BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Complaint of Orwell Natural Gas Company,	)	
v.	)	Case No. 15-637-GA-CSS
Orwell-Trumbull Pipeline Company, LLC.	)	

MEMORANDUM CONTRA ORWELL-TRUMBULL PIPELINE'S APPLICATION FOR REHEARING BY OFFICE OF THE OHIO CONSUMERS' COUNSEL

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I. INTRODUCTION

Orwell Natural Gas Company ("Orwell") brought a complaint against Orwell Trumbull Pipeline Company ("OTP") claiming that the special contract between Orwell and OTP was not the product of arms-length negotiation, and resulted in unjust and unreasonable rates for Orwell's GCR customers. This special contract also placed in effect a number of provisions that harmed the public interest by forcing Orwell's residential Gas Cost Recovery ("GCR") customers to rely on interruptible and unreliable gas service. The Office of the Ohio Consumers' Counsel ("OCC") intervened to protect the interests of over 7,500 of Orwell's residential customers. OTP has filed an application for rehearing that claims that the Public Utilities Commission of Ohio's ("PUCO") Opinion and Order violates the constitutional protections against the abrogation of contracts and *Mobile-Sierra* doctrine. However, these assignments of error present a

deeply flawed understanding of these legal doctrines. Even if those doctrines apply, the serious public policy concerns raised by the parties allow for this contract to be modified.

II. ARGUMENT

A. The PUCO did not violate the Constitution when it acted to protect customers from the unreasonable OTP contract.

OTP claims that the PUCO's modification of the 2008 Affiliate Transportation Agreement[1] ("Affiliate Agreement") violates Article 1, section 10, clause 1 of the U.S. constitution and Article II, Section 28 of the Ohio constitution.[2] This conclusion necessitates a misreading of the case law. The application of these documents has been looked at specifically in the public utilities context, and under that regulatory structure, the PUCO's order is appropriate and well within its jurisdiction.

Both the US and Ohio constitutions contain provisions that protect against the impairment of contracts.[3] However, both the federal and state case law support the argument that the PUCO has police-power authority that does not conflict with Contract Clause challenges.[4] In fact, the U.S. Supreme Court has fashioned a test to determine whether contracts are unconstitutionally impaired. The first inquiry is, "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship."[5] Yet, the PUCO's modifications were narrowly tailored to protect the public interest.[6]

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[1] OCC Exhibit 2 at Attachment GS-5 (Slone Direct).

[2] OTP Application for Rehearing at 6-8.

[3] *See* U.S CONST. art. I, §10, cl. 1; OHIO CONST. art. II, §28 ("Contract Clause").

[4] Util. Serv. Partners v. Pub. Util. Comm'n, 124 Ohio St.3d 284, 292-293.

[5] Energy Reserves Group v. Kansas Power & Light Co., 459 U.S. 400, 411 (1983).

[6] *See* Opinion and Order at ¶39-¶40 (June 15, 2016) (determining that the PUCO should not set aside the agreement, but rather only modify portions of it).

Furthermore, OTP has failed to present any evidence on the nature of the impact on them, let alone that any impacts are substantial.

The second prong examines the extent to which the contractual impairment is also a function of industry regulation. If the industry has already been subject to regulation, then it decreases the extent of the impairment.[7] OTP is an intrastate pipeline company, which means it is a fully regulated public utility (by the PUCO) under Ohio law.[8] As stated above, there is no question that these contracts are subject to the supervision of the PUCO. Therefore, the nature of impairment (to the extent any impairment exists) is severely decreased.

Even if the regulation or order impairs a substantial right, it is still appropriate if there is a significant and legitimate public purpose behind the regulation or if the order is emergency or temporary.[9] In this case, the order serves the important public interest of ensuring that there is reliable gas service to Orwell's residential GCR customers.[10] These are customers who depend on natural gas heating and need multiple reliable sources of gas for their homes. This is especially true, because the PUCO has recently raised numerous issues regarding the pipeline safety practices of the affiliate companies of OTP.[11] Requiring multiple sources for natural gas service is in accordance with past

[7] "One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the state by making a contract about them." *Id.* (citing *Hudson Water Co. v. McCarter*, 209 U.S. 349, 357 (1908)).

[8] *See* R.C. 4905.03 (E).

[9] *Energy Reserves Group*, 459 U.S. at 411-412.

[10] Opinion and Order at ¶46 (June 15, 2016).

[11] *In the Matter of the Commission's Investigation into Ohio Rural Natural Gas Co-op and Related Matters*, Case No. 16-1578-GA-COI, Staff Report at 20 (July 15, 2016) (Ohio Rural Natural Gas Co-op is an affiliate wholly owned by Richard Osborne that is a "willful and persistent violator of the Pipeline Safety Regulations.").

PUCO orders regarding Orwell and the provision of natural gas in general to residential customers.[12]

OTP's U.S. and Ohio Constitutional arguments to the PUCO must be rejected. In the words of the Ohio Supreme Court "[t]his point of law is amplified by numerous cases in which we have affirmed the commission's police-power orders against Contract Clause challenges."[13] These cases have made clear that neither the U.S. nor the Ohio constitution "affect the power of the state to protect the public health or the public safety."[14] This case has a direct impact on the reliability of natural gas that is provided for Orwell's residential customers and therefore directly impacts their public health and safety.

In support of their argument, OTP cites a number of cases that seem to claim that the PUCO is retroactively applying statutory provisions to the contract.[15] OTP does not refer to the fact that Ohio law plainly gives the PUCO continuing authority over these types of contracts, and is broad in its scope.[16] The statute specifically states, "[e]very such schedule or reasonable arrangement shall be under the supervision and regulation of the commission, and is subject to change, alteration, or modification by the commission."[17] The statute unmistakably maintains that these contracts are under the "supervision" of the PUCO, therefore, the PUCO has continuing authority over these

[12] *See infra* p. 9-10.

[13] Util. Serv. Partners, 124 Ohio St.3d at 292-293.

[14] *Id.*

[15] OTP's Application for Rehearing at 7.

[16] *See* R.C. 4905.31.

[17] R.C. 4905.31 (E).

contracts. It is evident from an analysis of the relevant case law that OTP's claim must fail, and the PUCO is well within its statutory and constitutional authority.

B. The PUCO did not err when it rejected the *Mobile-Sierra* doctrine from applying to contracts approved under R.C. 4905.31.

Mobile-Sierra is a federal doctrine that allows the Federal Energy Regulatory Commission ("FERC") to change or adjust independently bargained rate setting contracts only when, "the rate is so low as to adversely affect the public interest-as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory."[18] This has been traditionally applied by the U.S. Supreme Court in the context of the Natural Gas Act and the Federal Power Act for wholesale gas and electricity contracts.[19] However, this is a court doctrine that deals with federal laws and the authority of a federal agency, FERC.

As was previously discussed, the state authority with regard to contracts is not as circumscribed as federal authority because of the states' police power authority.[20] Furthermore, the context of *Mobile-Sierra* has consistently been rate challenges.[21] The challenges that are now brought in this case go far beyond simply contesting the rate that OTP is providing gas. In fact, the only issues that OTP argues in its application for rehearing are the switching of gas from interruptible to firm, suspension of the arbitration provision, and the limitation preventing Orwell from using other pipeline systems.[22]

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[18] *Fed. Power Comm'n v. Sierra Pacific Power Co*., 350 U.S. 348, 355 (1956).

[19] *Id*.(applying the doctrine to the Federal Power Act); *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 333 (1956) (applying the doctrine to the Natural Gas Act).

[20] *See Util. Serv. Partners*, 124 Ohio St.3d at 292-293.

[21] *See NRG Power Mktg. LLC v. Maine Pub. Util. Comm'n*, 558 U.S. 165, 168 (2010) (stating that "the *Mobile-Sierra* public interest standard would govern rate challenges.").

[22] OTP's Application for Rehearing at 2.

These were all changes that the PUCO made to protect the residential customers of Orwell, they are not rate challenges. Furthermore, as noted by the PUCO, neither the Federal Power Act nor the Natural Gas Act gives FERC the authority to change or modify contracts, which is explicitly granted by Ohio's reasonable arrangement law.[23] The U.S. Supreme Court defined the authority of FERC under the Natural Gas Act as, "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."[24] This is much more constrained than the PUCO's power where "[t]here is no dispute that pursuant to R.C. 4905.31, the [PUCO] has authority to regulate, supervise, and modify special contracts."[25] OTP's claim that the PUCO must conform to the *Mobile-Sierra* doctrine must fail.

C. OCC's original arguments regarding the *Mobile-Sierra* Doctrine apply.

Even if the PUCO were to apply the *Mobile-Sierra* doctrine to reasonable arrangements under R.C. 4905.31, the Affiliate Agreement would still not meet the standards that are imposed there. Not only had OTP already violated its own contract by issuing invoices outside the contract that were retracted the day before the hearing,[26] this contract was not the product of arms-length bargaining as required by the doctrine.[27]

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[23] *See* R.C. 4905.31 (E) (stating that "[e]very such schedule or reasonable arrangement shall be under the supervision and regulation of the commission, and is subject to change, alteration, or modification by the commission.").

[24] *United Gas Pipe Line Co*., 350 U.S. at 341.

[25] *Martin Marietta Magnesia Specialites, LLC v. Pub. Util. Comm'n*, 129 Ohio St.3d 485, 492 (2011).

[26] OTP claims that no one contested that contested that OTP failed to conform to the terms of the contract. However, this is simply not the case, OCC and Orwell provided evidence where OTP broke the contract by attempting to double-charge Orwell over $2.6 million for the use of gathering lines that were covered by the contract. *See* Opinion and Order at ¶26.

[27] *See* Opinion and Order at ¶35.

Going a step farther, even if the doctrine applied to this contract, the modifications ordered by the PUCO are necessary to protect consumers and preserve the public interest and would therefore be permitted under the *Mobile-Sierra* doctrine.

1. The *Mobile-Sierra* Doctrine does not apply to the Affiliate Agreement because it was not the result of an arm's length negotiation.

The *Mobile-Sierra* doctrine does not apply to a contract that has significant defects in its formation. The *Mobile-Sierra* doctrine rests on the premise "that the contract rates are the product of fair, arm's length negotiations."[28] Once the activities of the parties have demonstrated that this premise is not true, when there is unfair dealing at the formation stage, FERC has the authority to set aside the contract.[29] The U.S. Supreme Court in *Morgan Stanley* explained that "[t]o be sure, FERC has ample authority to set aside a contract where there is unfair dealing at the contract formation stage — for instance, if it finds traditional grounds for the abrogation of the contract such as fraud or duress."[30] In this case, the PUCO has the role of FERC, in its authority over an intrastate gas transportation contract. And it is evident that *Mobile-Sierra* does not apply because there are fundamental issues in the contract formation stage and a complete lack of the arm's length negotiations that should have protected consumers.[31]

The Affiliate Agreement was a contract that was not the result of arm's length bargaining, had a harmful effect on consumers, and as articulated in OCC's previous

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[28] *Morgan Stanley Capital Group Inc. v. Public Utility District No. 1 of Snohomish County et al.*, 554 U.S. 527, 554 (2008) ("*Morgan Stanley*").

[29] "FERC has ample authority to set aside a contract where there is unfair dealing at the contract formation stage--for instance, if it finds traditional grounds for the abrogation of the contract such as fraud or duress." *Id.* at 547.

[30] *Morgan Stanley*, 554 US at 547.

[31] *See* OCC Ex. 2 at 11 (Slone Direct).

briefs and the PUCO Order[32], suffered from serious defects in the formation of the original contract. Therefore, under existing U.S. Supreme Court precedent, the *Mobile Sierra* doctrine does not apply.

As was detailed in OCC's initial brief and the testimony of OCC witness Slone,[33] the Affiliate Agreement was not the result of proper arm's length negotiations. There was no separation between the leadership of OTP and Orwell, and Mr. Smith and Mr. Rigo (the individuals who signed the Affiliate Agreement) both simply worked for Richard Osborne. Any other distinction was purely secondary.[34] This contract formation was not the product of arm's length negotiations, and there were significant defects associated formation of this contract—defects that resulted in inferior and less reliable service for customers. That the terms of the Affiliate Agreement plainly favor OTP to the detriment of its affiliate, Orwell, and Orwell's retail customers. This leads to the reasonable conclusion that duress played an important role in Orwell's negotiation of this contract. Therefore this Affiliate Agreement is not entitled to the protection of the *Mobile-Sierra* doctrine.

2. The Affiliate Agreement was so harmful to consumers that even if the greater deference of the *Mobile-Sierra* doctrine applied to this Contract, the PUCO had justification to set it aside.

The *Mobile-Sierra* doctrine creates a standard of greater deference for privately negotiated contracts that are the result of arms-length bargaining. Even under that higher

[32] *See Id.* (discussing how "both signatories to the contract reported to Richard Osborne; Mr. Tom Smith, who signed on behalf of Orwell had signed a contract on behalf of OTP six months prior, and OTP employee depositions demonstrated that both Mr. Rigo (signatory for OTP) and Mr. Smith (signatory for Orwell) did work for each company and did not make distinctions between the companies[.]").

[33] *See* Initial Brief, Office of the Ohio Consumers' Counsel at 6-8; OCC Ex. 2 at 7-15 (Slone Direct).

[34] OCC Ex. 2 at 11 (Slone Direct).

standard, the PUCO had ample authority to modify this contract. In fact, the original case law allows for the abrogation of contracts when they "cast upon consumers an excessive burden, or [are] unduly discriminatory."[35] The Affiliate Agreement is both.

As was detailed in OCC's initial brief and the testimony of OCC witness Slone, OTP set a price for transportation along its pipeline that was nearly double that of similarly situated pipelines providing the inferior interruptible service.[36] In addition to imposing an exorbitant price on Orwell (that GCR customers then paid), OTP also inhibited the supply diversity that was available to Orwell by prohibiting Orwell from being supplied by other systems.[37] Ensuring a certain amount of supply diversity is a stated goal of the PUCO (for purposes of ensuring reliability and lower costs),[38] and the exclusivity clause of the 15-year agreement flies in the face of that requirement.

In fact, in the 2014 gas cost recovery case, the Staff of the PUCO found that Orwell's over reliance on OTP harmed customers. The report stated:

> The Company's [Orwell] focus on supply deliveries from the single supplier into OTP resulted in the exclusion of other supply and alternative delivery path options and ignored earlier market signals. These market signals existed throughout the winter season, yet the company did not pursue nor consider eastern supply options until its system's integrity was in jeopardy.[39]

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[35] *Sierra Pacific Power*, 350 U.S. at 355.

[36] OCC Ex. 2 at 16 (Slone Direct).

[37] OCC Ex. 2 at 14, Attachment GS-5 (Slone Direct).

[38] *See In the Matter of the Investigation Into the Gas Purchasing Practices and Policies of Columbia Gas of Ohio, Inc*., Case No. 83-135-GA-COI; *In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of Columbia Gas of Ohio, Inc. and Related Matters*, Case No. 84-6-GA-GCR, Opinion and Order at 20 (October 8, 1985).

[39] *In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained within the Rate Schedules of Brainard Gas Corporation, Northeast Ohio Gas Corporation, and Orwell Natural Gas Company and Related Matters*, Case Nos. 14-206-GA-GCR, 14-209-GA-GCR, 14-212-GA-GCR, Staff Report of the Financial Audit at 15-16 (Jan. 27, 2015).

Orwell was locked into a supply contract that forced it and its customers to take service from OTP. That prevented Orwell from considering or using eastern supply options that may have been available through Dominion (East Ohio Gas Company).[40] During the period this occurred, Richard Osborne was in control of OTP and Orwell,[41] so Orwell's reliance on OTP directly benefitted Mr. Osborne. While customers were paying significantly more for their gas, Mr. Osborne was benefitting by depriving those same customers of alternative and more reliable supply options.

The exclusivity clause of the Affiliate Agreement placed an excessive burden on consumers and it is unequivocally in the public interest to set aside that contract and allow Orwell to pursue other supply options. While, at times, Orwell may have had less expensive gas from the Chicago market, the issue is not which gas is the lowest cost, but rather the ability of the distribution company (Orwell) to obtain gas from multiple sources. Therefore, even if the *Mobile-Sierra* doctrine were applied, the PUCO should uphold its decision because it found that the Affiliate Agreement was contrary to the public interest and had to be modified.[42]

III. CONCLUSION

OTP's arguments simply fail customers at every level. The PUCO was well within its constitutional, statutory and regulatory authority to order the modifications to the Affiliate Agreement. Those modifications were in the public interest, and were

[40] On or about the time the Affiliate Agreement was signed, a number of taps to Dominion's (East Ohio Gas Co.) system were disabled. *See* OCC Ex. 2 at 18 (Slone Direct).

[41] Richard M. Osborne only resigned as CEO of Gas Natural, Inc. (Parent company of Orwell) in July of 2014.

[42] *See* Opinion and Order at ¶40.

necessary to protect Orwell's residential customers from the harmful actions that have been taken by OTP's management.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of this Memorandum Contra was electronically served on the persons stated below this 25th day of July 2016.

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Summary: Memorandum Memorandum Contra Orwell-Trumbull Pipeline's Application for Hearing by The Office of the Ohio Consumers' Counsel electronically filed by Ms. Jamie Williams on behalf of Kumar, Ajay Mr.