of Two New Transportation Service Contracts*, Case No. 08-1244 (Entry) (December 19, 2008). These proceedings concern two disputes that relate to that agreement.

The first dispute (Case No. 14-1654-GA-CSS) related to a pair of invoices sent to Orwell by OTP seeking payment for purportedly unpaid (and previously unbilled) transportation services. OTP has since withdrawn the invoices. OTP Exhibit 1.

The second dispute (Case No. 15-637-GA-CSS) related to a rate adjustment, allowing OTP to unilaterally raise transportation rates if a negotiated adjustment could not be reached. Orwell claims that the rate imposed by OTP is detrimental to its ratepayers, as are a number of other provisions in the agreement. Orwell has requested that the Commission reevaluate the agreement to determine more suitable arrangements. It has also requested that the Commission order OTP to file new tariff rates for transportation service.

By Entry dated August 5, 2015, the Attorney Examiner found that a hearing should be scheduled in the cases. The Office of the Ohio Consumer' Counsel (OCC) intervened, and the Commission Staff notified the Attorney Examiner that it intended to participate in the hearing. The evidentiary hearing was conducted November 3rd and 4th, 2015.

After the cases were filed, but before the hearing commenced, OTP filed a demand for arbitration, claiming that Orwell had breached the 2008 OTP-Orwell Arrangement. OTP Exhibit 2. That proceeding has been scheduled, but has not yet occurred.

The Complainant, Orwell, and Respondent, OTP, filed post-hearing briefs on December 16, 2015, as did the intervenor, the Office of the Ohio Consumer' Counsel (OCC). Orwell and OCC argue that the Commission should reverse its decision approving the special contract, or, alternatively, significantly modify it. OTP argues that

the Commission has no jurisdiction to interfere with the dispute pending in arbitration, and that it lacks, or lacks justification to invoke, its authority to modify the arrangement. While there is some merit in each of these views, Staff respectfully submits that the transportation service agreement no longer, at least, serves the public interest, and that the Commission has both the authority and the responsibility to ensure that there are adequate safeguards in place to protect the customers of both Orwell and OTP.

ARGUMENT

I. The Commission's Authority

Orwell brought complaints in Case Nos. 14-1654-GA-CSS and 15-0637-GA-CSS pursuant to R.C. §§ 4905.06 and 4905.26, respectively. These provisions invoke both the Commission's general supervisory powers and its jurisdiction over service-related matters. In addition, both Orwell and OCC invoke the Commission's authority under R.C. §4905.31 to change, alter, or modify reasonable arrangements, like the 2008 OTP-Orwell Arrangement.

While acknowledging the Commission's jurisdiction under R.C. §4905.26, OTP argues that it has conformed to the Commission-approved terms of its agreement, that no grounds lie for granting the relief sought. In addition, OTP claims that the Commission's authority under R.C. §4905.31 does not extend to vacating the agreement. Moreover, it argues that the authority to change, alter, or modify an agreement is extraordinary, and is subject to a burden of proof of the highest order.

A. Over the Withdrawn Invoices

As noted above, Case No. 14-1654-GA-CSS related to a pair of invoices sent to Orwell by OTP seeking payment for purportedly unpaid (and previously unbilled) transportation services. OTP withdrew the invoices at the beginning of the evidentiary hearing. OTP Exhibit 1, Tr. Vol. I at 7-8.

As Orwell noted in brief, counsel for OTP represented that "the invoices to recover transport across the two-inch lines will not be reissued on the same theory." *Id.* at 11-12. Orwell asks the Commission to clarify that "the charges were unjust and unreasonable, and order OTP not to issue similar invoices to Orwell in the future." Orwell Post-Hearing Brief at 22.

Staff believes that Orwell has demonstrated that it has been complying with the 2008 OTP-Orwell Arrangement. Inasmuch as the invoices have been withdrawn, however, there is little, if any, basis for the remainder of the relief requested in Orwell's Complaint. Orwell has not demonstrated that it is entitled to attorney fees, nor, other than references to its efforts in litigating the case, has it alleged any damages for which relief can be granted pursuant to R.C. §4905.61.

B. Over Disputed Issues in Arbitration

At the outset of the evidentiary hearing, counsel for OTP moved the Commission for an order directing the demanded arbitration to go forward, and that Orwell be ordered to raise its issues in these complaints in that forum. Tr. Vol. I at 17, lines 8-19. The

Attorney Examiner denied that motion. Tr. Vol. I at 23, lines 11-12. OTP has since requested that an Interlocutory Appeal be certified from that ruling.

OTP relies on a provision in the 2008 OTP-Orwell Arrangement that all disputes shall be resolved by arbitration to argue that the Commission had no jurisdiction to proceed with the hearing in this case. R.C. §2711.01 (A) provides that such clauses "shall be valid, irrevocable, and enforceable, except upon grounds that exist at law or in equity for the revocation of any contract." OTP further relies on R.C. §2711.02 (B), which directs that a court "shall on application of one of the parties stay the trial of the action until the arbitration of the issue has been had in accordance with the agreement."

The Attorney Examiner's ruling was proper. R.C. §4905.26 confers jurisdiction to the Commission to hear any complaint against a public utility regarding whether a charge is unjust, unreasonable, unjustly discriminatory, unjustly preferential, or in violation of law. Indeed, the Ohio Supreme Court recently reaffirmed this view when it held that R.C. §4905.26 " 'confers exclusive jurisdiction on the PUCO to adjudicate complaints filed against public utilities challenging any rate or charge as "unjust, unreasonable, * * * or in violation of law." ' (Brackets sic.) *DiFranco v. FirstEnergy Corp.*, 134 Ohio St.3d 144, 2012-Ohio-5445, 980 N.E.2d 996, ¶ 19." *In re Complaint of Pilkington N. Am., Inc.*, Slip Opinion No. 2015-Ohio-4797, ¶ 24.

Further, R.C. §4905.26 gives the Commission *exclusive* jurisdiction over service-related issues regarding public utilities. *Corrigan v. Illuminating Co.*, 111 Ohio St.3d 265, 2009-Ohio-2524, 910 N.E.2d 1009, ¶¶ 8-10 (2009). This is true even where the Commission did not, as here, approve the underlying contract. OCC properly notes that

the Commission has recently reaffirmed that contractual issues involving service quality and PUCO regulations are within its jurisdiction. *In the Matter of Ohio Schools Council, Ohio School Boards Association, Ohio Association of School Business Officials, and Buckeye Association of School Administrators, dba Power Schools v. FirstEnergy Solutions Corp.*, Case No. 14-1182-EL-CSS, Entry at ¶9, (November 18, 2015).

Staff agrees with Orwell and OCC that arbitration is not the proper forum to resolve this Complaint. That does not mean, however, that arbitration is not a proper forum for resolving OTP's complaint. The record simply does not reveal that OTP's complaint is service-related.

OTP's demand for arbitration claims that Orwell is in breach of the 2008 OTP-Orwell Arrangement, that OTP had sustained damages in the amount of $100,000, and that those damages were ongoing. OTP apparently predicated its complaint on that provision of the agreement whereby Orwell "agreed to exclusively use OTP's pipelines to transport gas to its customers." OTP Exhibit 2.

On brief, Orwell claims that the "arbitrator will be determining the parties' rights under the sole-source provision and whether OTP has been adequately maintaining system pressure." Orwell Post-Hearing Brief at 23. Unfortunately, however, the record in this case is devoid of any other information regarding the particulars of that arbitration demand. The record does include Orwell's Counterclaim and OTP's Answer to that Counterclaim. *Id.* While many of those claims are comparable to issues raised in these cases, it is not possible for Staff to represent that the underlying complaint is not distinct,

separate, and appropriate to adjudicate in the arbitration process authorized when the Commission approved the 2008 OTP-Orwell Arrangement.

In argument before the Attorney Examiner, counsel for OTP asserted that the Commission "can address the arbitrator's determination once it has been entered." Tr. Vol. I at 17. Staff does not opine on whether the Commission would have jurisdiction to review, reverse, or modify the arbitrator's decision, but does recommend that the Commission order OTP to file any final determination in this docket for the Commission's further consideration once rendered.

C. Over the Reasonable Arrangement

The Commission is a creature of statute and, as such, has only that authority granted to it by the General Assembly. *Columbus S. Power Co. v. Pub. Util. Comm.*, 67 Ohio St.3d 535, 620 N.E.2d 835 (1993); *Pike Natural Gas Co. v. Pub. Util. Comm.*, 68 Ohio St.2d 181, 22 O.O.3d 410, 429 N.E.2d 444 (1981); *Consumers' Counsel v. Pub. Util. Comm.*, 67 Ohio St.2d 153, 21 O.O.3d 96, 423 N.E.2d 820 (1981); and *Dayton Communications Corp. v. Pub. Util. Comm.*, 64 Ohio St.2d 302, 18 O.O.3d 478, 414 N.E.2d 1051 (1980). The Commission has the authority to hear and decide this case, notwithstanding the arbitration proceeding that is currently pending under its terms. This authority derives from multiple statutory sources.

In the first instance, the General Assembly has given the Commission broad power to regulate public utilities. The Commission is granted broad and plenary power to supervise, regulate, and monitor almost every aspect of the operations and charges of

public utilities. *State ex rel. Columbus S. Power Co. v. Fais*, 117 Ohio St.3d 340, 2008-Ohio-849, 884 N.E.2d 1, ¶19 ("The commission has exclusive jurisdiction over various matters involving public utilities, such as rates and charges, classifications, and service, effectively denying to all Ohio courts (except [the Ohio Supreme Court]) any jurisdiction over such matters."). The Ohio Supreme Court found that

> The General Assembly has created a broad and comprehensive statutory scheme for regulating the business activities of public utilities. R.C. Title 49 sets forth a detailed statutory framework for the regulation of utility services and the fixation of rates charged by public utilities to their customers. As part of that scheme, the legislature created the Public Utilities Commission and empowered it with broad authority to administer and enforce the provisions of Title 49.

Kazmaier Supermarket, Inc. v. Toledo Edison Co., 61 Ohio St.3d 147, 150, 573 N.E.2d 655, 658 (1991).

The Commission also has authority to modify rates in a complaint proceeding. The Commission is not precluded from regulating rates under R.C. §4905.26. The Ohio Supreme Court has repeatedly held that the Commission has considerable authority under R.C. §4905.26 to investigate the reasonableness of any rate or charge and impose new utility rates or change existing rates of a public utility. *Consumers' Counsel v. Pub. Util. Comm.*, 110 Ohio St.3d 394, 2006-Ohio-4706, ¶¶ 29, 32. See, e.g., *Allnet Communications Servs., Inc. v. Pub. Util Comm.*, 32 Ohio St.3d 115, 117, 512 N.E.2d 350 (1987) ("R.C. 4905.26 is broad in scope as to what kinds of matters may be raised by complaint before the PUCO.").

In the *Consumers' Counsel* case, the OCC argued that a utility seeking to change its existing rates for customers must file an application under R.C. §4909.18 and follow all of the requirements of that statute and R.C. §4909.19. The agreement to raise utility rates in that case arose in the context of a complaint case rather than in a rate-increase proceeding. *Id.* at ¶ 28. The Court held that the Commission acted lawfully and noted that it had allowed the Commission to impose new utility rates in other R.C. §4905.26 proceedings. *Id.* at ¶ 32. The Court held the Commission complied with all of the procedural requirements in R.C. §4905.26 and that is all that was required. *Id.*

Under R.C. §4905.26 the Commission shall fix a time for hearing, give notice, and parties to the proceeding "shall be entitled to be heard, represented by counsel, and to have process to enforce the attendance of witnesses. The Commission did all of that here. It held a hearing, and took testimony from witnesses called or subpoenaed to do so. Given adequate record evidence to support a change, the Commission is empowered to fix rates for OTP in this proceeding.

Finally, the General Assembly granted the Commission broad authority over the approval and supervision of reasonable arrangements. R.C. §4905.31 permits "reasonable arrangement[s]" between utilities and customers. Parties may propose several types of arrangements for Commission approval, including "[a]ny * * * financial device that may be practicable or advantageous to the parties interested." R.C. §4905.31(E). These financial devices often take the form of negotiated rate schedules tailored to govern a specific utility-customer relationship. R.C. §4905.31 explicitly states that every "reasonable arrangement shall be under the supervision and regulation of the

commission, and is subject to change, alteration, or modification by the commission." See *Martin Marietta Magnesia Specialties, L.L.C. v. Pub. Util. Comm.*, 129 Ohio St.3d 485, 2011-Ohio-4189, 954 N.E.2d 104, ¶ 32 ("There is no dispute that pursuant to R.C. §4905.31, the commission has authority to regulate, supervise, and modify special contracts.").

For example, the Ohio Supreme Court has stated that R.C. §4905.31 authorizes the Commission to modify or change the terms of a reasonable arrangement without the consent of the utilities. *In re Application of Ormet Primary Aluminum Corp.*, 29 Ohio St.3d 9, 2011-Ohio-2377, 949 N.E2d 991, ¶¶ 36-38.[1] The Court in *Ormet* noted that the "statute does not expressly require the utility's consent to a reasonable arrangement." *Id.* at ¶ 29.

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[1] The Ohio Supreme Court has held, however, that the Commission must affirmatively invoke its authority under R.C. §4905.31 in order to make such modifications. Specifically, the Court held:

> There is no dispute that pursuant to R.C. 4905.31, the commission has authority to regulate, supervise, and modify special contracts. But nowhere in the commission's orders in this case did it claim to be using that authority to supervise, regulate, or modify appellants' special contracts. In fact, the commission *expressly denied* on rehearing that it had modified the terms of these special contracts in the underlying cases. Given that the commission never invoked the authority provided by R.C. 4905.31 in the proceedings below and affirmatively disclaimed that it was modifying the contracts, it cannot defend its decision on that basis on appeal.

Martin Marietta Magnesia Specialties, L.L.C. v. Pub. Util. Comm., 129 Ohio St.3d 485, 2011-Ohio-4189, ¶ 32 (emphasis in original).

While a utility's *consent* to such an arrangement is not required, its *compliance* with an arrangement approved by the Commission is. The Court explicitly found that:

> although R.C. 4905.31 does not expressly require utility consent, it expressly requires utility compliance. The statute states, "No * * * arrangement is lawful unless it is filed with and approved by the commission." Subsection (E). The next sentence then commands the utility "to conform its schedules of rates, tolls, and charges to such arrangement"—that is, the commission-approved arrangement. Rather than giving utilities the right to cancel or consent, the statute requires utilities to conform to the approved arrangement.

Id. at ¶ 34.

OTP correctly argues that the Commission has opined that cancellation is not a remedy specifically contemplated by R.C. §4905.31. OTP Post-Hearing Brief at 7. Staff agrees with OTP, as more particularly described below, that the arrangement should not be terminated. Staff does recommend, however, that the Commission exercise its authority under R.C. §4905.31 to revise certain of its provisions.

The Commission should not, and does not, undertake the modification of reasonable arrangements lightly. OTP argues that the *Mobile-Sierra* doctrine dictates that agreements may be modified only in circumstances of unequivocal public necessity, subject to a burden of proof of the highest order. OTP Post-Hearing Brief at 8.

In general, the *Mobile-Sierra* doctrine provides that a rate that is the result of freely negotiated contract is presumed to be "just and reasonable" under the Federal Power Act, and may only be upset if that presumption is rebutted by evidence demonstrating that it is contrary to the public interest. *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *Federal Power Comm'n v. Sierra Pac.*

Power Co., 350 U.S. 348 (1956). OTP extends that principle to argue that setting aside or modifying any contract requires a demonstration of unequivocal public necessity. OTP Post-Hearing Brief at 8-9.

OTP's argument goes too far. Its reliance on the *Mobile-Sierra* doctrine depends on interpretations of the Natural Gas Act and Federal Power Act, not Commission precedent or Ohio law. This is important, because the statutory authority granted to the Public Utilities Commission is fundamentally different than that granted to either the Federal Energy Regulatory Commission or the Federal Power Commission.

As the Supreme Court noted:

> The basic power of the Commission is that given it by § 5(a) to set aside and modify any rate or contract which it determines, after hearing, to be "unjust, unreasonable, unduly discriminatory, or preferential." This is neither a "rate-making" nor a "rate-changing" procedure. It is simply the power to review rates and contracts made in the first instance by natural gas companies and, if they are determined to be unlawful, to remedy them.

United Gas Pipe Line Co., 350 U.S. 332, 341 (1956). The Court found that the comparable provisions of the Federal Power Act were "in all material respects substantially identical to the equivalent provisions of the Natural Gas Act." *Sierra Pac. Power Co.*, 350 U.S. 348, 353 (1956). This is in stark contrast to the authority given to the Public Utilities Commission by Ohio's General Assembly. As noted above, the Ohio Supreme Court has unequivocally stated that "[t]here is no dispute that pursuant to R.C. 4905.31, the commission has authority to regulate, supervise, and modify special contracts." *Martin Marietta*, 129 Ohio St.3d 485, 2011-Ohio-4189, ¶ 32.

The characterization of these as "special contracts," and OTP's repeated characterization of its agreement as a "contract," is a bit of a misnomer. Rather, they are "reasonable arrangements." Such arrangement need not even be in the form of a contract. While the 2008 OTP-Orwell Arrangement happens to be in the form of a contract, it has no independent legality or enforceability outside of the provisions of R.C. §4905.31. Indeed, R.C. §4905.31 specifically states that "[n]o such . . . arrangement is lawful unless it is filed with and approved by the commission." The very statute that authorizes the creation of such arrangements, in whatever form, specifies that they are subject to change or modification by the commission, authority not granted to either the Federal Energy Commission or the Federal Power Commission. No showing of "unjust, unreasonable, unduly discriminatory, or preferential" treatment is necessary for the Commission to invoke its authority under R.C. 4905.31.

But even were the Commission to adopt OTP's overstated position, Staff submits that Orwell and OCC have adequately demonstrated that the public interest demands certain modifications of this arrangement. As demonstrated in their briefs, and as more fully discussed below, this transaction (in contrast to those involved in the *Mobile-Sierra* cases) did not involve an arm's length transaction, demanding sole-sourcing while providing inferior quality service to human needs customers. The Commission has the clear authority, long recognized by the Ohio Supreme Court, to hear and decide this matter, including modification of the arrangement to the extent necessary to protect the public interest.

D. To Order Refunds

Orwell and OCC recommend that OTP be ordered to refund $1,524,586 to Orwell, and $12,714 to Brainard, for excessive charges. Orwell Post-Hearing Brief at 25; OCC Post-Hearing Brief at 14. They argue that the agreement was not an arm's length agreement, but neither offers an acceptable legal basis for ordering such refunds.

OCC predicates its argument on the Commission's decision in *In the Matter of the Complaint of the Office of the Consumers' Counsel on behalf of Jim and Helen Heaton, et al v. Columbus and Southern Ohio Electric Company*, Case No. 83-1279-EL-CSS, (Opinion and Order) (April 16, 1985). That case concerned a rural line extension plan, and an "essentially untariffed" Aid to Construction requirement that customers pay the cost of extending service up front. The Commission found that the utility failed to offer the plan or denied extensions to eligible customers, imposing unwritten eligibility requirements in violation both the Ohio Administrative Code and its own tariffs. The Commission granted refunds to those complainants who paid amounts in excess of what they would have been paid had the utility offered service appropriately. *Id.* at 19.

The *Heaton* case is simply inapposite. This case falls squarely within the "filed rate doctrine." That doctrine has been codified, in part, in R.C. §§4905.22 and 4905.32. Under those sections, a public utility may neither charge nor collect a different rate than that specified in Commission-approved schedules that were in effect at the time the service was rendered. Specifically, R.C. §4905.22 provides that:

> All charges made or demanded for any service rendered, or to be rendered, shall be just, reasonable, and not more than the charges allowed by law or by order of the public utilities

> commission, and no unjust or unreasonable charge shall be made or demanded for, or in connection with, any service, or in excess of that allowed by law or by order of the commission.

Ohio Rev. Code Ann. § 4905.22. R.C. §4905.32 provides that:

> No public utility shall charge, demand, exact, receive, or collect a different rate, rental, toll, or charge for any service rendered, or to be rendered, than that applicable to such service as specified in its schedule filed with the public utilities commission which is in effect at the time.
>
> No public utility shall refund or remit directly or indirectly, any rate, rental, toll, or charge so specified, or any part thereof, or extend to any person, firm, or corporation, any rule, regulation, privilege, or facility except such as are specified in such schedule and regularly and uniformly extended to all persons, firms, and corporations under like circumstances for like, or substantially similar, service.

By charging the rates authorized by the Commission in effect at the time that bills were issued, OTP complied with the "filed rate doctrine" as embodied in Ohio law. There is nothing in the record that Orwell paid any rate for any service received that had not been approved by the Commission.

Ordering a refund would result in retroactive ratemaking, which is not permitted under Ohio's comprehensive statutory scheme. This doctrine was plainly articulated in *Keco Industries Inc. v. Cincinnati & Suburban Bell Tel. Co.*, 166 Ohio St. 254, 141 N.E.2d 465 (1957). In *Keco*, a consumer filed a complaint for restitution after the Court reversed a Commission order, resulting in lower rates. The Court held that such action would not lie because a "utility must collect the rates set by the commission." *Id.* at 166 Ohio St. 254, 257, 141 N.E.2d 465, 468. There is no question here that OTP charged,

and Orwell paid, rates approved by the Commission. The Ohio Supreme Court has consistently held that "[n]either the commission nor this court can order a refund of previously approved rates, however, based on the doctrine set forth in *Keco* . . . " *Green Cove Resort I Owners' Assn. v. Pub. Util. Comm.*, 103 Ohio St.3d 125, 2004-Ohio-4774, 814 N.E.2d 829, ¶ 27.

The filed rate doctrine and the rule against retroactive ratemaking generally restricts the right or ability of the Commission to permit a public utility to recover *past losses* through *future rates.* It also prevents *refunds* to consumers of profits of a utility which are subsequently found to have been *excessive*. Staff agrees with the position taken by OTP that the requested refunds cannot, and should not, be ordered in this case.

II. The Contract Provisions

Complainant, Orwell, and OCC object to the validity of the 2008 OTP-Orwell Arrangement. They argue that there is no contract. Because of the relatedness of the parties to the agreement, the lack of clarity of their respective responsibilities, and the oversight of their common owner, Richard Osborne, the contract, they argue, was not negotiated at arm's length. Consequently, they submit that the arrangement was void, and not merely voidable, and that the Commission should withdraw its previous approval.

Company witness Sarver, a member of the Commission Staff appearing in response to a subpoena, testified that Staff's review of applications for reasonable arrangements is typically limited to the application itself. Tr. Vol. 1 (November 3, 2015) at 181, lines 23-24. Although he himself was not responsible for the initial Staff review

of the 2008 OTP-Orwell Arrangement, he was not aware that any of the issues raised by Orwell or OCC in this proceeding were investigated by the Staff at the time that the contract was approved. *Id.* at 185, line 12.

Staff has serious concerns about the validity of the 2008 OTP-Orwell Arrangement. These concerns are similar to those voiced by Staff in its prior audits of Orwell's gas cost recovery (GCR) filings. In the 2010 audit proceeding, Mr. Sarver recommended that contracts with related gas suppliers be rejected, for many of the same reasons.

> Staff is still recommending that Orwell reject its contracts with its related party suppliers and asset manager. Staff is deeply troubled by Orwell's contractual relationship with ONG Marketing (ONG), John D. Oil and Gas Marketing, LLC, (JDOG) and Great Plains Exploration, LLC, (Great Plains), as well as the number of personnel that hold the same position within the utility and these related parties. These companies are the related party suppliers. It is my opinion that Orwell imprudently entered into, executed, and enforced contracts with these related parties . . .

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 Nos. 10-209-GA-GCR, *et al.,* Staff Ex. 1, Direct Testimony of Roger L. Sarver, at 6, lines 4-11. Notwithstanding these concerns, Staff is taking no position in this case whether the 2008 OTP-Orwell Arrangement should now be disapproved.

The passage of time has seen the development of serious conflicts between these parties, including the removal of alternative delivery options and the refusal to engage in

negotiations. As the Commission is aware, the disputes have even resulted in Gas Pipeline Safety investigations into tampering that cut off the flow of gas to certain customers. *In the Matter of the Commission's Investigation into Cobra Pipeline Co., LTD and Related Matters*, Case No. 14-1709-GA-COI (Staff Report) (September 26, 2014). In discovery, OTP indicated that it may choose not to enter into a new Transportation Service Agreement with Orwell if the agreement at issue is revoked. Staff is concerned that the revocation of this agreement may leave Orwell without a viable means of serving its customers.

Rather than recommend that the arrangement be terminated, Staff recommends that the Commission exercise its authority under R.C. §4905.31 to revise certain of its provisions.

A. Quality of Service

The 2008 OTP-Orwell Arrangement calls for delivery of gas supplies on an interruptible basis. Specifically, Section 1.1 of the agreement provides that:

> Shipper shall arrange with suppliers of Shipper's selection to have Gas in an amount not to exceed Shipper's MDQ adjusted for OTP's Shrinkage as specified on Exhibit B, tendered to the Receipt Point(s) as specified on Exhibit B, for delivery into the OTP Pipeline on Shipper's behalf. OTP shall then redeliver, on an *interruptible* basis, such quantities, less OTP's Shrinkage, to Shipper . . .

ONG Exhibit 1, Attachment A, page 4 (emphasis added).

Interruptible service is an inferior service. As defined by the agreement, interruptible volumes will be redelivered if OTP "determines that capacity exists after all

the Firm transport needs are accounted for to permit redelivery." *Id.* at page 3. Orwell witness Zappitello described the difference:

> Q (Mr. Serio). To the extent that you are involved in purchasing, you understand the distinction between an interruptible contract and a firm contract, right?
>
> A (Mr. Zappitello). Yes.
>
> Q. What's the difference between the interruptible and firm contract?
>
> A. Interruptible, your supply could be cut. Firm contract guarantees the deliverability outside of a force majeure.

Tr. Vol. I (November 3, 2015) at 30, line 25 – page 31, line 8.

Company witness Sarver testified that using interruptible transportation to serve residential customers was inappropriate.

> Q (Mr. Serio). Generally speaking, does the Staff of the Commission think it's appropriate for distribution companies to rely on interruptible service to serve the winter needs of human needs customers?
>
> A (Mr. Sarver). No, sir.
>
> Q. You would also agree that the Public Utilities Commission does not favor local distribution companies relying on interruptible service to serve human needs customers during the peak winter heating season, correct?
>
> A. No, we do not.

Tr. Vol. I (November 3, 2015) at 188, lines 4-14. This sentiment was echoed by OCC witness Slone. OCC Exhibit 2 at 12.

Mr. Sarver also testified that the Commission generally reviews such agreements in light of its Gas Transportation Program Guidelines, first established in Case No. 85-500 "85-800 Guidelines"). *Id.* at 183; *In the Matter of the Commission Ordered*

Investigation of the Availability of Gas Transportation Service Provided by Ohio Gas Distribution to End-Use Customers, Case No. 85-800-GA-COI. Those Guidelines provide that human needs and public welfare customers must have adequate backup or a reliable alternative supply "sufficient to maintain minimal operations." *In the Matter of the Commission Implementation of FERC Order 636 and Related Matters*, Case No. 93-1636-GA-UNC (Entry on Rehearing) (November 2, 1995) at Appendix A, pgs. 1-2.

Distribution companies, like Orwell, should not be permitted to serve residential and other human needs customers using interruptible transportation absent reliable, firm backup. Staff recommends that the Commission exercise its authority under R.C. §4905.31 to modify the 2008 OTP-Orwell Arrangement to require that the transportation service be firm, and not interruptible, in nature.

B. Sole-Source Supplier

The 2008 OTP-Orwell Arrangement calls for Orwell to use OTP exclusively to receive its gas supplies. Specifically, Section 1.2 of the agreement provides that:

> ONG agrees that during the term of this Transportation Service Agreement it will use only OTP's pipelines to transport gas for any of its customers, provided, however, that this exclusive use of the OTP pipelines shall remain in effect as long as OTP has available capacity within its pipelines. Should available capacity not exist, then during that period only ONG may use other pipelines to transport its gas requirements.

ONG Exhibit 1, Attachment A, page 4.

Sole-source arrangements are not uncommon, and have even been ordered by the Commission. In a recent case involving a reasonable arrangement between an electric distribution utility and an industrial customer, the Ohio Supreme Court noted that, although there was no evidence that the customer had agreed to a sole-source provision, it did not appeal a Commission order imposing such a provision. Consequently, the Court held that the customer was bound by the provision. *In re Ormet,* 129 Ohio St.3d 9, 2011-Ohio-2377, ¶ 22 (2011). Although the utility argued that the sole-source provision violated Ohio's "basic and central" electric policies: namely, those favoring the development of competitive markets, retail shopping, and customer choice, the Court found the impact on the competitive market to be a question of fact, rejecting the utility's argument due to a lack evidentiary support. *Id.* at ¶ 24.

By contrast, there is more than adequate evidentiary support in this record to justify a finding that the sole-source provision negatively affects Orwell's ability to serve its customers. Orwell witness Zappitello testified that the company had previously had a firm transportation agreement with Dominion East Ohio that was not only both of better quality and more economical, but also allowed Orwell to pursue additional transportation options. That agreement was abandoned, and a number of taps into Dominion were dismantled, as a result of the 2008 OTP-Orwell Arrangement. ONG Exhibit 1, Direct Testimony of Michael S. Zappitello, pages 7-8. "This overreliance on OTP does not allow Orwell to timely ensure gas supplies will always be available for its customers." *Id.* at 9.

Staff agrees that the sole-source provision has negatively impacted both Orwell and its customers. As Mr. Zappitello explained, the "Polar Vortex" that impacted many of Ohio's distribution companies placed Orwell in a position of having to purchase abnormally expensive gas. *Id.* at 11. Although the Staff found that Orwell's own actions contributed to the ultimate disallowance that Mr. Zappitello alluded to, Staff agrees that much of that cost could have been avoided if the company had had alternative transportation options. *In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained Within the Rate Schedules of Brainard Gas Corporation, Northeast Ohio Natural Gas Corporation, and Orwell Natural Gas Company and Related Matters*, Case Nos. 14-206-GA-GCR, et al. (Staff Report) (January 27, 2015) at 15; Orwell Post-Hearing Brief at 13.

Mr. Zappitello also testified that Orwell's customers are obliged to incur costly winter-time imbalances to allow OTP to maintain pressures adequate to serve Orwell customers. ONG Exhibit 1, Direct Testimony of Michael S. Zappitello, page 11. Staff agrees with Orwell that this problem could be minimized, if not eliminated altogether, if Orwell was able to contract for alternative transportation services. *Id.* at 12, Orwell Post-Hearing Brief at 11-12.

Finally, as Orwell noted, Staff member Sarver testified that the sole-source arrangement limits Orwell's ability to bring more suppliers to market, and to better competitively source their supplies. This limits Orwell's ability to respond to changes in the market. He also testified that sole-sourcing increases the risk of credit limitations, holding the company and its customers captive. Tr. Vol. I at 209.

The record in this case demonstrates a need for Orwell to have the option of arranging for transportation service with sources other than OTP. It further demonstrates that both Orwell and its customers have been negatively affected, both in terms of service and cost, as a result of the sole-source provision. Staff recommends that the Commission exercise its authority under R.C. §4905.31 to modify the 2008 OTP-Orwell Arrangement to eliminate the sole-source provision.

C. Automatic Price Adjustment

Section 2.1 of the 2008 OTP-Orwell Arrangement states that Orwell will pay OTP a Commodity Rate as contained in schedule, Exhibit B, attached to the agreement. The schedule provides that:

> Rates will adjust every five (5) years commencing on July 1, 2013 and continuing on each fifth (5th) anniversary date for the remaining term of this Agreement to reflect the higher of $0.95 per Thousand Cubic Feet (Mcf) or a negotiated rate to reflect the then current market conditions existing on each such rate adjustment date. If the parties cannot agree on a rate adjustment amount, OTP shall have the option to increase the Rate by the increase in the consumer price index all items (Cleveland, Ohio) ("CPI") as calculated from July 1, 2008 to each applicable rate adjustment date.

ONG Exhibit 1, Attachment A, page 11.

The rates did not adjust on July 1, 2013 as provided in the agreement. The record demonstrates that OTP notified Orwell that it was adjusting the rate upward from $0.95 / Mcf to $1.08 / Mcf fifteen (15) months after the agreed upon date, back-billing more than $80,000. *Id.*, Attachment J.

Staff is troubled by Orwell witness Zappitello's testimony that "OTP did not provide Orwell any prior notice regarding the proposed rate increase and did not attempt to negotiate the rate with Orwell prior to unilaterally increasing the rate." ONG Exhibit 1, Direct Testimony of Michael S. Zappitello, page 13. While the agreement permits OTP to unilaterally adjust the rate, its refusal to negotiate[2] reinforces Staff's belief that the Commission must affirmatively act to modify this arrangement.

As noted above, the Commission has the statutory authority to establish rates in this proceeding. Staff believes that the rates currently being charged by OTP are unjust and unreasonable, given the quality of service provided. The record demonstrates that Orwell is being charged more by OTP for interruptible transportation to serve human needs customers than OTP charges other customers for firm service. *Id.* at 13.

Staff is not, however, recommending that a new transportation rate be established in this case. As Orwell noted on brief, other customers on OTP are paying lower rates, ranging from $0.50 / Mcf to $0.95 / Mcf, for firm service. Orwell Post-Hearing Brief at 16. It is unreasonable to permit OTP to charge Orwell a higher rate for a lower quality service. But Staff is not persuaded that the currently charged $1.01 / Mcf rate would be unreasonable if the transportations service being provided was firm, as Staff recommends.

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[2] Staff does recognize that OTP acknowledged Orwell's claim that OTP has misapplied the CPI in calculating the new rate, and that OTP adjusted its new rate downward to reflect the correction. Staff also acknowledges that the plain language of the 2008 OTP-Orwell Arrangement clearly specified that the 5-year adjustments could only result in a rate that was the "higher of" the current or a CPI-adjusted rate.

Staff agrees with Complainant that OTP should be required to file a new transportation tariff. The OTP tariff does not specify a standard transportation rate. Rather, it requires all transportation customers to enter into a transportation service agreement. Given OTP's unwillingness to negotiate with Orwell, and its indication that it may choose not to enter into a new Transportation Service Agreement with Orwell if the agreement at issue is revoked, Orwell has no other means of serving its customers.

Staff believes that this is unjust and unreasonable, and recommends that the Commission exercise its general authority, and that granted by R.C. §4905.26, to order that OTP file a new transportation tariff to include standard rates for firm and interruptible transportation.

To this extent, Staff disagrees with OCC's recommendation that the Commission set a rate under the tariff for OTP to serve Orwell. While OCC witness Slone has proposed a $0.50 / Mcf rate, his recommendation is based on "what OP charges other customer and what Orwell pays other pipelines." OCC Post-Hearing Brief at 14. Staff submits that the present record is inadequate to set tariff rates for firm and interruptible transportation service, and that any tariff filing should be subjected to the Commission's scrutiny regarding the establishment of new rates.

D. 15-Year Term

The 2008 OTP-Orwell Arrangement calls for the agreement to run for 15 years. Specifically, Section 3.1 of the agreement provides that:

> The Agreement shall be effective as of the 1st day of July, 2008 and shall continue in full force and effect, terminating 15 years thereafter and shall continue from year to year thereafter, unless cancelled by either party upon 30 days written notice.

ONG Exhibit 1, Attachment A, page 5.

Transportation contracts of this length are quite unusual.

> Q (Mr. Serio). In your role as purchasing gas either for Orwell-Trumbull Pipeline or for the utilities, have you ever signed a contract with a 15-year term?
>
> A (Mr. Zapitello). No.
>
> Q. Are you aware of any other contracts that Orwell-Trumbull Pipeline or Orwell Natural Gas have that have a 15-year term?
>
> A. No.
>
> Q. For the majority of the gas purchasing and transportation contracts that you're familiar with in your employment with Orwell-Trumbull or Orwell, what would be the term that you normally have in those contracts?
>
> A. Just for transportation?
>
> Q. Let's take transportation first, yes.
>
> A. Generally all of them are signed year-to-year and have rollover periods.
>
> * * *
>
> Q. Have you negotiated gas transportation contracts that included terms of a year-to-year contract with rollover provisions?
>
> A. Yes.
>
> Q. When you negotiate those contracts, why do you generally include a one-year term with a rollover?
>
> A. Market conditions change.
>
> Q. So to the extent that you're negotiating a contract, do you find that the shorter year-to-year term is superior to a 15-year term contract?

A. Yes.

Tr. Vol. I (November 3, 2015) at 33, line 7 – page 34, line 13.

Company witness Staff member Sarver reiterated the same point:

> Q (Mr. Yuick). But doesn't a 15-year contract, a 15-year length of contract, doesn't that limit the ability -- particularly when it's in tandem with a sole source, doesn't that limit the ability of a natural gas utility to respond to changes or alterations in the market structure and commodity?
>
> * * *
>
> A. The answer is yes.

Tr. Vol. I (November 3, 2015) at 210, lines 3-14.

The fact that such term lengths are unusual does not necessarily mean that they are unreasonable, however. Nonetheless, Staff believes that this provision, when considered together with the quality of service, sole-source, and automatic rate adjustment provisions significantly disadvantages Orwell and its customers. Staff supports Orwell's recommendation that the contract should be in effect only until OTP files an approved tariff. ONG Exhibit 1, Direct Testimony of Michael S. Zappitello, page 22.

E. Arbitration Clause

The 2008 OTP-Orwell Arrangement contains an arbitration clause. That clause, which appears in Section 7.6, states that

> The parties agree that any dispute arising hereunder or related to this Agreement shall be resolved by binding arbitration under the auspices of the American Arbitration Association. Prehearing discovery shall be permitted in accordance with the procedures of the Ohio Rules of Civil Procedure. The

> arbitrator or arbitrators shall have authority to impose any remedy at law or in equity, including injunctive relief. The parties agree that any heating [*sic*] will be conducted in Lake County, Ohio.

ONG Exhibit 1, Attachment A, page 9.

As noted above, Staff believes that the presence of an arbitration clause in a contract, or reasonable arrangement, approved by the Commission does not deprive the Commission of its authority over that arrangement. The Commission's supervisory authority under R.C. §4905.31 supersedes any such clause that purports to supplant the Commission's authority.

The Commission has historically approved arbitration clauses in such arrangements. The practice was particularly common in the telecommunications industry. The fact that an arrangement contains such a clause does not *per se* render an agreement either unlawful or unreasonable.

Staff has objected to mandatory arbitration provisions in the past, but only in limited circumstances. For example, the Staff found that a competitive retail natural gas service supplier's customer agreement requiring customers "to submit to final binding arbitration under the American Arbitration Association rules" did not comply with the Commission's Minimum Gas Service Requirements. *In the Matter of the Application of Commerce Energy, Inc. d/b/a Just Energy for Certification as a Competitive Retail Natural Gas Provider*, Case No. 02-1828-GA-CRS (Staff Report) (September 20, 2010) at 5. Those standards explicitly require suppliers to inform customers that the Staff is available to mediate complaints. In that case, the Commission approved a stipulation

where the provider agreed to remove the arbitration language from its contracts. *Commerce Energy, Inc. d/b/a Just Energy,* Case No. 02-1828-GA-CRS (Opinion and Order) (November 22, 2010) at 9.

Indeed, the Commission's own rules provide for mediation and arbitration, both under the auspices of the Commission and before neutral third parties. Ohio Admin. Code Chapter 4901:1-26. Even under these rules, the Commission explicitly retains the right to proceed with a formal complaint pending before it, and parties retain the same rights of rehearing and appeal as they would have with any other Commission order. Ohio Admin Code 4901:1-26-04 (I), (J).

The Commission has historically favored alternative dispute resolution, and should not find the 2008 OTP-Orwell Arrangement to be either unlawful or unreasonable because of the inclusion of the Section 7.6 arbitration clause. Staff recommends that the Commission exercise its authority under R.C. §4905.31 to modify the 2008 OTP-Orwell Arrangement to replace the word "shall" in the arbitration clause with "may," to remove any confusion over the Commission's jurisdiction to resolve disputes relating to the contract. The Commission may also wish to clarify that it retains the authority to confirm, vacate, modify or enforce any arbitration award, consistent with Ohio Admin. Code 4901:1-26-04 (I).

III. The Osborne Companies

When the Commission issued its Opinion and Order in Orwell's 2012 Gas Cost Recovery (GCR) case, it stated that:

> The evidentiary record in these cases demonstrates a clear need for sweeping action. The Commission has authority to make whatever changes are necessary to ensure that the Companies operate in the best interests of their customers and in accordance with the law.
>
> * * *
>
> The Commission finds that an investigative audit of the Companies and all affiliated and related companies should be undertaken by an outside auditor.

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 Nos. 12-209-GA-GCR et al. (Opinion and Order) (November 13, 2013) at 56-7.

A forensic audit was ordered, and conducted during 2014 and docketed on January 23, 2015. *In the Matter of the Commission Investigative Audit of Brainard Gas Corporation, Northeast Ohio Gas Corporation and Orwell Natural Gas Company*, Case No. 14-205-GA-COI (General Investigation Report) (January 23, 2015).

From the time of the events that gave rise to the Commission's ordered audit until the time that the audit commenced, Richard M. Osborne either owned or controlled, individually or as CEO and Chairman of Gas Natural, Inc. (GNI), the distribution companies (Brainard, Northeast, Orwell) and pipelines. Commission records show that Richard M. Osborne, individually and/or as trustee, controls Cobra Pipeline Co., LTD., Orwell-Trumbull Pipeline Co., LLC, and Spelman Pipeline Holdings LLC. By May 1, 2014, however, before the auditors had begun their work, Mr. Osborne retired from GNI, relinquishing control over the distribution companies and severing the relationship

between them and the pipelines that he still controls. Consequently, the Commission-ordered forensic audit does not address concerns about the remaining Richard Osborne-controlled entities.

The concerns continue. Serious issues remain concerning companies that Mr. Osborne owns or controls, and the impact that his management has or may have on customers, potentially impacting health and safety.

Orwell and OCC recommend that the Commission investigate the management of the regulated utilities under Mr. Osborne's control. Such an investigation may be appropriate. Staff believes that Mr. Osborne's operations certainly merit greater scrutiny by the Commission due to the litany of complaints, issues and concerns raised by Staff and other parties.

CONCLUSION

Orwell Natural Gas and Orwell-Trumbull Pipeline were once both controlled and largely owned by Richard M. Osborne. While so related, they entered into an arrangement that was approved by the Commission. In a series of audits, Staff came to realize how intertwined and mismanaged these companies had become. The Commission-ordered investigation has set Orwell on an acceptable path, but its ability to adequately and reasonably serve its customers is threatened by an overpriced inferior quality sole sourced transportation agreement of unreasonable duration. The Commission should invoke its authority under R.C. §4905.31 to modify this agreement to ensure that human needs customers are assured of firm, reliable service at reasonable

cost. The Commission should further order that Orwell-Trumbull revise its transportation tariff to establish standard transportation rates.

Respectfully submitted,

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PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Reply Brief**, submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by via electronic mail upon the following parties of record, this 8th day of January, 2016.

/s/ Werner L. Margard III

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