BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of The East Ohio Gas Company d/b/a Dominion East Ohio and Related Matters.	)))))	Case No. 05-219-GA-GCR

OPINION AND ORDER

The Commission, having considered the testimony, the exhibits, and the stipulation and recommendation (stipulation) presented by some of the parties and being otherwise fully advised, hereby issues its opinion and order.

APPEARANCES:

Jones Day, by Helen L. Liebman and Mark A. Whitt, 325 John H. McConnell Boulevard, Suite 600, Columbus, Ohio, 43216-5017, on behalf of The East Ohio Gas Company d/b/a Dominion East Ohio.

Marc Dann, Attorney General of the State of Ohio, Duane W. Luckey, Senior Deputy Attorney General, by William L. Wright and John H. Jones, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215-3793, on behalf of the staff of the Commission.

Janine L. Migden-Ostrander, Office of the Ohio Consumers' Counsel, by Ann M. Hotz and Joseph P. Serio, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, on behalf of the residential consumers of The East Ohio Gas Company d/b/a Dominion East Ohio.

Chester, Wilcox & Saxbe LLP, by John W. Bentine and Bobby Singh, 65 East State Street, Suite 1000, Columbus, Ohio 43215-4213, and Vincent A. Parisi, General Counsel, Interstate Gas Supply, Inc., 5020 Bradenton Avenue, Dublin, Ohio 43017, on behalf Interstate Gas Supply, Inc.

McNees Wallace & Nurick LLC, by Samuel C. Randazzo, Lisa G. McAlister, and Daniel J. Neilsen, 21 East State Street, 17th Floor, Columbus, Ohio 43215, on behalf of Industrial Energy Users-Ohio.

Joseph P. Meissner, Legal Aid Society of Cleveland, 1223 West Sixth Street, Cleveland, Ohio 44113, on behalf of Consumers for Fair Utility Rates, The Greater

Cleveland The Housing Network, Neighborhood Environmental Coalition, and The Empowerment Center of Greater Cleveland.

OPINION:

I. Background

The East Ohio Gas Company d/b/a Dominion East Ohio (DEO) is a natural gas company as defined in Section 4905.03(A)(6), Revised Code, and a public utility under Section 4905.02, Revised Code. DEO is, therefore, subject to the supervision and jurisdiction of the Commission. DEO is the largest of three regulated gas distribution subsidiaries of Dominion Resources, Inc.[1] Pursuant to Section 4905.302(C), Revised Code, the Commission promulgated rules for a uniform purchased gas adjustment clause to be included in the schedule of natural gas companies subject to the Commission's jurisdiction. These rules, which are contained in Chapter 4901:1-14, Ohio Administrative Code (O.A.C.), separate the jurisdictional cost of gas from all other costs incurred by a natural gas company and provide for each company's recovery of these costs.

Section 4905.302, Revised Code, also directs the Commission to establish investigative procedures, including periodic reports, audits, and hearings to examine the arithmetic and accounting accuracy of the gas costs reflected in the company's gas cost recovery (GCR) rates, and to review each company's production and purchasing policies and their effect upon these rates. Pursuant to such authority, Rule 4901:1-14-07, O.A.C., requires that periodic financial audits of each natural gas company be conducted. Section 4905.302(C), Revised Code, and Rule 4901:1-14-08(A), O.A.C., require the Commission to hold a public hearing at least 30 days after the filing of an audit report and Rule 4901:1-14-08(C), O.A.C., specifies that notice of the hearing be published in at least one newspaper of general circulation in each county within the company's service area at least 15 days, but not more than 30 days prior to the date of the scheduled hearing.

On January 12, 2005, the Commission initiated this case, involving the purchased gas adjustment clause within the rate schedules of DEO. Beginning on January 21, 2005, DEO began filing monthly GCR reports in this docket. On August 24, 2005, the Commission issued an entry that established the management/performance (m/p) audit review period and the filing date of the m/p audit report. The entry also set the date for the hearing on the m/p audit as July 18, 2006. By entry of September 14, 2005, the Commission established the financial audit review period, and the filing dates of the financial audit report, and established the date for the hearing on the financial audit as

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[1] The other two gas distribution subsidiaries of Dominion Resources, Inc. are Dominion Hope, serving parts of West Virginia, and Dominion Peoples, serving parts of Pennsylvania (Commission Ordered Ex. 4 at ES-3).

July 18, 2006. On October 12, 2005, the Commission selected The Liberty Consulting Group (Liberty) to conduct the m/p audit. By entry of December 2, 2005, Consumers for Fair Utility Rates, The Greater Cleveland Housing Network, Neighborhood Environmental Coalition, and The Empowerment Center of Greater Cleveland (collectively "Citizens Coalition") and Interstate Gas Supply, Inc. (IGS) were granted intervention in this proceeding; however, nine requests for relief sought by Citizens Coalition were denied. Citizens Coalition filed an application for rehearing of the denial of its requests for relief; however, Citizens Coalition's application for rehearing was denied by entry issued January 9, 2006. On January 30, 2006, the Office of the Ohio Consumers' Counsel (OCC) was granted intervention in this proceeding. By entry of May 18, 2006, the hearing in this case was continued from July 18, 2006, to July 25, 2006. The entry also directed DEO to modify the language of the notice to reflect the new hearing date.

On May 19, 2006, Deloitte & Touche, LLP (D&T) filed its *Financial Audit Report*, (Commission Ordered Ex. 1), its *Independent Accountants' Report on Applying Agreed-Upon Procedures for Validity of Costs* (Commission Ordered Ex. 2); and *Independent Accountants' Report on Applying Agreed-Upon Procedures for Uncollectible Expense Recovery Mechanism* (Commission Ordered Ex. 3). On May 22, 2006, Liberty filed its m/p audit report. On July 7, 2006, a stipulation was filed between DEO, IGS, Industrial Energy Users-Ohio (IEU), and staff of the Commission that resolves the issues in this proceeding. Neither OCC nor the Citizens Coalition signed the stipulation. By entry of July 13, 2006, IEU was granted intervention in this proceeding.

On July 18, 2005, the hearing commenced for the purpose of allowing public testimony. No members of the public appeared. The hearing was recessed and the parties agreed to reconvene the hearing on August 30, 2006. By entry of August 22, 2006, the hearing was continued from August 30 to September 13, 2006. On September 12, 2006, DEO filed the proofs of publication for the notices required in this matter. The hearing in this matter was resumed and held on September 13 and 14, 2006. At the hearing, Phillip S. Teumin and Donald T. Spangenberg testified on behalf of Liberty; Jeffery A. Murphy and Ronald A. Walther testified on behalf of DEO; Michael P. Haugh and Bruce M. Hayes testified on behalf of OCC; and Paul T. Kroll testified pursuant to an OCC subpoena. Initial briefs were filed by DEO and OCC on October 20, 2006, and reply briefs were filed by staff, DEO, OCC, IGS, and Citizens Coalition on November 3, 2006.

II. Financial Audit

D&T examined the monthly filings of DEO which support the GCR rates for the periods November 1, 2004, to February 3, 2005; December 2, 2004, to January 4, 2005;

January 5, 2005,[2] to February 3, 2005; February 4, 2005, to March 6, 2005; March 7, 2005, to April 5, 2005; April 6, 2005, to May 4, 2005; May 5, 2005, to June 5, 2005; June 6, 2005, to July 5, 2005; July 6, 2005, to August 3, 2005; August 4, 2005, to September 1, 2005; September 2, 2005, to October 3, 2005; October 4, 2005, to November 1, 2005; November 2, 2005, to December 4, 2005; December 5, 2005, to January 5, 2006; January 6, 2006, to February 6, 2006; February 7, 2006, to March 7, 2006; March 8, 2006, to April 5, 2006; and April 6, 2006, to May 7, 2006. D&T reported that DEO has fairly determined, in all material respects, the GCR rates for the subject periods in accordance with the financial and procedural aspects of the uniform purchase gas adjustment clause, as set forth in Chapter 4901:1-14 and related appendices of the O.A.C., and properly applied the GCR rates to customer bills. D&T also reported that DEO's latest analysis of unaccounted for gas (UFG) indicates that, as of November 2005, the UFG percentage is below the five percent ceiling currently imposed by the Commission (Commission Ordered Ex. 1, at 1, 4).

III. M/P Audit

In its m/p audit, Liberty investigated DEO's management policies and operational procedures and reviewed DEO's effectiveness in fuel procurement. Liberty also examined DEO's Choice Program and reviewed the revenue generated from non-traditional capacity and commodity arrangements (Commission Ordered Ex. 4 at 1). Liberty found that DEO's demand forecasting was reasonably performed. Liberty also determined that DEO's LDC Gas Supply Group (GSG), which is responsible for gas procurement functions, was appropriately staffed with qualified individuals, utilized reasonable operating methods in general, and kept abreast of trends in the industry and the gas supply market (*Id.* at ES-5).[3]

However, with respect to management oversight, Liberty concluded that DEO's internal controls were weak, the organization structure within the GSG did not adequately separate the activities of the DEO and its affiliates, DEO's senior management oversight was weak and there were weaknesses in the internal auditing of GSG (*Id.*). In addition, Liberty referenced a civil lawsuit, filed in West Virginia by Paul T. Kroll, a former employee of Dominion Hope, who alleged that DEO and its affiliated companies conducted fraudulent gas transactions. These allegations are discussed later in this order.

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2 On October 1, 2004, DEO filed its quarterly filing (November 2004 through February 3, 2005). On November 23, 2004, the Commission directed DEO to revise its GCR rate effective December 2, 2004, and again, effective January 5, 2005. *In the Matter of the Application of The East Ohio Gas Company, d/b/a Dominion East Ohio, for a Revision to its Gas Cost Recovery Rate,* Case No. 04-1717-GA-UNC. On January 12, 2005, the Commission authorized DEO to make monthly adjustments to the expected gas cost (EGC) component of its GCR rate, beginning on February 4, 2005. *In the Matter of the Application of The East Ohio Gas Company, d/b/a Dominion East Ohio, for Authority to Make Monthly Adjustments to the Expected Gas Cost Component of its Gas Cost Recovery Rate,* Case No. 04-1912-GA-UNC.

3 Gas Supply Group is part of Dominion Energy, which is one of four primary operating segments of Dominion Resources, Inc.

Liberty noted that investigation of the allegations was beyond the scope of its m/p audit and that the m/p audit did not cover a significant portion of the time period during which the alleged improper conduct would have been planned and executed (*Id.* at ES-5). Liberty found that DEO was unable to provide evidence of a significant, comprehensive and objective managerial or supervisory review that would have properly evaluated whether the existing controls would have tended to prevent actions of the type alleged (*Id.*). Based on these findings, Liberty stated that it was unable to conclude that DEO's gas supplies were purchased at the lowest reasonable cost (*Id.* at I-20).

Liberty made four recommendations with respect to DEO's organization staffing and control. First, it suggested that DEO revise the procedures for control of the telephone recording system used in the GSG so that access to the tapes containing recorded conversations of gas traders is controlled by two parties outside of the GSG (*Id.* at I-20). Second, Liberty advised that DEO require internal auditing to conduct detailed statistical examinations and comparisons of prices paid for gas by affiliated and non-affiliated entities on a biennial basis, in order to confirm that DEO's interactions with its affiliates are appropriate (*Id.*). Liberty's third recommendation is that DEO institute a system of senior management oversight and control over the activities of the Gas Supply Group that includes more than administrative areas, such as oversight and control over strategic and operational areas. Finally, Liberty recommended that DEO conduct an independent examination of affiliate transactions among the three DEO local distribution companies (LDC) and their transactions with third parties, in sufficient detail to determine whether and, if so, to what extent customers of DEO have been harmed as a result of possible inappropriate transferring of revenue and costs among these entities (*Id.* at I-21). Liberty also recommended that the Commission should re-examine the issue of revenue-sharing from capacity releases, bundled sales, and park, loan, and exchange (PLE) transactions (*Id.* at ES-7), even though it noted the Commission had extensively reviewed this matter in DEO's 2003 GCR proceeding.[4]

IV. Disputed Issues

In this proceeding, OCC raised two principal issues at the hearing. First, OCC claimed that DEO had participated in gas transactions with its affiliates, prior to the m/p audit period in this case, that caused Ohio ratepayers to pay more for gas. OCC argued that these transactions, coupled with the allegations of fraud in Mr. Kroll's civil lawsuit, warranted the Commission conducting a m/p audit of all of DEO's gas purchases prior to

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4 Park transactions involve DEO accepting gas from a third party and returning the same quantity of gas to that customer at a later date. Loan transactions involve DEO delivering gas to a third party at one point in time and accepting the return of the same amount of gas at a later point in time. Exchange transactions involve DEO accepting gas from a third party at one location and that entity taking gas from DEO at another location.

the m/p audit period in this case. Second, OCC argued that DEO's GCR customers were harmed by DEO engaging in PLE transactions, rather than off-system sales, and it urged the Commission to reexamine the allocation of revenue from those PLE transactions.

A. DEO's Pre-M/P Audit Period Gas Purchases

1. Liberty's Findings

In its audit, Liberty reported that a civil lawsuit had been filed in West Virginia alleging the transfer of costs and revenue among the three Dominion natural gas utilities (Commission Ordered Ex. 4, at ES-5). Liberty found that there were specific allegations of wrongdoing in the lawsuit which, it true, would have affected the costs for customers of DEO; however, Mr. Spangenberg testified that Liberty did not conduct any investigation of those allegations (Tr. I at 102). He also indicated that DEO never denied Liberty access to any gas purchase transaction information in this m/p audit and that the auditors received all of the information that was requested. When questioned specifically about the types of transactions alleged to have occurred, Mr. Spangenberg affirmed that no straddle transactions[5] occurred during the m/p audit period (*Id.* at 73). Mr. Teumin testified that, based on his review of the transaction reports showing DEO's straddle transactions, it was not correct to say that DEO purchased gas from Dominion Hope, an affiliate of DEO, at first of the month index (FOMI) prices only when the daily market price was below the FOMI price (*Id.* at 90). Mr. Teumin explained that, statistically, if one were purchasing gas at the FOMI price, the expectation would be that the price paid would sometimes be below the daily market price and other times above the daily market price, but "...over a long period of time, you would expect the overs and unders to work out" (*Id.* at 94). Based in part on the allegations set forth in the civil lawsuit, Liberty recommended that there should be an independent examination to verify that there has been no shifting of costs and revenue that harmed Ohio customers (Commission Ordered Ex. 4 at I-21).

2. OCC's Position

According to OCC, questions about DEO's pre-m/p audit gas purchases were raised, in part, because Mr. Kroll filed a civil lawsuit alleging that DEO was involved in fraudulent gas transactions with DEO affiliated companies.[6] In his lawsuit, Mr. Kroll alleged that DEO, Dominion Hope, Dominion Peoples, and Dominion Resources Services knowingly and intentionally engaged in fraudulent gas transactions, made false entries in their financial records, and falsely documented and reported the revenue and losses of

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5 Straddle transactions are explained below, in our discussion of OCC's position.

6 Mr. Kroll alleged that, because he refused to participate in unlawful financial transactions, he was unlawfully terminated. At the time of this order, no hearing had been held or scheduled in Mr. Kroll's civil complaint.

their financial transactions and activities in order to manipulate governmental regulators (OCC Ex. 13, MPH Attachment 1 at 6).

OCC witness Michael P. Haugh claimed that, in the pre-m/p audit period, DEO purchased gas at prices that exceeded reasonable costs (OCC Ex. 13 at 3). Mr. Haugh referenced Mr. Kroll's complaint that noted that Dominion Hope operated under a gas rate moratorium from 1995 to 2003, where its sales and transportation rates were frozen by the Public Service Commission of West Virginia. Under the rate freeze, Dominion Hope could retain all profits it procured, but it was not able to recover losses it suffered. According to Mr. Haugh, Dominion Hope engaged in a number of hedging strategies to keep its costs below the frozen rate, one of which was to use straddle transactions. In these arrangements, Mr. Haugh asserted that Dominion Hope would sell a straddle to another party, taking as is the norm, a premium on that sale and, as a result, bearing increased market risk, as is also the norm.[7] As explained by Mr. Haugh, Dominion Hope, in order to avoid some of the negative economic effects of the purchases and sales required under the straddle, sold to DEO the gas that it was forced to buy from the straddle purchaser, at the same over-market price that was the straddle's strike price.[8] However, Mr. Haugh stated that DEO did not receive a premium from Dominion Hope to compensate DEO for its willingness to make such over-market purchases (OCC Ex. 13 at 7-8)

OCC argued that DEO was involved in these types of straddle transactions with Dominion Hope from February 1999 through April 2002 (OCC Ex. 13, at 13). OCC claimed that DEO's gas transaction reports reflect that, during this time, DEO only purchased gas from Dominion Hope at the FOMI price when the daily price was lower than the FOMI price. OCC also contended that DEO's gas purchases at the FOMI price prevented DEO from taking advantage of any daily market price declines (OCC Ex. 13 at 12). According to Mr. Haugh, DEO's purchases from Dominion Hope at the FOMI price cost DEO's GCR customers $4,177,700, over what they should have paid had gas been purchased at the daily market price (OCC Ex. 13, at 11-12; MPH Attachment 2A; Tr. II at 170). OCC argued that these gas transactions raise sufficient questions regarding the propriety of DEO's gas purchases with Dominion Hope, coupled with Mr. Kroll's allegations of fraudulent gas

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7 Straddle transactions involve both a call option (the right of the straddle purchaser to buy gas at a set, or "strike" price) and a put option (the right of the straddle purchaser to sell gas at the same set "strike" price). The straddle purchaser generally exercises its call option when the market price is higher than the strike price and exercises its put option when the market price is lower than the strike price. Thus, the straddle results in the transfer of market risk from the straddle buyer to the straddle seller. For bearing this market risk, the straddle seller receives an immediate economic benefit or "premium" equal to the cost of the straddle. (OCC Ex. 13, at 6-7)

8 The strike price for these straddles was, according to Mr. Haugh, the published first-of-the-month index (FOMI) calculated as a weighted average of reported purchases and sales at various pipeline locations. The FOMI is set once a month.

transactions, to warrant the Commission conducting a m/p audit of all of DEO's gas purchases between February 1999 and April 2002. (OCC Initial Brief at 10-12.)

2. Staff's Position

Staff argued that there was no evidence that DEO engaged in any fraudulent or imprudent transactions during the m/p audit period of this case, pointing out that the allegations of fraud were based on transactions and that, for the most part, occurred prior to the m/p audit period (Staff Brief at 9, 10-11). Staff noted that Mr. Donald T. Spangenberg, one of the Liberty auditors, testified that DEO engaged in no straddle transactions during the m/p audit period (Tr. I at 73). Staff noted that the m/p auditors found that an investigation of the allegations was beyond the scope of their audit and did not recommend any refunds or reconciliation adjustments for DEO. While staff acknowledged that there were certain deficiencies noted by Liberty, they maintained that the stipulation addressed the issues related to organization, staffing, and controls relative to DEO's telephone recording system, internal auditing, and senior management oversight and control over administrative, strategic and operational areas of the gas supply. (Staff Brief at 10-11.)

In addition, staff maintained that the allegations of fraud were based on gas transactions that occurred prior to the m/p audit period in this case and there is insufficient evidence to support such allegations (Staff Initial Brief at 9). Staff indicated that DEO's policy was to purchase gas from many sources, including its affiliates, and all of these purchases were made at the FOMI price. Staff recognized that, at times, the daily price was above the FOMI price and, at other times, the daily price was below the FOMI price. Staff noted that, according to Mr. Walther, DEO purchased gas from Dominion Hope under both pure load transactions, where DEO purchased a uniform amount of gas each day during the month, and on a volume flexible basis, where DEO agreed to purchase gas on a daily basis up to a certain quantity Dominion Hope had available. (Tr. I at 226, 229-231; Staff Initial Brief at 13-15.) Further, staff noted that Philip S. Teumin, an auditor with Liberty, testified that it was incorrect to say the DEO purchased gas at the FOMI price only when the daily market price was below the FOMI price (*Id.* at 90).

Staff also questioned Mr. Kroll's and OCC's claims regarding the legitimacy of DEO's pre-m/p audit gas transactions. Staff noted that Mr. Kroll was unable to identify any transaction which was admitted into the record and that would support his allegation that Dominion Hope or DEO knowingly and intentionally made false entries in their financial records or falsely documented and reported the revenue and losses of their financial transactions and activities (Staff Initial Brief at 15). In addition, staff pointed out that Mr. Kroll failed to produce any evidence of fraud in any of the gas transactions in the record (Tr. II at 115-118, 135-136, 147-149). Staff further disputed OCC's claim that these

transactions transferred risk to DEO, because DEO only acted as a back-up market for Dominion Hope and DEO did not have to accept gas from Dominion Hope if operationally unable to consume the gas (Tr. II at 226, 231). According to staff, because there is no proof that DEO was a party to any fraudulent gas purchases, either before or during the m/p audit period, the Commission should decline conducting the requested audit (Staff Initial Brief at 17).

3. DEO's Position

DEO argued that there is no support for OCC's and Mr. Kroll's claims. Mr. Ronald Walther, director of LDC Gas Supply, testified that DEO has always purchased gas at the FOMI price and that most LDCs in the nation do as well (Tr. I at 215, 226). DEO noted that all of the transactions between DEO and Dominion Hope were reviewed in prior audits and neither the financial auditors nor the m/p auditors in those audits raised any issue regarding the reasonableness of those purchases (DEO Initial Brief at 7). According to Mr. Walther, buying gas at the FOMI price locks in the price for each day of the month. As a result, he stated that sometimes the FOMI price is above the daily price, sometimes it is below the daily price, and sometimes the daily price will rise and fall on a daily basis (Tr. II at 232). DEO argued that, had it not made these gas purchases from Dominion Hope at the FOMI price, it would have made the same gas purchases, on the same days and at the same price from other entities. In addition, DEO argued that the risk associated with these transactions was the risk assumed by Dominion Hope and that the risk did not transfer to DEO or its GCR customers because DEO had the right, if it was operationally unable to take gas on any day, to return the gas to Dominion Hope (Tr. I at 225-226).

DEO disputed all of Mr. Kroll's allegations and claimed that he was motivated solely by a personal financial interest related to his civil lawsuit. DEO argued, as staff did, that Mr. Kroll could not identify any transaction that OCC had introduced into the record to support his allegations that Dominion Peoples, Dominion Hope, or DEO knowingly and intentionally made false entries in their financial records or falsely documented or reported the revenue and losses of their financial transactions and activities (Tr. II at 115-118, 135-136, 147-149, 152-155). DEO also argued that Mr. Kroll could not produce any evidence or point to any specific gas transaction in the record to support his allegations of fraud against DEO or any of the other affiliates. Further, DEO claimed that Mr. Kroll provided no evidence of a single allegation in his complaint and presented no evidence at hearing to support them (*Id.* at 148-149; DEO Initial Brief at 6-7).

In addition, DEO noted that Mr. Haugh had no knowledge of the accounting practices set forth in Mr. Kroll's allegations and had no knowledge of how DEO booked its transactions (*Id.* at 175, 184). DEO also questioned the basis for Mr. Kroll's accounting expertise by noting that Mr. Kroll claimed that DEO committed fraud because its records

failed to report the price that he believed should have been paid for gas, and instead, identified the price DEO actually paid (*Id.* at 153-155).

4. Commission Decision

Pursuant to Rule 4901:1-14-07(D), O.A.C., m/p audits cover a designated time period. In this case, the m/p audit period was between November 1, 2003, and October 31, 2005, and the evidence shows that DEO was involved in no straddle transactions during the m/p audit period in this case. Thus, the propriety and legitimacy of DEO's gas transactions at issue involve a time period that precedes that audit period of this case.

In GCR proceedings, the Commission historically has only reviewed matters that transpired during the audit period involved in the case, although the Commission has made exceptions to this practice. In I*n the Matter of the Regulation of the Electric Fuel Component Contained Within the Rate Schedules of Columbus Southern Power Company and Related Matters,* Case No. 83-38-EL-EFC, Opinion and Order (February 2, 1984), the Commission permitted a review of clerical errors that occurred in a previous GCR proceeding to be reviewed. In addition, the Commission has permitted a review of pre-audit period activities when there have been allegations that the natural gas company under review has been involved in fraudulent transactions. In this case, because there were allegations that DEO participated in fraudulent gas transactions and because these allegations were incorporated as rationale for some of the findings in Liberty's m/p audit, the parties were permitted to conduct discovery related to DEO's pre-m/p audit period gas transactions and to present evidence at the hearing on DEO's gas transactions prior to the m/p audit period. The issue of fraud and the propriety of DEO's gas transactions with its affiliates were presented at the hearing through the testimony of Mr. Kroll and Mr. Haugh. After review of the record evidence, we find no merit to the allegations of fraud or the unreasonableness of DEO's gas transactions with Dominion Hope.

With respect to Mr. Kroll's testimony, he failed to present any evidence of fraud on the part of DEO. He failed to identify any transaction to support his allegation that Dominion Peoples, Dominion Hope, or DEO knowingly or intentionally made false entries in their financial records or falsely documented and reported the revenue and losses of their financial transactions and activities. He was unsure of how DEO's accounting entries were recorded, he was unaware of how DEO made such entries, and he could not recall ever examining any of DEO's accounting records. Further, even though Mr. Kroll alleged in his complaint that gas commodity costs were falsely recorded in the books and records of DEO, Mr. Kroll failed to bring copies of any documents that supported his allegations, failed to cite to any documents that would demonstrate such claims, and was unable to

recall if he had any such documents.[9] Mr. Kroll's fraud allegations also were based on his argument that DEO should have recorded the daily market prices for gas rather than the actual prices paid, when the price paid was higher than the market price. We find this assertion to be dubious at best.

The evidence also does not support Mr. Haugh's claim that DEO's gas transactions were imprudent or that DEO only purchased gas from Dominion Hope at the FOMI price when daily price was lower than the FOMI price. DEO disputed this claim, the auditor disagreed with this claim, and the documents OCC relied on to make the claim do not support it. The evidence shows that DEO's policy was to purchase gas at the FOMI price and, as noted by DEO, had it not purchased gas from Dominion Hope at the FOMI price, DEO would have purchased the same amount of gas, on the same days, from another entity, at the FOMI price (Tr. I at 228-230). The transaction reports cited in MPH Attachment 2a, which formed the basis for Mr. Haugh's claim of improper gas purchases, identify the days between February 1999 and April 2002 when DEO purchased gas from Dominion Hope, the then current FOMI price, the daily market price, and the amount of gas purchased. This exhibit shows that DEO purchased gas from Dominion Hope almost every month during that time and on most days of those months. Further, for most of those purchases, the FOMI price paid by DEO exceeded the daily market price. There are also many days when no purchases were made and the FOMI price was less than the daily market price. Nonetheless, there were several days in February, May, July, and September 1999, when the FOMI price that DEO paid was equal to the market price. There were other months, like December 1999, when DEO purchased gas from Dominion Hope on only two days and, on one of those two days, the daily price exceeded the FOMI price. Similarly, in each of March 2000 and April 2000, DEO only purchased gas from Dominion Hope on one day. The March purchase reflected a daily price that exceeded the FOMI price. The April transaction occurred when the two prices were equal. In addition, in June 2000, DEO purchased gas from Dominion Hope on 24 days and, on seven of those days, the daily market price exceeded the FOMI price. (MPH Attachment 2a).

Based on the evidence, we are unable to conclude that DEO's purchases of gas from Dominion Hope at the FOMI price were unreasonable, improper, or unlawful. While the evidence shows that, for most days during this time, DEO purchased gas from Dominion Hope when the FOMI price exceeded the daily price, there were several days when the FOMI price paid by DEO was less than or equal to the daily market price on the date of purchase. The evidence shows that DEO's policy was to purchase gas from many sources, including its affiliates, and all of these purchases were made at the FOMI price. As a result, many times the daily price was above the FOMI price and, at other times, the daily

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9 Mr. Kroll appeared under directive of a subpoena to bring all documents in his possession that reveal information about purchases made between Dominion Hope and DEO that are the subject of the civil lawsuit.

price was below the FOMI price. In addition, the purchases made by DEO from Dominion Hope were either pure load transactions, where DEO purchased a uniform amount of gas each day during the month, volume flexible purchases, where DEO agreed to purchase gas on a daily basis up to a certain quantity that Dominion Hope had available. Further, there was insufficient evidence to demonstrate that DEO was involved in a concerted effort to defraud GCR customers in this time period by purchasing gas at the FOMI price rather than the daily price or that its purchases of gas, whether from Dominion Hope or any other supplier, were improper or unreasonable. In addition, there was insufficient evidence to demonstrate that DEO's practice of purchasing gas at the FOMI price was any more risky than purchasing gas at the daily market price or any other purchasing strategy.

While the auditors referenced Mr. Kroll's complaint, they noted that they did not investigate or judge the truth of the allegations in his complaint, although this was, in part, a reason why the auditors stated that they were unable to conclude that DEO's gas supplies were purchases at the lowest reasonable cost. The auditors also noted that they were never denied access to any information regarding DEO's gas purchases in this m/p audit and they indicated that DEO provided them with information concerning all m/p audit period gas purchases to the level of detail that was requested (Tr. I at 102). Further, in no previous GCR proceeding for DEO has any auditor questioned DEO's gas transactions with Dominion Hope or presented any evidence of fraud or raised any question regarding the reasonableness of DEO's gas transactions. Accordingly, we find insufficient basis to recommend that an m/p audit of DEO's gas purchases during this pre-m/p audit period should be conducted.

B. PLE Transactions

The second issue raised by OCC related to DEO's participation in PLE transactions and OCC's request that the Commission reconsider its position that DEO is not required to share with GCR customers the revenue it receives from PLE transactions. OCC requests that PLE transaction revenue should be shared in the same manner as off-system sales revenue. As noted previously, PLE transactions are secondary market activities that rely on non-GCR capacity. On the other hand, off-system sales transactions do utilize GCR capacity. In DEO's 2003 GCR proceeding, we rejected OCC's position that, because the capacity used for PLE transactions was GCR capacity, DEO should be required to share the revenue it derives from PLE transactions. *In the Matter of the Regulation of the Purchase Gas Adjustment Clause Contained Within the Rate Schedules of the East Ohio Gas Company d.b.a. Dominion East Ohio and Related Matters*, Opinion and Order (March 2, 2005), Entry on Rehearing (June 29, 2005), Second Entry on Rehearing (August 24, 2005). We found as follows in the entry on rehearing:

> [T]he capacity used for PLE transactions did not impact GCR customers. Further, there was no evidence that, at all times during the audit period,

> GCR customers did not have available to them the capacity they paid for and that was purchased to serve their needs. In addition, OCC presented no evidence to the contrary. Upon further review of the evidence, we are now convinced that DEO did not use GCR-funded capacity when it engaged in PLE transactions because the capacity used for DEO's PLE transactions during the audit period did not exceed the amount of capacity allocated to non-GCR customers, and DEO ensured that GCR customers had available to them at all times during the audit period the capacity they had paid for and that was purchased to serve them.

In the present case, OCC argues that the Commission should revisit the issue of the sharing of DEO's PLE transaction revenue because it claims that DEO's decision to engage in PLE transactions, instead of off-system sales, was driven by its ability to retain 100 percent of the revenue from PLE transaction. On the other hand, OCC notes it would only retain 25 percent of the revenue from off-system sales. OCC contends that this disparity resulted in DEO failing to minimize gas prices for its GCR customers. For the reasons stated below, we decline to modify our policy on DEO's PLE transactions or the revenue which DEO receives from PLE transactions.

1. Liberty's Position

In this case, Liberty reviewed DEO's secondary market activities, including its PLE transactions (Commission Ordered Ex. 4, at III-8-15). Liberty reported that DEO's on-system storage facilities enabled it to operate without requiring peaking facilities. In addition, Liberty indicated that DEO maintained a good measure of flexibility in its transportation asset portfolio to accommodate fluctuations in its sales load associated with the choice program and its standard service offer (SSO) program filing, pursuant to which DEO will exit the merchant function. Liberty also found that DEO actively managed its portfolio to accommodate the choice program and maintain the flexibility necessary for unexpected changes in migration levels (*Id.* at III-10). Liberty noted that it was unaware of any impediments to DEO engaging in off-system sales and found insufficient DEO's justification for not participating in off-system sales, i.e., because it lacked Commission approval of a revenue-sharing mechanism for such sales (*Id.* at III-12). Liberty recommended that DEO consider the issue of an outside asset manager to manage and optimize its pipeline and upstream storage assets and to provide guidance on the dispatch of DEO's on-system storage. Liberty also recommended that the Commission re-examine its treatment of revenue and revenue-sharing to ensure that DEO is optimizing the total of its latent assets including the use of capacity releases, bundled sales, and PLE transactions, but recognized that the Commission considered this issue in DEO's 2003 GCR proceeding and accepted the current structure (Tr. I at 70).

Mr. Teumin acknowledged that Liberty made no finding that DEO had excess capacity, but indicated that the m/p audit report discovered a misalignment between peak day resources and peak design day requirements that resulted from a weakness in its forecasting methodology (*Id.* at 42-43). Mr. Teumin also agreed that the choice program requires that DEO have some flexibility in its portfolio and he indicated DEO reviewed its capacity portfolio with OCC and staff (*Id.* at 99). He testified that DEO engages in capacity release and PLE transactions, but not off-system sales or storage arbitrage (*Id.* at 51). He also noted the conclusion of the m/p audit report that the existing compensation system creates an incentive for DOE to engage in PLE transactions over other off-system sales transactions (*Id.* at 61, 65-70). Mr. Teumin recommended that the incentives for all secondary market activities should be the same (Id. at 60). Mr. Teumin did not agree with OCC's contention that DEO's failure to participate in off-system sales resulted in GCR ratepayers failing to receive a reduction in their gas costs (*Id.* at 66).

2. OCC's Position

OCC claimed that DEO engaged in PLE transactions that benefited shareholders instead of off-system sales transactions that would have provided financial savings to GCR customers. OCC witness Bruce M. Hayes claimed that off-system sales transactions are generally more profitable than other types of secondary market activities because of the bundling of the natural gas commodity with transportation capacity (OCC Ex. 4, at 10; OCC Initial Brief at 38). OCC pointed to the m/p auditor's finding that LDCs favored bundled sales because they produce higher revenue than capacity releases (Commission Ordered Ex. 4 at III-12). OCC points to the auditor's suggestion that DEO had an incentive that favors PLE transactions, rather than other transactions, because it retained all of the revenue from PLE transactions and only retained about 15 percent of capacity release revenue and 20 percent of off-system sales revenue (*Id.* at III-11, 13).

OCC disputed DEO's claim that it had no authority to engage in off-system sales because it had no Commission authority and claimed that DEO could not point to any Commission order that prohibited off-system sales transactions or permitted PLE transactions (Tr. I at 118). OCC also cited the auditor's finding that DEO had ample opportunity to go to the Commission and get whatever authorization was necessary, had it elected to do so (Commission Ordered Ex. 4 at III-12). OCC acknowledged that DEO will, in the future, no longer provide gas via the GCR, and will move toward a market driven system of gas pricing through its application to exit the merchant function and offer gas through a SSO program.[10] OCC nevertheless argued that there is no operational reason why DEO could not engage in off-system sales during the period after the last GCR

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[10] DEO's exit from the merchant function was approved by the Commission in its opinion and order, issued on May 26, 2006, in *In the Matter of the Application of the East Ohio Gas Company d/b/a Dominion East Ohio for the Approval of a Plan to Restructure its Commodity Service Function*, Case No. 05-474-GA-ATA,

other than financial motivation and that there is no justification for not engaging in off-system sales prior to the actual implementation of Phase 2 of DEO's SSO program. In addition, OCC claimed that, under DEO's current SSO program schedule, there are over 27 months left before Phase 1 is completed and, during this time, DEO could engage in off-system sales that could potentially generate millions of dollars in revenue to benefit GCR ratepayers (OCC Initial Brief at 44).

OCC also claims that DEO had excess capacity which could have been used to provide off-system sales services. OCC claims that this excess capacity is explained by Liberty's finding that DEO's 2004-2005 winter gas supply plan indicated a misalignment of 207 MMcf (Commission Ordered Ex. 4 at II-15). OCC claimed that this misalignment could have been used by DEO for PLE transactions, with DEO keeping all of the revenue from these transactions. OCC also claimed that other LDCs, with similar capacity and types of assets, engage in various different forms of secondary market activities, namely upstream interstate pipeline transportation capacity, upstream interstate storage capacity, and on-system storage capacity. Mr. Hayes argued that DEO could have used its available daily storage capacity as a daily arbitrage opportunity by purchasing gas at one point in the day and then selling the gas or injecting it into storage for later use (OCC Ex. 14 at 6-7). However, he acknowledged that he had not specifically evaluated the risks associated with arbitrage transactions or conducted any studies associated with various types of storage arbitrage (Tr. II at 206, 207). OCC also contended that, even during the winter heating season, DEO's purchases of gas for use by GCR customers could have used those same supplies to take advantage of more beneficial arbitrage opportunities, which would have benefited GCR customers.

3. Staff's Position

Staff argued that the record in this case does not support any deviation from the Commission's prior treatment of revenue associated with DEO's PLE transactions. According to staff, there was no evidence in the case that shows that GCR assets were used for DEO's PLE transactions or that GCR customers were harmed by DEO's PLE transactions as the Commission had explained would be necessary to support an allocation of PLE revenue. Staff pointed to Mr. Murphy's testimony that DEO's PLE transactions during the m/p audit period utilized non-GCR capacity held by DEO for operational balancing purposes and that the capacity used for PLE transactions is not interchangeable with GCR capacity, is held for different purposes, was acquired for different purposes, and was operated differently (Tr. II at 246). Staff also maintained that DEO holding operational balancing capacity held by DEO benefited GCR customers who enjoyed a lower price of gas during the heating season because gas was purchased during the summer months and placed into storage (Staff Initial Brief at 5-8).

4. DEO's Position

DEO argued that its PLE transactions and other secondary market activities were reasonable and lawful. DEO claimed that OCC's witness assumed incorrectly that DEO has "latent assets." It cites to Mr. Hayes' statement that LDCs "almost always have assets that are underutilized . . . during non design conditions." (OCC Ex. 14 at 4; DEO Initial Brief at 16-17.) DEO noted that OCC presented no specific proof that DEO has any idle on-system storage capacity. Mr. Murphy explained that DEO needs storage capacity to provide commodity service to sales customers throughout the entire winter season (Tr. at 240). Further, DEO contended that Liberty and OCC were incorrect in the assertion that capacity releases, off-system sales, and PLE transaction are all made using the "pool of DEO assets" used to provide sales and transportation service to DEO customers. (Commission Ordered Ex. 4 at III-15). DEO maintained that it had an incentive to engage in both PLE and capacity release transactions because it obtained revenue from both; however, the choice to engage in one type of transaction over another was dependent on the available capacity.

According to Mr. Murphy, the revenue sharing mechanism applied to different types of transactions cannot be compared. He stated that "[t]he capacity used for park, loan, and exchange transactions is not interchangeable with GCR capacity. They are held for different purposes. They are acquired for different purposes, and they are operated differently." (Tr. I at 133; Tr. II at 246.) Mr. Murphy confirmed that PLE transactions in the m/p audit period continued to be made with non-GCR capacity held by DEO for operational balancing purposes (Tr. II at 238). He also explained that off-system sales in general are not functionally interchangeable with PLE transactions because such sales do not support operational balancing in the same way PLE transactions do (*Id.* at 246-247).

DEO also argued against Liberty's recommendation of an asset manager. DEO witness Murphy testified that DEO will be moving from GCR service to a SSO in less than 20 days. He noted that, when that occurs, there will be no assets to be managed, because DEO will have allocated all of the nonoperational balancing capacity to the SSO suppliers. As a result, Mr. Murphy claimed that there would be no possible role for an asset manager, going forward (*Id.* at 245).

In addition, DEO disputed OCC's claim that there were other secondary market activities that it could have engaged in. DEO argued that it could not engage in daily price differential arbitrage, as suggested by Mr. Hayes, because there is no hourly futures market and LDCs cannot hedge against a lower price later in the day. DEO also claimed that it has no obligation to engage in any off-system sales, citing to the Commission's opinion and order in DEO's 2003 GCR proceeding. (DEO Initial Brief at 18.) In that case, the Commission approved a stipulation providing that DEO would, at its discretion,

undertake off-system sales when appropriate. Mr. Murphy noted that DEO engaged in a seasonal arbitrage to the benefit to GCR customers by buying gas in the summer and selling it to GCR customers in the winter (*Id.* at 243).[11] DEO further indicated that the m/p audit report in the 2003 GCR proceeding recommended that DEO consider off-system sales if it decided to continue providing gas via the GCR. According to DEO, because it decided not to retain its merchant function, it chose not to engage in off-system sales.

5. IGS's Position

IGS observed that, to the extent that the Commission orders a sharing of revenue generated by PLE transactions, that revenue should be allocated only between transportation customers and DEO (IGS Reply Brief at 1). IGS contended that the record demonstrates that DEO engaged in PLE transactions using assets procured for and funded only by transportation customers and GCR customers were not harmed by the PLE transactions. Therefore, IGS claimed that, before any PLE transaction revenue should be shared with GCR customers, OCC must first demonstrate that the capacity used by DEO exceeded the amount of capacity funded by non-GCR customers. In addition, IGS argued that, in order to prevail, OCC would have to show that DEO did not ensure that GCR customers had available to them, at all times, capacity that was procured and paid for by GCR customers (*Id.* at 2). IGS stated that OCC failed to make either showing. Thus, according to IGS, any allocation of PLE transaction revenue to GCR customers would result in an unlawful subsidy in favor of GCR customers.

6. Commission Decision

Based on the evidence of record, we find no basis to modify our policy on how PLE transaction revenue is treated by DEO. OCC advanced several arguments with respect to the revenue DEO receives from PLE and off-system sales gas transactions. First, OCC claimed that, because DEO failed to engage in off-system sales, DEO failed to maximize the value of what was labeled "latent assets" and, in the process, failed to provide least cost reliable service to GCR customers. The evidence shows that, during the m/p audit period, DEO engaged in both capacity release and PLE transactions and that DEO participated in these transactions over other types of transactions based on the available capacity used to make those transactions. As noted by Mr. Murphy, the capacity used for PLE transactions is not interchangeable with GCR capacity. They are held for different purposes, acquired for different purposes, and they are operated differently. There was no evidence presented to the contrary. There was also no evidence that DEO had "latent"

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[11] Mr. Murphy testified that because gas was purchased at a lower price in the summer injection season and sold to GCR customer over the winter, gas costs for GCR customers were reduced by approximately $11.2 million (*Id.* at 251).

assets that it could have used for off-system sales and which it intentionally chose not to use.

OCC also argued that DEO should have engaged in daily arbitrage strategies and other off-system sales transactions in order to receive revenue that would benefit GCR customers. We disagree. The evidence shows that DEO engaged in seasonal arbitrage which benefited GCR customers by allowing DEO to purchase lower priced gas in the summer and sell it to GCR customers in the winter (Tr. II at 243). However, there was no testimony that Mr. Hayes, who promoted the arbitrage strategy, had analyzed the risks or had completed any studies associated with arbitrage before arguing that DEO was failing to maximize revenue by not participating in such transactions (*Id.* at 191, 192, 208). In addition, while OCC claimed that DEO's reasons for not participating in off-system sales were unjustifiable, including that it had no Commission authority, there was no obligation on the part of DEO to participate in any off-system sales or in daily arbitrage where gas prices and sales are uncertain and risky. While OCC argued that DEO's principal basis for engaging in PLE transactions, over off-system sales, was because DEO was able to retain all of the revenue generated by PLE transactions and only a portion of the revenue of off-system sales, the evidence shows that DEO's participation in these transactions was determined by the available capacity. Further, there was no evidence that DEO had excess capacity or that any capacity was misused by DEO (*Id.* at 98).

OCC further argued that the m/p audit report indicated that DEO's 2004-2005 winter gas supply plan contained a misalignment of 207 MMcf, which constituted excess capacity that DEO "could" have used to engage in PLE transactions. The evidence does not support that contention. There was no evidence that this imbalance was specific only to GCR customers or that any of the imbalance was used by DEO for its PLE transactions. In fact, Liberty specifically determined that the 207 MMcf was related to underestimation issues in connection with DEO's forecasting methodology (Commission Ordered Exhibit 4 at II-15). In addition, Table II.16 of the Liberty's m/p audit report, which forms the basis for OCC's claim, provides information on DEO's 2004-2005 winter supply plan for the months of November through March and includes peak day gas requirements. This table indicates that there was a difference or imbalance between the total peak supply and total peak requirements of 207 MMcf, which included total retail, total traditional transport, total energy choice transport company use, UFG, on-system base, on-system peak, and gas injections and that this imbalance specifically related to DEO's forecasting methodology.

We note that Liberty recommended that DEO consider the use of an outside asset manager. By opinion and order issued on May 26, 2006, in *In the Matter of the Application of the East Ohio Gas Company d/b/a Dominion East Ohio for the Approval of a Plan to Restructure its Commodity Service Function,* Case No. 05-474-GA-ATA, the Commission authorized DEO to proceed with the first phase of its plan to eliminate its GCR and obtain and price its natural gas supplies through a market-based rate methodology and to provide gas to its

sales customers at a SSO based on its cost of acquiring supplies. The evidence shows that, once DEO's SSO goes into effect, DEO's pipeline capacity assets will largely be assigned to the SSO suppliers and DEO will not have the level of capacity to participate in off-system sales. As noted by Mr. Murphy, while some capacity will be available, it will primarily be held for operational balancing for the system (Tr. I at 127). Thus, because most of DEO's pipeline capacity assets will be assigned to the SSO suppliers, those assets, which previously were used for PLE and capacity release transactions, will largely be unavailable for an asset manager to manage. Therefore, we decline to adopt this recommendation. Nevertheless, we would consider revisiting this recommendation if DEO's SSO Program is terminated and DEO returns to GCR pricing.

V. Stipulation of the Parties

In the stipulation, DEO, IGS, IEU, and staff agree that the costs reflected in DEO's GCR rates for the financial audit period were properly incurred by DEO, the GCR rates were accurately computed by DEO for the financial audit period, and that DEO has accurately applied the GCR rates to customer bills during the financial audit period. The signatory parties recommended that the opinions and findings of D&T, as set forth in Commission Ordered Exhibits 1, 2, and 3, should be approved and adopted by the Commission. Specifically, the parties stipulated that:

(1) DEO shall revise its procedures for control of the telephone recording system used in DEO's internal Gas Supply Group to clarify that the director of the Gas Supply Group cannot block access to the tapes. DEO shall review the revised procedures with staff before they are implemented.

(2) DEO shall require its internal auditing group to conduct, prospectively and biennially, detailed statistical examinations and comparisons of prices paid by DEO for gas purchased from affiliated and non-affiliated entities to confirm that the prices paid to affiliates are comparable with the prices paid to non-affiliates for comparable purchases.

(3) The next m/p auditor should be directed to conduct an examination of DEO's gas purchase transactions during the m/p audit period then under review with its LDC affiliates to ensure that they do not result in the inappropriate transfer of costs and revenue among the affiliates.

(4) DEO shall test alternative design-day equations with potential variables as suggested in the alternative demand forecast method

outlined in DEO's 2003 long-term forecast report (LTFR) and incorporate them into any future LTFR that DEO is required to file.

(5) On the start date for DEO's phase I of its SSO Program, DEO will cease to offer GCR service and will no longer be required to file a LTFR. Should DEO return to GCR service, for whatever reason, DEO and staff shall determine which of the recommendations in Section II of the m/p audit (other than recommendation number 4, which is addressed in paragraph 6 of the stipulation) DEO should implement.

(6) Should DEO use capacity paid for by sales customers to make PLE transactions, DEO shall document the negotiations regarding those transactions and shall allocate an appropriate portion of the revenue from those transactions to sales customers. No party to the stipulation relinquishes any claims or defenses relating to DEO's use of assets and capacity not paid for by GCR customers to engage in revenue-generating transactions or the allocation of portions of revenue from such transactions.

(7) DEO shall develop and implement a procedure for documenting the steps in the gas supply procurement bid evaluation and vendor selection process.

(8) DEO shall develop and implement a system for generating Gas Supply Group performance reports, for distribution to the director of the Gas Supply Group, and to senior management, that will include sales volumes and expenditures by vendor, compare contract to spot purchase prices, describe trading activities, and contain a variance analysis.

(9) In its May 26, 2006 opinion and order approving Phase 1 of the SSO, the Commission stated that, before proceeding to Phase 2 of the SSO, it would consider changes in DEO's expense and rate base items to ensure that there are no duplicative costs imbedded in the rates customers pay. DEO agrees that, in connection with its Phase 2 filing, it will perform a study assessing whether there is any duplication in the costs recovered in DEO's base rates and those recovered through the riders approved in Phase 1. DEO reserves the right to contest any attempt to widen the scope of the study beyond the issue of duplicative costs recovery.

(10) DEO shall undertake a full study of its lost and UFG.

(11) Prospectively, DEO shall apply to new and renegotiated contracts its method for analyzing incremental losses associated with negotiated rate customers.

VI. Discussion and Conclusion

Rule 4901-1-30, O.A.C., authorizes parties to Commission proceedings to enter into stipulations. Although not binding upon the Commission, the terms of such an agreement are accorded substantial weight. See, *Consumers' Counsel v. Pub. Util. Comm.* (1992), 64 Ohio St. 3d 123, at 125, citing *Akron v. Pub. Util. Comm.* (1978), 55 Ohio St. 2d 155. In this case, OCC and Citizens Coalition were not signatories to the stipulation.

The standard of review for considering the reasonableness of a stipulation has been discussed in a number of prior Commission proceedings. *See, e.g., The Cincinnati Gas & Electric Co.*, Case No. 91-410-EL-AIR (April 14, 1994); *Ohio Edison Co.*, Case No. 91-698-EL-FOR, et al. (December 30, 1993); *The Cincinnati Gas & Electric Co.*, Case No. 92-1463-GA-AIR, et al. (August 26, 1993); *Ohio Edison Co.*, Case No. 89-1001-EL-AIR (August 19, 1993); *The Cleveland Electric Illuminating Co.*, Case No. 88-170-EL-AIR (January 31, 1989); and *Restatement of Accounts and Records (Zimmer Plant)*, Case No. 84-1187-EL-UNC (November 26, 1985). In these cases and others, the Commission has used the following criteria in considering the reasonableness of a settlement agreement:

(1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?

(2) Does the settlement, as a package, benefit ratepayers and the public interest?

(3) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve cases by a method economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.* (1994), 68 Ohio St. 3d 559, citing *Consumers' Counsel, supra,* at 126. The court stated in that case that the Commission may place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission.

OCC claimed that the stipulation should be rejected because it is not the product of serious bargaining among capable knowledgeable parties. OCC noted that no GCR customers or parties representing GCR customers support the stipulation and the parties who have signed have no stake in maintaining a low GCR rate. OCC asserted that there

was no record of any serious bargaining among the parties once all of the evidence was available and no bargaining at all since the stipulation was signed or after the hearing, where the allegations of Mr. Kroll were presented. Citizens Coalition also argued that the first criterion was not met because there was no evidence about the capability and knowledge of the signatory parties as it relates to GCR issues. Citizens Coalition explained that its participation in stipulation negotiations would not have been worthwhile because it believed that DEO lacked any incentive to negotiate with it. In addition, Citizens Coalition maintained that, even with negotiated agreements, the Commission has modified such agreements to the detriment of the stipulating parties, so there is no assurance that a stipulation would not be altered by the Commission. According to DEO, the stipulation in this case is the product of serious bargaining among DEO, staff, IEU, and IGS, which are certainly capable and knowledgeable about the issues involved in this matter. Staff declared that the first criterion is met because all the parties were represented by able counsel and all either participated or had the opportunity to participate in settlement discussions.

We find that the settlement process clearly involved serious bargaining by knowledgeable, capable parties. DEO, Interstate, IEU, staff have been involved in many cases before the Commission, including a number of GCR cases. Moreover, these parties have consistently provided extensive and helpful information to the Commission regarding DEO's GCR and fuel-related policies and practices. We note that not all parties signed the stipulation; however, all parties to this proceeding had ample opportunity to be involved in the development of the stipulation and to present evidence for the Commission's consideration. Furthermore, the existence of a stipulation between some of the parties prior to the hearing did not foreclose any party from requesting amendments to the stipulation after it was filed. In addition, in any proceeding where a stipulation is submitted by the parties, the Commission must review and determine whether that stipulation should be approved as submitted or should be modified. In such a case, the parties always had the opportunity to ask the Commission to reconsider its stipulation modifications on rehearing.

As to the second part of the standard, OCC claimed that the settlement does not benefit rate payers or the public interest. According to OCC, the stipulation failed to show that DEO delivered gas at the lowest reasonable cost. OCC argued that the failure of the auditor to find that DEO's gas supplies were purchased at the lowest reasonable cost is significant and the Commission should not have confidence in the stipulation. OCC also maintained that the stipulation ignores the harm to GCR customers resulting from the company's failure to engage in off-system sales transactions that would have reduced GCR costs. OCC noted that the stipulation acknowledges that there are management structure and oversight issues that are at the heart of the FOMI transactions issue and, therefore, such questions render the stipulation not in the public interest. Citizens Coalition similarly advanced the argument that the stipulation does not benefit

ratepayers or the public interest because it fails to take seriously the findings of the Liberty m/p audit regarding weaknesses in the DEO's internal system of control and management oversight.

DEO argued that the stipulation does, as a whole, benefit ratepayers and the public interest because it addresses certain management control issues raised by Liberty, it provides for enhancements to DEO's load forecasting process, it required several studies recommended by the auditor, and it provides for revenue sharing where PLE transactions use GCR capacity. Staff agreed with DEO that the second criterion is met because the agreement obligates DEO to undertake steps to strengthen and tighten management controls and oversight as it relates to the gas purchasing function. In addition, staff claimed that the stipulation provisions are responsive to the concerns raised in Liberty's m/p audit report and should result in a better, more efficient gas procurement process in the future.

The stipulation meets the second criterion. As a package, the stipulation advances the public interest by attempting to resolve all of the issues related to the review of DEO's GCR and fuel-related policies and practices during the m/p audit period. We believe that the stipulation provisions are responsive to the concerns raised in Liberty's audit. Further, we believe that the stipulation will obligate DEO to undertake steps to strengthen and improve its management controls and oversight of gas purchasing.

OCC claimed that the stipulation also fails to satisfy the third part of the test because it violates several important regulatory principals and practices. OCC contends that the stipulation was signed before all of the evidence regarding DEO's pre-m/p audit gas transactions was on the record and ignores the auditor's conclusions regarding DEO's purchase of gas supplies. OCC argued that the Commission should not approve a stipulation that ignores the conclusions and recommendations of the auditor and that pre-dates and attempts to avoid consideration of evidence presented at hearing. Citizens Coalition agreed with OCC's contention that the approval of the stipulation would allow DEO to recover GCR costs that were unreasonably and inappropriately incurred, while, at the same time, the company failed to carry out gas purchase activities which could have benefited its own customers.

DEO disputed the arguments of OCC and Citizens Coalition and urged the Commission to approve the stipulation and find that its gas purchasing practices and policies during the m/p audit period promoted minimum prices consistent with an adequate supply of gas. DEO claimed that Liberty had all of the information it needed to make a judgment about DEO's gas purchases and practices during the m/p audit period and it was not denied access to any gas purchase transaction information during its audit. Further, DEO argued that Liberty found nothing to suggest that any of its gas purchases were imprudent or unreasonable or that its gas purchasing practices and policies did not

promote minimum prices consistent with an adequate supply of gas. Staff also claimed that the stipulation meets the third criteria. Staff notes that, while Liberty stated that it was unable to conclude that DEO's gas supplies were purchased at the lowest reasonable cost, it acknowledged that the statement did not represent a conclusive statement that DEO did or did not procure gas at lowest reasonable cost. Staff also pointed out that Liberty was concerned mainly with DEO's management structure and oversight issues. These issues coupled with unsubstantiated allegations from a civil lawsuit made it difficult for Liberty to make a definitive finding on DEO's purchases of gas. Staff argued that the stipulation provisions will tighten and improve management oversight concerns that the m/p audit identified.

We believe that the stipulation meets the third criterion and does not violate any important regulatory principle or practice. The stipulation includes terms designed to enhance DEO's ability to provide service to its customers and encourages off-system sales and the efficient use of capacity, thereby reducing gas costs and GCR rates. We believe that the record evidence is insufficient to support a finding that DEO engaged in nefarious activity related to its gas transactions with its affiliate, Dominion Hope, at any time during the m/p audit or prior to the m/p audit in this case. In addition, we find nothing to suggest that any of DEO's gas purchases were imprudent or unreasonable or that DEO's gas purchasing practices and policies did not promote minimum prices consistent with an adequate supply of gas. We also find that DEO's gas transactions benefited GCR customers and that its participation in PLE transactions was not to the detriment of GCR customers. While we note that Liberty was unable to find that DEO's gas supplies were purchased at the lowest reasonable cost, that finding was made, in part, based on the allegations which we have found not to be supported by the evidence. Further, D&T reported that DEO has fairly determined, in all material respects, the GCR rates for the subject periods in accordance with the financial and procedural aspects of the uniform purchase gas adjustment clause as set forth in Chapter 4901:1-14 and related appendices of the O.A.C., and properly applied the GCR rates to customer bills. We find that DEO's gas purchasing practices and policies during the m/p audit period promoted minimum prices consistent with an adequate supply of gas. Accordingly, the stipulation should be adopted and approved.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) DEO is a natural gas company within the meaning of Section 4905.03(A)(6), Revised Code, and, pursuant to Section 4905.02, Revised Code, is a public utility subject to the jurisdiction of the Commission.

(2) Pursuant to Section 4905.302, Revised Code, and Rule 4901:1-14-08, O.A.C., this proceeding was initiated by entry of January 12, 2005.

(3) The Commission granted intervention to IEU, IGS, OCC, and Citizens Coalition.

(4) The financial audit and m/p audit were performed in substantial compliance with Section 4905.302, Revised Code, and Rule 4901:1-14-07, O.A.C.

(5) On May 19, 2006, D&T filed its *Financial Audit Report; Independent Accountants' Report on Applying Agreed-Upon Procedures for Validity of Costs,* and *Independent Accountants' Report on Applying Agreed upon Procedures for Uncollectible Expense Recovery Mechanism.*

(6) On May 22, 2006, Liberty filed its *Final Report Management/Performance Audit.*

(7) Pursuant to Section 4905.302(C), Revised Code, and Rule 4901:1-14-08(A), O.A.C., a public hearing was held on July 25, 2006.

(8) DEO published notice of the hearing in compliance with Rule 4901:1-14-08(C), O.A.C.

(9) A stipulation signed by DEO, staff, IEU, and IGS was filed on July 7, 2006.

(10) The stipulation represents a just and reasonable resolution of the issues in this case and should be approved and adopted.

(11) DEO's determination of its GCR rates for the audit period was in accordance with the financial and procedural aspects of Chapter 4901:1-14, O.A.C., and such rates were properly applied to customer bills. Accordingly, the gas costs passed through DEO's GCR clause for the audit period were fair, just, and reasonable.

ORDER:

It is, therefore,

ORDERED, That the stipulation be approved and adopted. It is, further,

ORDERED, That a copy of this opinion and order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Alan R. Schriber, Chairman

Ronda Hartman Fergus

Judith A. Jones

Valerie A. Lemmie

Donald L. Mason

SEF:ct

Entered in the Journal

JAN 31 2007

Reneé J. Jenkins
Secretary