

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Commission's :
Investigation into Ohio Rural Natural Gas : Case No. 16-1578-GA-COI
Co-Op and Related Matters. :

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

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**On behalf of the Staff of
The Public Utilities Commission of Ohio**

October 4, 2016

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INTRODUCTION

Ohio Rural Natural Gas Co-Op (ORNG or Company) claims that it has complied, or is in the process of complying, with all of the orders made by the Commission Staff.¹ But the record reflects otherwise. The record demonstrates that ORNG has conducted its business without regard to rules or regulations, and has only made token efforts to abide by those rules and regulations when compelled to do so by threats of forfeitures. Staff has – and the Commission should have – no confidence that ORNG can operate lawfully or safely.

¹ Company Post-Hearing Brief at 1.

DISCUSSION

A. ORNG is a Willful and Persistent Violator of the Commission's Regulations.

The record clearly demonstrates that ORNG's argument that it is not a willful and persistent violator of the Commission's regulations is without merit. ORNG's disregard for the Safety Regulations² was evident from its inception. Those responsible for starting the company had extensive knowledge of both the natural gas business and regulatory practices. Richard M. Osborne, who, together with companies he owns, holds all of the debt that bankrolled ORNG. Mr. Osborne owns or has owned natural gas distribution companies in multiple states, and was chairman and CEO of Gas Natural, Inc., a holding company that distributes and sells natural gas through regulated utilities operating in Montana, Ohio, Pennsylvania, Maine, North Carolina and Kentucky. Darryl Knight, Mr. Osborne's hand-picked president for ORNG, had years of experience that should have prepared him to lead ORNG. He had literally decades of managerial responsibility for companies operating pipelines subject to safety regulations.³

And yet, ORNG began constructing its pipelines without registering with the Ohio Secretary of State to do business in the state, using operators not qualified by ORNG to do the work, and without having adopted any of the policies or procedures required by the Ohio Administrative Code. If not incapable of operating within Ohio's regulatory

² The Commission has adopted the gas pipeline safety regulations of the Pipeline and Hazardous Materials Safety Administration, Department of Transportation, contained in 49 C.F.R. 40, 49 C.F.R. 191, 49 C.F.R. 192 and 49 C.F.R. 199. Ohio Admin.Code 4901:1-16-03(A) (Safety Regulations).

³ Tr. at 28, 30.

framework, Messrs. Osborne and Knight clearly showed a disregard for Ohio's laws and the Commission's regulatory authority.

This is not an observation unique to the Commission Staff. When Mr. Osborne recently attempted to regain his seat on Gas Natural's Board of Directors, and also to nominate Darryl Knight for a seat on the Board, the Board sent a letter to shareholders opposing their candidacy, noting:

Richard Osborne claims that he and one of his nominees, Darryl L. Knight, have extensive experience in the utility industry. We agree they do have experience — in mismanaging our utilities. . . . We believe Richard Osborne and his nominees lack the experience to effectively lead, manage and govern public utilities, and his history demonstrates his disregard for our regulators, lack of understanding of utility operations, and furtherance of his own self-serving interests.⁴

That mismanagement is also evident in ORNG's operations. The Commission Staff conducted multiple inspections and audits (to the extent Mr. Osborne did not actively prohibit them from doing so⁵), and issued three (3) separate Notices of Noncompliance. Staff found multiple violations of the Safety Regulations, some of them recurring, and issued Compliance Orders. Many of those ordered compliance measures remain unfulfilled.

⁴ June 30, 2016 Letter to Shareholders, <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9NjM4NDE3fENoaWxkSUQ9MzQzMzcwFR5cGU9MQ==&t=1> (accessed Oct. 3, 2016). .

⁵ Staff Report of Investigation, Staff Ex. 1, at 10.

1. The March 10, 2015 Notice of Probable Noncompliance

ORNG's argument that it complied with the violations cited in Staff's March 10, 2015 Notice of Probable Noncompliance highlights the very problem at issue here. The Company claims that all instances of noncompliance have "been corrected *as they relate to the system at issue there.*"⁶ As with all of Staff's Notices, the violations that needed correction related to the Company's entire operations, not just a single system. Where the Company has made corrections, it has done so locally, and not globally. This was certainly true of the March 10, 2015 Notice of Probable Noncompliance.

On March 10, 2015, ORNG was notified that it did not have the plans, procedures and programs required under 49 C.F.R. 192, including procedures for the design, installation, construction, inspection and testing of piping, and operations and maintenance manual, emergency response plan, public awareness plan, operator qualification plan, and integrity management plan.⁷ The Company acknowledged that it *still* does not have a complete Operator Qualification manual, more than a year and a half later.⁸

The Company insists that its employees and contractors have been qualified and requalified. Mr. Knight is now, and has always been, the *only* member of the Company's

⁶ Company Post-Hearing Brief at 3.

⁷ Staff Report of Investigation, Appendix A, Staff Ex. 1.

⁸ Company Post-Hearing Brief at 3.

Evaluation Committee.⁹ But Mr. Knight admitted that the Company’s manual does not contain the method of qualification, or the means by which the method is documented, for almost all – 73 of the 75 – tasks for which operators must be qualified.¹⁰ Staff has other concerns about the operators apparent inability to correctly perform the tasks for which they are supposedly qualified, but it is plain that the Company has not yet complied with the March 10, 2015 Notice.

The Company’s lack of understanding is compounded by its statement that “all issues identified in . . . Staff’s July 24, 2015 letter to ORNG Co-op have now been corrected.”¹¹ In that letter, Staff acknowledged that the Company had apparently developed the necessary plans and procedures identified as lacking in the March 10, 2015 Notice. Staff noted that there were a few issues with the Operator Qualification (OQ) plan that needed to be addressed.¹² Mr. Knight admitted that the Co-Op did not address those deficiencies, but claimed that it had since done so.¹³ But the OQ plan submitted with his testimony *still* fails to comply with the safety regulations. Those deficiencies have *still* not been addressed.

⁹ Tr. at 61.

¹⁰ Tr. at 62.

¹¹ Company Post-Hearing Brief at 3.

¹² Staff Report of Investigation, Appendix B, Staff Ex. 1.

¹³ Direct Testimony of Darryl Knight, Company Ex. 1, at 8-9.

More importantly, Staff directed that the Company not commence operations until it had established a Maximum Allowable Operating Pressure (MAOP).¹⁴ The Safety Regulations require that new pipeline segments may not be operated until they have been tested to substantiate the MAOP, and each potentially hazardous leak has been located and eliminated.¹⁵ The Company was found to be operating without establishing an MAOP in Staff's December 1, 2015 Notice of Probable Noncompliance,¹⁶ and has admitted that it cannot demonstrate that it established MAOPs for its Reynolds Road, Williams Road Barn, OsAir, Oak Street, Muzic systems, and cannot do so for its Williams Road Steel-Head Run system.¹⁷ Mr. Knight admitted that he knew that pressure testing to establish an MAOP had to be conducted before putting a line in service.¹⁸ Despite this knowledge, the Company *continues* to operate in violation of the Safety Regulations.

ORNG does not appear to understand what is required to comply with the Safety Regulations. It believes that it is in compliance when it has been shown that it clearly is not. Staff submits that the Company's conduct demonstrates that its actions are both willful and persistent, and that it is not capable of safely operating a pipeline system.

¹⁴ *Id.*

¹⁵ 49 C.F.R. 192.503(a).

¹⁶ Staff Report of Investigation, Appendix C, Staff Ex. 1.

¹⁷ Company Post-Hearing Brief at 4.

¹⁸ Tr. at 55.

2. The December 1, 2015 Notice of Probable Noncompliance

The Company's response to the December 1, 2015 Notice of Probable Noncompliance is similarly flawed. Again, the Company purported to have "remedied all the instances of noncompliance that Staff observed *at the Tin Man Storage facility*."¹⁹ This again reflects a failure to generalize the need for compliance system-wide. When a company is informed that pipelines are not to be operated without establishing an MAOP,²⁰ it should understand that this regulation applies to *all* pipeline segments, and not just those specifically referred to in the Notice. The same is true for line marking, leakage testing, and the other violations found in the December 1 Notice.

Moreover, the Company admits that it has not complied with all of the directives contained in the December 1 Compliance Order.²¹ Staff ordered the Company to "perform a visual inspection of all regulator stations currently in its system for correct design . . . and correct any deficiencies found."²² The Company argued that one (1) of its three (3) regulator stations (Hallock-Young) has been replaced, and that another (Tin Man) was inspected and approved by Staff. But the Company admitted that it "does not have records showing that it inspected its regulator stations for correct design and

¹⁹ Company Post-Hearing Brief at 3.

²⁰ Staff Report of Investigation, Appendix C, Staff Ex. 1.

²¹ Company Post-Hearing Brief at 4.

²² Staff Report of Investigation, Appendix C, Staff Ex. 1.

correction of any deficiencies,”²³ and offered no demonstration that it had done so for its Ellsworth Road station. ORNG has not complied with the December 1, 2015 Notice of Probable Noncompliance.

Although ORNG claims that it “continues to work in good faith to correct” these issues, eleven months have passed, most of that on Mr. Knight’s watch, with only minimal effort being made to bring the Company into compliance.

3. The April 5, 2016 Notice of Probable Noncompliance

The Company believes that its operators were qualified to install the Duck Creek and Ellsworth Road systems. While being “qualified” is necessary, it is clearly not sufficient to constitute compliance. These supposedly qualified operators improperly installed pipe, and made unacceptable fusions, using damaged and defective equipment, following faulty procedures, without the benefit of critical pages in the procedures manual. Even Mr. Knight acknowledged that the work of these “qualified” operators was improperly done.²⁴ ORNG’s “paper compliance” meant nothing in the field where compliance is critical.

The Company was ordered to excavate, cut out, and replace all of the joints in the Duck Creek Road system.²⁵ It has not done so.²⁶ The Company was ordered to take the

²³ Company Post-Hearing Brief at 4.

²⁴ Tr. at 77.

²⁵ Staff Report of Investigation, Appendix D, Staff Ex. 1.

²⁶ Tr. at 80.

Ellsworth Road system out of service, and to excavate, cut out, and replace all of the joints in that system.²⁷ It has not done so.²⁸ Moreover, it has stated that it will not comply until the Commission issues its order in this case.²⁹ The Company's willful refusal to comply with Staff directives poses a serious threat of property damage and the potential for loss of life. The Commission must direct that the Ellsworth system be taken out of service immediately.

4. The May 2016 Audit

As with the three (3) Notices of Probable Noncompliance, the Company claims that it has corrected "the majority" of the instances of noncompliance, but admits that there remain outstanding issues. The MAOP calculations and OQ manual issues have persisted since Staff's very first contact with ORNG. They remain uncorrected.

There are, however, other issues that the Company incredulously believes have been adequately addressed; specifically, those relating to cathodic protection. The Company cannot demonstrate that its steel pipe is cathodically protected. The Company claims that this is not a "present concern" since it will continue to perform cathodic protection monitoring and testing in accordance with its O&M manual. But the record demonstrates that Company operators did not follow the O&M manual in installing pipe. The record demonstrates that the Company cannot demonstrate that it has, to date,

²⁷ Staff Report of Investigation, Appendix D, Staff Ex. 1.

²⁸ Tr. at 81.

²⁹ Company Post-Hearing Brief at 6.

performed cathodic protection monitoring and testing in accordance with its O&M manual. Continuing inspections as evidenced by Continuing Surveillance, Atmospheric Corrosion, and Leak Surveys, which Mr. Knight claimed were sufficient to demonstrate compliance, cannot demonstrate the adequacy of cathodic protection. The Commission should take no solace in the Company's assurances when the Company does not appear to understand how compliance must be demonstrated.

The efficacy of cathodic protection is determined by taking measurements of pipe-to-soil potentials or electrode potential.³⁰ A photograph does not, and cannot, demonstrate that. Staff inspection would not demonstrate that. The Safety Regulations require "a record of each test, survey, or inspection required by this subpart in sufficient detail to demonstrate the adequacy of corrosion control measures or that a corrosive condition does not exist," including a map "showing a stated number of anodes, installed in a stated manner or spacing."³¹ ORNG has no such records.

That the Company relies on a General Maintenance Schedule to excuse its failure to document required protection further demonstrates its lack of willingness to comply with the Safety Regulations is disturbing. The audit specifically referred to 49 C.F.R. §192.465 which states that:

Each pipeline that is under cathodic protection must be tested at least once each calendar year, but *with intervals not exceeding 15 months*, to determine whether the cathodic protection meets the requirements of §192.463.

³⁰ *Id.*

³¹ 49 C.F.R. 192.491.

In the absence of *any* cathodic protection test records, it was irresponsible, and a violation of the regulations, to refuse to perform such testing for an additional six (6) months.

5. Conclusion

The Company asserts that it is either now in compliance with Staff's orders, or working to correct those items. But the evidence clearly demonstrates otherwise.

The Company has not complied with numerous directives. Instead, it continues to operate in complete disregard for the Pipeline Safety Regulations, complying only when specifically directed by Staff to do so, and then often only partially.

B. Staff's Requested Relief.

The Company claims that the requested forfeiture of \$600,000 is not appropriate, both in light of statutory criteria and Commission precedent. Staff disagrees.

1. Statutory Criteria

The relevant statutory provision provides that:

(B) If, pursuant to a proceeding it specially initiates or to any other proceeding and after the hearing provided for under division (A) of this section, the commission finds that:

(1) An operator has violated or failed to comply with, or is violating or failing to comply with, sections 4905.90 to 4905.96 of the Revised Code or the pipe-line safety code, the commission by order:

* * *

(b) May assess upon the operator forfeitures of not more than one hundred thousand dollars for each day of each violation or noncompliance, except that the aggregate of such forfeitures shall not exceed one million dollars for any related series of violations or noncompliances. In determining the

amount of any such forfeiture, the commission shall consider all of the following:

- (i) The gravity of the violation or noncompliance;
- (ii) The operator's history of prior violations or noncompliances;
- (iii) The operator's good faith efforts to comply and undertake corrective action;
- (iv) The operator's ability to pay the forfeiture;
- (v) The effect of the forfeiture on the operator's ability to continue as an operator;
- (vi) Such other matters as justice may require.³²

Staff respectfully submits that the record in this case demonstrates that the proposed forfeiture is appropriate in this case.

(i) Gravity of the Violation or Noncompliance

Contrary to the Company's assertion,³³ most of the instances of noncompliance do *not* relate to recordkeeping matters. There is no evidence that qualified personnel installed pipe. There is evidence that procedures were not followed, resulting in improperly installed meters and fused pipe segments. There were leaks that resulted in response by emergency personnel who had no idea who to contact to fix the problem. There are stations still in place that may not have adequate safeguards against tampering and over-pressurization. And the Company continues to operate without having established a valid MAOP or performed leak surveys to determine if hazardous leaks are present. That there has been no damage to person or property is more a testament to

³² Ohio Rev.Code 4905.95(B)(1)(b).

³³ Company Post-Hearing Brief at 9.

providence than competence. These are serious violations that both Staff³⁴ and the Company³⁵ acknowledge pose a threat of explosion.

(ii) History of Prior Violations or Noncompliances

ORNG would prefer to view the entirety of Staff's findings as a whole, and not as a history of violations and noncompliance. But the Staff issued three (3) Notices of Probable Noncompliance in 14 months, and the record demonstrates continuing violations of each one. In addition, an audit revealed additional violations, some of which, again, are continuing from previous inspections. This company's entire operations have been a record of violation and noncompliance.

(iii) Efforts to Comply and Undertake Corrective Action

Issues of noncompliance have persisted since this company first began laying pipe, some despite repeated citations in Staff Notices. And there have been repeated Notices, an extraordinary three (3) Notices of Probable Noncompliance within 14 months.

Despite Mr. Knight giving his "full attention" to achieving compliance, manuals are still incomplete, inspections have not been conducted, and testing has not been performed. Systems are being operated without ensuring that they are adequately protected, appropriately pressurized, or have needed backup capabilities. If these are the

³⁴ Prepared Testimony of Peter Chace, Staff Ex. 3, at 13, 19.

³⁵ Tr. at 82.

best efforts of someone giving their full attention to a system that serves a mere 72 customers, more than 50 of them in a single location, then the Commission should be very concerned, indeed.

As Staff demonstrated, not only has the Company still not complied with numerous directives, it has shown a shocking lack of understanding about what must be done to show compliance. All of the correct processes and procedures are contained in the Company's manuals. The Company has neither complied, nor demonstrated that it understands what must be done to comply, not just with the Safety Regulations, but also with its own procedures. It is both of these factors – the noncompliance and the apparent lack of understanding – that so concern Staff in this case.

(iv) Ability to Pay the Forfeiture

At the outset, it is relevant to note that Ohio Rev.Code 4905.95(B)(1)(b) authorizes a fine of up to \$100,000 *per day* for violations, and that many of ORNG's violations have been ongoing for months, and nearly years. While ORNG has demonstrated that it does not have the cash to pay a \$600,000 fine, it is clear that those who control this company have the means to do so. Despite its co-operative status, this company only exists because of the financing provided by Richard M. Osborne and his controlled companies.³⁶ If the Company cannot afford the fine, then it clearly cannot be expected to take the corrective actions necessary to operate safely.

³⁶ Tr. at 101.

(v) Effect on Ability to Continue as an Operator

It is quite possible that the proposed forfeiture will negatively impact ORNG's ability to continue as an operator. Inasmuch as Staff recommends that the Company's facilities be declared hazardous and that the Commission compel it to cease operations, this is not a major concern for Staff. Staff is more concerned about the potential danger that continued operations pose to life and property, and believes that a cessation of operations will be more beneficial than allowing ORNG to continue to operate.

Staff is concerned about the effect that a bankruptcy could have on ORNG's customers. Many of those customers, of course, were already being served by Orwell Natural Gas, and those lines largely remain in place. Service to those customers can as readily be switched back to Orwell as they were, without notice or warning, switched from Orwell to ORNG.

The remaining customers, and particularly those residential customers who may be receiving natural gas service for the first time, must be protected. Staff urges the Commission to fashion its order in such a manner that ORNG is obliged to either transition those customers to another distribution utility, or to effectuate their switch to, or back to, propane service.

2. Commission precedent

The Company claims the forfeiture recommended by the Staff is not consistent with fines levied by the Commission in cases that it characterizes as similar or even more serious. To the contrary, the Company's reliance on those cases is misplaced.

ORNG relies heavily on the recent *Columbia Gas* case³⁷ involving a home that exploded in Upper Arlington. In the first instance, the product of that case was an agreement, which the Commission approved. The Commission found the terms of the agreement acceptable, evaluating it under its reasonableness test³⁸ rather than under the statutory test for forfeitures. There was no record, as there is here, of persistent and willful disregard for the Safety Regulations. While more than \$9 million in damage was done in the *Columbia* case, which Columbia is also obliged to pay, ORNG is serving customers with knowingly defectively fused pipe, as but one instance of noncompliance, potentially placing human life at risk. The Commission is committed “to ensuring consumer safety and requiring operators of gas pipelines to take all reasonable steps to provide necessary safeguards.”³⁹ The risk posed by ORNG operations, and the Company’s recalcitrance at remediating its violations, more than justifies the sum sought by Staff in this case.

The *Ohio Cumberland Gas* case⁴⁰ also relied on by the Company, also involved a stipulation. While there are similarities with this case, there is a significant distinction. Ohio Cumberland Gas had *already complied* with all of the terms of the stipulation by the

³⁷ *In the Matter of the Investigation of Columbia Gas of Ohio, Inc. Relative to Its Compliance with the Natural Gas Pipeline Safety Standards and Related Matters*, Case No. 15-1351-GA-GPS (Finding and Order) (Jan. 20, 2016).

³⁸ *Id.*, ¶7.

³⁹ *Id.*, ¶8.

⁴⁰ *In the Matter of the Investigation of Ohio Cumberland Gas Company Relative to Its Compliance with the Natural Gas Pipeline Safety Standards and Related Matters*, Case No. 06-640-GA-GPS (Finding and Order) (Oct. 4, 2006).

time the stipulation was filed with the Commission. By contrast, ORNG has openly *refused* to comply with orders issued by the Commission's Gas Pipeline Safety Staff.

CONCLUSION

Staff made a number of recommendations in its Report. Staff respectfully submits that the record demonstrates that ORNG's facilities are currently hazardous to life and property, and requests that the Commission so find. Consequently, the Commission should that all construction and operations cease until the Company completes, to Staff's satisfaction, all of the items from Staff's cumulative correction action plans, corrects all of the violations cited in the Staff Report from the May, 2016 annual audit, and can demonstrate that it possess the knowledge and management oversight to consistently follow the pipeline Safety Regulations.

Staff has also recommends that a fine of \$600,000 be assessed against the Company. While ORNG has demonstrated that it does not have the cash to pay such a fine, it is clear that those who control this company have the means to do so. If the Company cannot afford the fine, then it clearly cannot be expected to take the corrective actions necessary to operate safely.

In the interest of protecting public health and safety, Staff submits that the Commission must act swiftly to declare the ORNG pipeline system to be a hazardous facility, and to order it to cease all operations immediately.

Respectfully submitted,

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**On behalf of the Staff of
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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 regular U.S. mail, postage prepaid, or hand-delivered, upon the following Parties of Record, this 4th day of October, 2016.

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