FILE

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

APPLICATION FOR REHEARING BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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March 2, 2007

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The Office of the Ohio Consumers' Counsel ("OCC") on behalf of the residential gas consumers of the Dominion East Ohio ("the Company" or "DEO") and, pursuant to Ohio Revised Code § 4903.10 and Ohio Adm. Code 4901-1-35(A), applies for rehearing of the Opinion and Order ("O&O") issued by the Public Utilities Commission of Ohio ("PUCO" or "the Commission") on January 31, 2007 in this docket. The OCC submits that the Commission's O&O, which found that DEO had demonstrated that its purchases from its affiliate Hope Gas, Inc. dba Dominion Hope ("Hope") were prudent and that adopted the Stipulation and Recommendations filed by the Company on July 7, 2006 ("Stipulation") is unreasonable and unlawful in the following particulars and grounds:

A. In considering whether to approve a Stipulation and Recommendation, the Commission should (but failed) to consider whether it is the product of serious bargaining among a representative cross-section of interested parties, including parties that represent the customers that will pay any rates under the Stipulation or will otherwise be directly affected by the Stipulation.

B. The Commission should refine and amend the Commission's criteria for the approval of settlements to address the due process rights of those opposing such settlements.

C. The Commission may not approve a Stipulation and Recommendation that violates Ohio law, regulatory principles and practices, and does not benefit ratepayers or the public interest.

1. The Stipulation's failure to return money to GCR customers that was imprudently incurred by the Company through its Park, Loan and Exchange transactions and its first of the month index option purchases from Dominion Hope violate Ohio law, regulatory principles and practices and do not benefit ratepayers and the public interest.

D. The Commission's Finding that the DEO/Hope Transactions were prudent and not unreasonable, improper or unlawful was against the manifest weight of the evidence and so clearly unsupported as to show misapprehension or mistake or willful disregard of duty.

Respectfully submitted,

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MEMORANDUM IN SUPPORT

I. INTRODUCTION

The Commission initiated this gas cost recovery case ("GCR") pursuant to Ohio Revised Code 4909.302(C) and Ohio Adm. Code 4901:1-14-08(A) on January 12, 2005. Under those provisions, this GCR case provided for a Management Performance ("M/P") audit and hearing of DEO's gas purchasing practices for the two year period ending October 31, 2005. The M/P Auditor, Liberty Consulting Group ("Liberty") filed a report of its audit results ("Audit Report") on May 22, 2006. On July 7, 2006 DEO filed a Stipulation and Recommendation ("Stipulation") entered into by DEO, Interstate Gas Supply ("IGS"), Industrial Energy Users-Ohio ("IEU") and the Staff of the Commission ("Staff") that resolved the issues in this proceeding. The Commission held an evidentiary hearing beginning on September 13, 2006 and ending on September 14, 2006. The OCC and DEO filed initial briefs on October 20, 2006 and OCC, DEO, IGS, and the Citizens

Coalition[1] filed reply briefs on November 3, 2006. On January 31, 2007, the Commission issued its O&O adopting the Stipulation.

Two issues were contested at hearing: the prudence of some of DEO's transactions with its affiliate, Dominion Hope ("Hope") and the prudence of DEO's Park, Loan and Exchange ("PLE") transactions that DEO engaged in which benefited the Company instead of other secondary market transactions that would have benefited GCR customers.

II. LAW AND ARGUMENT

A. In considering whether to approve a Stipulation and Recommendation, the Commission should (but failed) to consider whether it is the product of serious bargaining among a representative cross-section of interested parties, including parties that represent the customers that will pay any rates under the Stipulation or will otherwise be directly affected by the Stipulation.

The Commission should reverse, pursuant to O.R.C. 4903.10 its O&O that approved the Stipulation among DEO, IGS, IEU and the Staff, none of whom actually pay GCR rates or represent parties who pay GCR rates. DEO is the Local Distribution Company ("LDC") whose natural gas procurement practices and policies were subject to review by the M/P Auditor in this proceeding. IGS is a natural gas Marketer, and IEU represents large industrial customers, who transport natural gas on the DEO system, but do not purchase GCR supplies.[2]

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[1] In its Motion to Intervene, the Citizens Coalition identified itself as Consumers for Fair Utility Rates, The Greater Cleveland Housing Network, the Neighborhood Environmental Coalition, and the Empowerment Center of Greater Cleveland. The Citizens Coalition was granted intervention in this case on December 2, 2005.

[2] IEU Motion to Intervene at 3-4.

The approval of the Stipulation unlawfully and unreasonably violated the Ohio Supreme Court's direction to the PUCO as set forth in *Time Warner AxS v. Pub. Util. Comm.*[3] In *Time Warner,* the Court expressed "grave concern" about "settlement talks from which an entire customer class was intentionally excluded."[4] Such an exclusion is also contrary to the Commission's own negotiation standards.[5] Although the OCC was present during settlement discussions, the resulting Stipulation essentially excluded OCC and residential customers because it ignored the issues of concern to OCC and residential customers.

OCC, the statutory representative of residential customers, was not a signatory party to the Stipulation. The only other party who even arguably represented customers who actually pay GCR rates, the Citizens' Coalition, also opposed the Stipulation. As a result, the interests of the entire customer class of residential customers who actually pay GCR rates were excluded from the final Stipulation. Therefore, the settlement negotiations were on their face unacceptable pursuant to *Time Warner.*

A "settlement" reached without the participation of an affected customer class cannot be a "settlement." Participation must include more than being invited to sit in a room, while other parties structure a settlement that ignores the rights of the customers who actually pay the rates at issue in a GCR case. A "settlement" has to be based on a give-and-take and a balancing of interests. The exclusion of the entire class of residential customers who actually pay GCR rates belies the notion that the negotiations that resulted

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[3] *Time Warner AxS v. Pub. Util. Comm.* (1996), 75 Ohio St. 3d 229.

[4] Id at 233.

[5] Id.

in the Stipulation constituted serious bargaining among the parties. There was no serious give and take among the signatory parties because the signatory parties all received wanted benefits in exchange for imposing costs on the GCR customers who did not sign the Stipulation.

When the Commission first established this stipulation evaluation criteria, the Commission recognized the value of having a wide diversity of parties and interests supporting a stipulation.[6] The Commission pointed out that diverse representation on a stipulation was an important component of determining whether the first prong of the stipulation evaluation criteria is met.[7] In the Zimmer Plant Case, the Commission stated that:

> The diversity of the interests represented by the signatories is remarkable, a fact which, of itself, is strong testimony to the reasonableness of the settlement package. In short, the Commission has no cause for concern as to the efficacy of the negotiations which produced the stipulation and recommendation.

When the diversity represented by the signatory parties in the Zimmer Plant Case is contrasted with the lack of diversity represented by the signatory parties to the Stipulation in this case, the efficacy which the Commission once took for granted cannot be similarly presumed here. In the Zimmer Plant Case, the Companies, Staff, OCC, industrial customers and other consumers groups (Montgomery County coalition) all supported the stipulation, while the City of Cincinnati was the only party who opposed

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[6] As an alternative, the PUCO could find that the words "capable, knowledgeable" as applied to bargaining parties under the PUCO's first prong of the test encompass the standard that OCC references in this section toward disapproving settlements that lack, for example, broad representation of residential consumers.

[7] See, *In the Matter of the Restatement of the Accounting and Records of the Cincinnati Gas & Electric Company, the Dayton Power & Light Company, and The Columbus Southern Ohio Electric Company,* Case No. 84-1187-EL-UNC, Opinion and Order (November 26, 1985). ("Zimmer Plant Case").

the stipulation. In the current proceeding, the only parties who represent GCR customers (OCC and the Citizens Coalition) all opposed the Stipulation.

In further contrast to the Zimmer Plant Case, the Stipulation in this case is the product of parties whose interests were to obtain benefits for themselves at the expense of the excluded parties and without any consideration of the impact on the excluded parties. In this case, the excluded parties (GCR customers represented by the OCC) fund a large portion of the benefits for the signatories. The resulting "settlement" is nothing more than an agreement to benefit a few at the expense of the excluded. The result of such a process is not a "settlement," and the process is not a "negotiation." *Time Warner* addressed this very situation.

In this case, where ratepayers, especially GCR customers, were required to fund the deal and derive no benefit from it, the impasse meant that there was no settlement, at least with respect to the issues affecting GCR ratepayers. The impasse meant that the settlement negotiations, at least with respect to those issues, had failed. In that case, if DEO persisted in pursuing its proposal, the matter should have been considered a contested case. The PUCO's consideration of the deal as a "settlement" put opponents at an unfair disadvantage.

Here, where the parties were not in agreement and whole classes of interests were intentionally excluded from the settlement negotiations, the Commission should find that the Stipulation is self-serving to the interests of its signatory parties at the expense of those excluded. Where there has been such exclusion, it is the fear of backroom deals that favor one class or interest over another that led the Court to issue its' admission in *Time Warner* that at least some representation for each customer class or interest be included in settlement negotiations. The Commission should find that the stipulation evaluation standards should be modified in accordance with OCC's arguments.

B. The Commission should refine and amend the Commission's criteria for the approval of settlements to address the due process rights of those opposing such settlements.

OCC requests that the Commission reverse and vacate its O&O, and in doing so, to modify the criteria that it has relied on in the past to determine the reasonableness of settlements before the PUCO. These criteria are:

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?[8]

The Court endorsed the PUCO's efforts to use these criteria to resolve PUCO cases in a method economical to ratepayers and public utilities.[9]

Given these criteria, the words "stipulation and recommendation" on a document filed at the PUCO should not change the nature of the PUCO's review. As used today, the words "stipulation and recommendation" signal to the PUCO that a "settlement" has been reached. The criteria have resulted in an unfortunate pattern wherein settlements in the form of "stipulations and recommendations" are brought before the PUCO even though intervening parties have been systematically and deliberately excluded from the resulting settlement.

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[8] *Consumers' Counsel v. Pub. Util. Comm.*, (1992), 64 Ohio St. 3d 123.

[9] Id. at 126.

The problem with the manner in which current criteria are applied is that the criteria permit settlements to occur that include some, but not all, of the knowledgeable parties. The criteria allow parties not necessarily imbued with the public interest to opine nonetheless that the public interest has been satisfied. In this case, the position of DEO, IEU and IGS -- that the public interest has been satisfied -- is based on the fact that their own respective private interest has been satisfied. It does not mean that the interests of the consumers who actually pay the rates that were the subject of the underlying proceeding have been addressed, let alone satisfied. If parties with a real and substantial interest in a proceeding (which must be demonstrated as a basis for intervention) are summarily excluded from a settlement, then the outcome cannot and does not reflect a meeting of the minds or compromise in which all those interests and perspectives have been taken into account.

Moreover, as in this case, the applicant (DEO) bore the burden of proving that the rates charged to GCR customers during the audit period were fair, just and reasonable.[10] The PUCO's application of the settlement criteria has effectively shifted the burden of proof from the Company to the parties opposing the Stipulation.

The Commission has also not allowed discovery on side agreements that may have caused certain parties to sign stipulations, except when directed upon remand to do so by the Ohio Supreme Court.[11] While the Commission claims that it has tried to support settlements where all parties are present, the Commission ignores the fact that not

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[10] O.R.C. 4905.302 and Ohio Adm. Code 4901:1-14 (7) and (8).

[11] *Ohio Consumers' Counsel v. Pub. Util. Comm.*, 2006-Ohio-5789 (November 22, 2006).

all parties supported this Stipulation, and that in fact an entire customer class opposed it. As Commission Attorney Examiner R. Russell Gooden stated at a recent hearing:

> The Commission has always endorsed and tried to support settlements where all parties are present, and I think this Supreme Court has expressed its opinion on that as well. However, whether you were or were not at those negotiations does not change the position that if there are sidebar agreements, that is not what the Commission will be passing upon or finding as reasonable in the proceeding. The Commission will be deciding the reasonableness of the Stipulation before it, and whether there are sidebars, the Commission is not passing upon those, nor does the Commission know if there are any. I think the Commission has expressed its opinion with regards to what you look at when you have a stipulation and not trying to get into the mind of individuals when they sign on the stipulations; therefore, I will deny the motion to compel discovery in this matter.[12]

In addition to the due process problems, the Commission's review of settlements pursuant to the criteria has been cursory. The criteria are overly broad, and they are loosely applied. The Commission makes unsupported statements that the criteria have been met. It is rare, if ever, that the Commission rejects a stipulation and recommendation put before it, especially if one of the parties is the Company. The Commission applies the criteria for settlements, generally finding that the criteria have been satisfied (after all, the parties have agreed to a resolution) and adopts the stipulation and recommendation. Most stipulations are approved, some with modest revisions, but few, if any, are ever rejected outright.

OCC has participated in many stipulations, but only when it believed that the interests of residential ratepayers were enhanced. If not, OCC must oppose the

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[12] *Dayton Power and Light Company*, Case No. 02-2779-EL-ATA et al., Tr. Vol. III at 29-30 (June 17, 2003).

stipulation and recommendation. In that case, it has become clear, as the instant brief demonstrates, that the Commission's criteria for the approval of settlements fail to provide due process protections for the parties who must oppose the stipulation. In the past, Commissioners have grappled with the inadequacy of the three criteria to address problems with contested settlements and proposed revisions to them.[13]

The Commission should reconsider its application of the criteria for the approval of settlements and consider modifying them to address the frequent problem that parties face when opposing the settlement. Moreover, modified criteria would be more in line with the intent expressed by the Commission in the Zimmer Plant Case.

Therefore, OCC asks the Commission to modify, pursuant to O.R.C. 4903.10, the criteria it relies on by the PUCO to judge the reasonableness of a settlement. Revised criteria should direct the Commission to consider the following:

- All intervenors should have a fair and reasonable opportunity to participate in the settlement discussions so that their interests are addressed.

- All side-agreements that are entered into as an incentive for settlement should be entered into the record.

- There should be an opportunity for all parties opposing the settlement to conduct discovery and prepare their case so that the PUCO has a full record not only from the proponents of a settlement, but also from the opponents.

- There should be a requirement that the parties supporting the settlement bear the burden of proving that the settlement is just and reasonable.

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[13] See Dissenting Opinion of Commissioner Ashley C. Brown, *Ohio Edison Company*, Case No. 87-689-EL-AIR, Opinion and Order (January 26, 1988).

- Any settlement that excludes an entire class of customers should be subject to greater scrutiny and a higher burden of proof with regard to the public interest.

Some of these recommendations are taken from the standard used by the New York Public Service Commission in reviewing settlements.[14] These criteria, along with any other that the Commission may find appropriate to maintain the fairness of the process, should be added to the current criteria to address the due process rights of opponents to settlements. The current criteria do not present a sufficient basis upon which a settlement may be contested.

C. The Commission may not approve a Stipulation and Recommendation that violates Ohio law, regulatory principles and practices, and does not benefit ratepayers or the public interest.

The Commission needed to determine that the Stipulation does not violate any regulatory principles and practices and that it benefited ratepayers and the public interest.[15]

1. The Stipulation's failure to return money to GCR customers that was imprudently incurred by the Company through its Park, Loan and Exchange transactions and its first of the month index option purchases from Dominion Hope violate Ohio law, regulatory principles and practices and do not benefit ratepayers and the public interest.

The PUCO's adoption of the Stipulation, allowed DEO to retain monies that it earned through PLE transactions and to recover from GCR customers monies spent on transactions with its affiliate that were never shown to be prudently incurred, reasonable

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[14] *Re Procedures for Settlement and Stipulation Agreements,* Case Nos. 90-M-0255 and 92-M-0138, New York Public Service Commission, Opinion, Order and Resolution (March 24, 1992).

[15] *Consumers' Counsel v. Pub. Util. Comm.* (1992), 64 Ohio St. 3d 123, 125-126.

or appropriate as required under O.R.C. 4905.302. When the evidence showed that PLE transactions are very similar to off-system sales except that they provide no benefit to the GCR customers and significant benefit to the shareholders,[16] DEO simply claimed that they are not the same because they require different assets (even though DEO never claimed the assets were shareholder funded).

The Commission did not require DEO to demonstrate that different assets are needed to use for PLE than those used for other transactions, it simply took its word for it.[17] This is contrary to the Commission's requirement that parties cannot simply state "we disagree" to satisfy their burden of proof.[18] And even if PLE transactions require different assets, whatever assets they require have been paid for by customers not shareholders and allowing shareholders to retain all revenues from those transactions is on its face unfair. Therefore, the Stipulation that does not address the inequity that PLE funds are retained by shareholders but that customers pay for the assets used to earn those revenues is contrary to law, regulatory principals and practices and cannot benefit the public or the public interest.

Additionally, the Stipulation's treatment of the costs associated with the DEO/Hope first of the month index ("FOMI") option transactions was contrary to law, regulatory principals and practices and cannot benefit the public or ratepayers. The Commission did not require DEO to rebut the fact that the FOMI option transactions are on their face unfair to DEO GCR customers. The Commission accepted DEO's claim

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[16] M/P Audit Report at III-13.

[17] O&O at 18.

[18] *Syracuse* at 11.

that these transactions are reasonable even though they were not in form or in result. Again the Commission's acceptance of this incredible claim, without requiring the Company to show how it could possibly be reasonable is contrary to law, regulatory principals and practices cannot benefit the public.

Thus, the Stipulation's treatment of PLE revenues and DEO/Hope transaction costs did not meet the PUCO's criteria for the approval of settlements; it violated Ohio law, regulatory principles and practices and far from benefiting ratepayers, actually harmed them. The Stipulation should have been rejected.

Thus, the Stipulation approved by the Commission on January 31, 2007 did not meet the PUCO's own criteria for settlements. It violated important regulatory principles and practices; it did not benefit ratepayers or the public interest; in fact, it harmed ratepayers.

On their face, the PUCO's criteria for the approval of settlements ought to provide some restraint on Commission action. The second and third criteria are that the settlement, as a package, must benefit ratepayers and the public interest and must not violate any important regulatory principle or practice.[19] If the criteria had any meaning and if they were applied in any meaningful way, the Stipulation should have been rejected.

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[19] *Consumers' Counsel v. Pub. Util. Comm.* (1992), 64 Ohio St. 3d 123, 125-126.

D. The Commission's Finding that the DEO/Hope Transactions were prudent and not unreasonable, improper or unlawful was against the manifest weight of the evidence and so clearly unsupported as to show misapprehension or mistake or willful disregard of duty.

1. Standard of Review

The Commission has been directed by the General Assembly to review gas procurement costs accordingly:

> "The commission shall not at any time prevent or restrain such costs as are distributable under this section from being so distributed, unless the commission has reason to believe that * * * the company has not accurately represented the amount of the cost of a special purchase, or has followed imprudent or unreasonable policies and practices, * * * or has employed such other practices, policies, or factors as the commission considers inappropriate."

This standard is commonly referred to as the "Prudence Test."

a. Ohio Adm. Code Standards

The Commission has adopted a separate standard for review of gas procurement costs under Ohio Adm. Code 4901:1-14-08(B):

> The gas or natural gas company shall demonstrate at its purchased gas adjustment hearing that its gas cost recovery rates were fair, just and reasonable and that its gas purchasing practices and policies promote minimum prices consistent with the an adequate supply of gas. The commission shall consider to the extent applicable:
>
> (1) The results of the management performance audit;
> (2) The results of the financial audit;
> (3) Compliance by the gas or natural gas company with previous commission performance recommendations
> (4) The efficiency of the gas or natural gas company's gas production policies and practices; and
> (5) Such other practices, policies, or factors as the commission considers appropriate.

Moreover, the Commission identified the reasons it may adjust the company's future gas cost recovery rates by means of a reconciliation adjustment under Ohio Adm. Code 4901:1-14-08(F):

> (1) Errors or erroneous reporting;
> (2) Unreasonable or imprudent gas production or purchasing policies or practices;
> (3) Unaccounted-for gas above a reasonable level. It shall be presumed that unaccounted-for gas above five percent calculated pursuant to paragraph (FF) of rule 4901:1-14-01 of the Administrative code, is unreasonable, and the burden shall be on the company to prove otherwise; or
> (4) Such other factors, policies, or practices as the commission considers appropriate.

b. Case Law Standards

The Commission adopted the Burden of Producing Evidence Test because it incorporates the guidelines of the National Regulatory Research Institute, as set forth in "The Prudent Investment Test in the 1980's," for reviewing gas cost recovery dollar amounts. The Commission interpreted the first of these guidelines to mean, "There should exist a presumption that decisions of utilities are prudent" to mean that after the Company discloses the basis for its decisions, the burden of producing evidence is shifted from the utility company to the opposing party.[20] But the Commission maintained that the ultimate burden of proof remains with the utility company.[21] Moreover, the Commission explained that in contests of the Company's basis for its decisions, opposing

[20] *In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of Syracuse Home Utilities Company, Inc. and Related Matters* ("*Syracuse*"), Case No. 86-0012-GA-GCR, Opinion and Order at 10 (December 30, 1986).

[21] Id.

parties must "do more than essentially state 'we disagree' to shift the burden of producing evidence * * *."[22]

The Commission has also identified three areas of inquiry ("Areas of Inquiry Test") to consider for evaluating the reasonableness of utility decisions that impact customers and their pocketbooks.[23] "One area encompasses the facts and circumstances known or reasonably anticipated at the time the decision was made and whether such facts and circumstances were taken into proper consideration in the decision-making process."[24] A second area "involves the inquiry of whether any intervening circumstances occurred or facts become known which impacted the initial decision's results, whether such intervening factors caused or should have caused management to re-think the initial decision, and whether any action or non-action in light of the intervening factors was appropriate."[25] The last area identified was "an examination of the actual results achieved by virtue of the decision."[26]

2. The Commission did not require DEO to provide evidence to demonstrate that the form of the first of the month index option transactions was reasonable when on its face it is imprudent.

The Commission does not seem to understand what was at issue with the DEO/Hope transactions in this hearing. The Commission appears to believe that the

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[22] Id. at 11.

[23] *In the Matter of the Regulation of the Fuel Cost Adjustment Clause Contained Within the Rate Schedules of the Ohio Power Company and Related Matters,* Case No. 79-234-EL-FAC (Subfile A), Entry on Rehearing at 3 (October 15, 1980) ("*Ohio Power*").

[24] Id.

[25] Id.

[26] Id.

appropriateness of FOMI contracts was at issue.[27] The appropriateness of FOMI contracts was not at issue. At issue was DEO's purchase of gas at the FOMI price only on the days that the seller required it to purchase.[28] In essence, DEO gave Hope an option contract for free. Buying at FOMI price is only reasonable when the buyer buys the same volume everyday of the month or on a "base load" basis.

OCC witness Haugh testified that the form of the DEO/Hope transactions is on its face unreasonable and improper for DEO to engage in and would be imprudent for any party to engage in.[29] Mr. Haugh agreed that purchasing gas at the FOMI can be prudent.[30] However, he stated that it is only prudent to purchase gas at the FOMI if the purchaser is purchasing every day of the month.[31] When a buyer buys gas at the FOMI **every day** of the month, statistically, the expectation would be that the price paid would sometimes be below the daily price and other times above the daily price and as the auditor testified "over a long period of time, you would expect the overs and unders to work out."[32] But that is only if the buyer buys gas **every day**.[33]

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[27] O&O at 12.

[28] While Mr. Walther stated that these required purchases were limited by DEO's ability to accept the gas in its storage and by a ceiling amount. Tr. Vol. I at 215. But these limits did not prevent Hope from purchasing 97% of the time when it benefited Hope's shareholders and cost DEO's GCR customers.

[29] OCC Ex. 13 (Haugh Testimony) at 11.

[30] Id at 12.

[31] Id.

[32] Tr. Vol. 1 at 94.

[33] Id.

DEO did not buy every day. DEO bought only when Hope required DEO to buy.[34] Consequently over a period of 4 years, DEO paid more than it would have if it had bought everyday.

Mr. Walther, the person who oversaw these transactions, provided the only evidence to rebut this problem. He stated that DEO has always purchased gas at the FOMI price and that most LDCs in the nation do as well. OCC does not disagree with this statement. However, Mr. Walther did not state that most of the LDCs in the nation purchase at the FOMI price only if they purchase every day of the month (on a "base load" basis[35]) and not only when the seller requires them to. Most LDCs in the nation purchase at the FOMI price every day of the month. Most LDCs buy the same volume every day of the month expecting "the overs and unders to work out."[36] Thus, Mr. Walther's attempt to rebut OCC's position is flawed.

Mr. Walther did not state that DEO always enters into FOMI contracts and purchases gas only on the days the seller wants it to. To do so would be imprudent and unreasonable. Mr. Walther did not identify a single other instance in which DEO or any other LDC in the nation purchase at the FOMI price only when the seller required it to. In fact, Mr. Walther admitted that if DEO did not purchase FOMI gas from Hope only on the days Hope wanted it to, it would have bought the gas from another seller on a "base

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[34] Tr. Vol. 1 at 190 and Tr. Vol. 1 at 228, lines 6-8.

[35] Mr. Walther recognized himself that base load means the same as buying every day of the month. Tr. Vol. 1 at 229, lines 2-4.

[36] As the auditor said that it should. Tr. Vol. 1 at 94.

load" basis -- that is DEO would have bought gas from another seller at the FOMI price every day of the month.[37]

DEO attempted to explain why it entered into such obviously risky purchases by simply saying that the purchases were not risky.[38] This rebuttal is similar to saying "we disagree." The Commission has found that such a rebuttal is not sufficient under the *Syracuse* case.[39]

The M/P Auditor agreed with Mr. Haugh that buying at the FOMI price on only the days that the seller wanted the buyer to would only be reasonable or prudent for the buyer if the seller gave the buyer a reasonable premium.[40] In fact the M/P Auditor stated that the amount of the premium you should expect from that kind of an arrangement would have to be evaluated in light of the "risk associated with getting stuck with higher cost gas."[41] But Mr. Walther admitted that DEO did not get the full premium associated with its purchases from Hope.[42] Mr. Walther did not recall how his employees determined the amount of the premium paid to DEO by Hope for the purchases nor did he remember the amount.[43] He thought maybe it had been consensus between LDC Gas

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[37] Tr. Vol. 1 at 226, lines 22-23 and at 228, lines 22-24.

[38] Tr. Vol.1 at 229, lines 9-12.

[39] *Syracuse* at 11.

[40] Id. at 94, lines 19-21.

[41] Id. at 94 lines 23-24 and 95 lines, 1-4.

[42] (The premium amount was determined by the straddle contract that Hope had with Mirant. Under the DEO/Hope transactions, DEO had agreed to purchase all the gas that Hope purchased from Mirant at FOMI, when Mirant wanted Hope to purchase it. The full premium associated with its purchases is determined by the amount that Hope got from Mirant when Hope bought an amount of gas from Mirant on the same day that DEO bought the same amount of gas from Hope.) Id. at 191.

[43] Id. at 193, lines 2-3.

Supply and Hope.[44] As a result, a DEO representative may not even have had a say in the premium amount paid. Mr. Walther did not provide any corroborating evidence that demonstrated that any premium had been paid to DEO by Hope.

In any case, entering into an agreement to purchase gas or any volatile commodity at any pre-determined price, whether it be FOMI or not, only on days when the seller wants you to purchase gas is on its face unreasonable. Nor would it be reasonable to purchase highly volatile stocks at a predetermined price only when the seller required you to buy it. Even if the predetermined price was very, very low, the seller would face no risk because he or she would never allow you to buy. No buyer would enter into such a contract on an arms length basis. Even entering into such a contract in which the buyer would receive a premium for its inevitable losses would be exceptionally risky because the buyer would have no way of knowing how large those losses would be. For Mr. Walther to claim on the record that the DEO/Hope option FOMI transactions were not risky[45] reflects on either his poor judgment, in which case he should not be in the position he has, or his veracity.

Based on the form and arrangement of DEO's option transactions with Hope, DEO must have expected the huge losses they incurred. Otherwise, DEO would have been able to provide a plausible rebuttal. The only explanations DEO provided was Mr. Walther's statement that the DEO/Hope option contracts were reasonable and that other LDCs around the country enter into similar contracts. But Mr. Walther did not provide a single example in which DEO or another LDC entered into such an option contract.

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[44] Id. line 8.

[45] Tr. Vol. 1 at 229, lines 5-12.

The Commission relies upon Mr. Walther statements that it was DEO's policy to purchase gas from many sources, including its affiliates, and all of these purchases were made at the FOMI price.[46] The Commission also relies upon Mr. Walther's claims that that it was DEO's policy to purchase gas at the FOMI price and had it not purchased gas from Hope at the FOMI price, DEO would have purchased the same amount of gas, on the same days,[47] from another entity, at the FOMI price.

Mr. Walther's claim that DEO would have bought the same amount of gas on the same days that it bought from Hope, if it had bought from another source does not make sense. Mr. Walther stated twice that if DEO had bought from another source it would have bought on a base load basis.[48] If DEO had bought on a base load basis, it could not have bought gas on the same days it bought from Hope, because Hope did not permit it to buy every day of the month.

Moreover, if Mr. Walther's claims are true and all of DEO's purchases are made at the FOMI price in the same manner that DEO was purchasing from Hope, then DEO's policy is on its face, fundamentally flawed. If Mr. Walther's claims are true, the Commission should immediately require an audit of not just DEO's affiliate transactions, as the auditor recommended. The Commission should also immediately require an audit of all of DEO's FOMI purchases.

Whether 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 was not at

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[46] O&O at 11.

[47] Tr. Vol. I at 226, lines 22-23.

[48] Tr. Vol. 1 at 226, lines 22-23 and at 228, lines 22-24.

issue. The Commission's mention of this[49] indicates that misapprehension has contributed to its O&O. Mr. Haugh repeatedly stated that purchasing gas at the FOMI price is a reasonable purchasing strategy.[50] It was purchasing gas at the FOMI price only on the days that the seller permits that was at issue. That is the purchasing strategy that no other reasonable LDC would ever likely engage in. And if an LDC were ever to take that risk it would likely require that it be paid a very significant premium. Without significant price discounts or premiums, LDCs should be purchasing gas on the days that it needs gas and not when a seller wants to sell it to them.

3. The Commission did not require DEO to rebut evidence at hearing that the results of the transactions were on their face imprudent.

The significant losses that DEO incurred on behalf of the GCR customers in these DEO/Hope option transactions must have been expected by DEO, given the outrageous form of the options. In defending its decision, the Commission filled almost one-half of a page of its identifying each and every one of the 17 individual days out of the 1,065 days in the period in which DEO did not, in fact, purchase gas from Hope at the FOMI price when the daily price was lower than the FOMI price.

However, the Commission cannot reasonably rely on those rare occurrences as meaningful evidence. Of the 549 days in which DEO purchased gas from Hope at the FOMI price, on 532 of those days the daily price was lower than the FOMI price. Ninety-seven percent of the time that DEO purchased gas from Hope, DEO GCR customers paid at the higher of the two market prices and Hope shareholders received

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[49] O&O at 12.

[50] OCC Ex. 13 (Haugh's testimony) at 12, line 15-16.

above market payments from DEO GCR customers. Based on this statistical analysis, there can be no doubt that DEO GCR customers paid excessive amounts to Hope shareholders because of an imprudent and unreasonable agreement with Hope. The fact that DEO continued to engage in these purchases for at least three years, shows that DEO may have intended to benefit Hope shareholders in this way or that DEO was not paying attention.

And correspondingly, DEO was rarely permitted to purchase gas from Hope at the FOMI price on the 516 days that it could have bought at less than market price. Again, correspondingly, 97% of the time DEO GCR customers were not permitted to buy when it would benefit them through this DEO/Hope option contract by buying at the FOMI price when it was below market.

4. Based on the manifest weight of the evidence, the Commission erred in not adopting its own witness' recommendations that the DEO/Hope transactions should be audited further.

Because the DEO/Hope transactions are unquestionably unfair to GCR customers in their form and in their results the Commission's unwillingness to adopt its own witnesses', Liberty's recommendation that the Commission audit DEO's transactions with its affiliates is against the manifest weight of the evidence. Moreover, Liberty found that DEO had not conducted internal audits in 2004 and 2005 that contained detailed statistical comparisons of gas prices paid by DEO to its affiliates and paid by DEO to its non-affiliates as DEO had been directed to do so by the Commission.[51] Furthermore Liberty found that there was little management control over the gas purchasing unit to ensure that DEO GCR customers were not being harmed.

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[51] M/P Audit Report at I-18.

In the O&O, the Commission identified only Mr. Kroll's allegations of wrong-doing as Liberty's basis for recommending an audit of DEO/affiliate transactions. But, that was not the only basis for that recommendation.[52] Liberty stated:

> Moreover, had Liberty's inquiries demonstrated a significant, comprehensive, and objective Company approach to addressing the question of whether Ohio customers have been disadvantaged, there might not be a need for an additional recommendation * * * Liberty believes that the lack of strong, focused efforts by the Company to demonstrate the accuracy and propriety of Ohio costs makes it appropriate to recommend more than just an improvement in controls.

Therefore there are three reasons, beyond Mr. Kroll's allegations, at least, why the Commission should require an audit of affiliate transactions with DEO; the improper form and unquestionably excessive costs of the DEO/Hope option FOMI transactions, DEO's failure to conduct a statistical comparison of affiliate versus non-affiliate purchase prices even though it had been directed to do so by the Commission and DEO's lack of management and other controls to ensure the accuracy and propriety of costs.

Moreover, the Commission need not employ a special auditor to conduct this audit of affiliate transactions but could assign the next M/P Auditor to conduct such an audit. The last M/P Audit will cover only one year if DEO's current plans to leave the merchant function continue and could therefore be assigned other tasks such as an audit of previous affiliate transactions from 1995 through the current time as recommended by Liberty. In addition, because of the obvious impropriety of the DEO/Hope option FOMI transactions the Commission should order DEO to refund $4,177,700 immediately.

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[52] O&O at 12.

III. CONCLUSION

OCC respectfully requests that the Commission reconsider its adoption of the Stipulation filed in this case. The signatory parties are not representative of those customers who have the most to lose in this case -- GCR customers. Therefore, the Stipulation does not benefit ratepayers and instead harms them by permitting DEO to retain revenues from assets paid for by ratepayers and permitting DEO to avoid costs of imprudent transactions by recovering them through ratepayers. Furthermore, OCC would ask that the Commission further refine and amend the criteria relied upon by the PUCO to judge the reasonableness of a settlement in order to address the due process rights of those opposing the settlement. Revised criteria should be established as OCC has set forth herein. Finally, the Commission should not permit DEO to recover the $4,177,700 in costs of the imprudent purchases it made from Hope and should order the upcoming MP Auditor to audit DEO's transactions with its affiliates from 1995 until this time.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the Application for Rehearing by the Office of the Ohio Consumers' Counsel's was served by first class mail, postage prepaid on the persons stated below, this 2nd day of March 2007.

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