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Released From Confidential Status

Case Number: 02-219-GA-GCR

Date: 11/21/2007

OCC EXHIBIT ______

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 East Ohio Gas Company, dba Dominion East Ohio, and Related Matters.	)))))	Case No. 02-219-GA-GCR

TESTIMONY
of
STEVEN B. HINES

CONFIDENTIAL VERSION

ON BEHALF OF
THE OHIO CONSUMERS' COUNSEL
10 West Broad Street, 18th Floor
Columbus, Ohio 43215-3485
(614) 466-8574

June 13, 2003

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ATTACHMENTS

I. INTRODUCTION

Q1. PLEASE STATE YOUR NAME, ADDRESS, AND POSITION.

A1. My name is Steven B. Hines. My business address is 10 West Broad Street, 18th Floor, Columbus, Ohio 43215-3485. I am employed by the Ohio Consumers' Counsel (OCC) as a Senior Regulatory Analyst.

Q2. WOULD YOU PLEASE BRIEFLY SUMMARIZE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE?

A2. I earned a Master of Business Administration degree from Ashland University in 2000. I also earned a Master of Arts degree from The Ohio State University in 1981 and a Bachelor of Fine Arts degree from Ohio University in 1978. I joined the OCC in April 1984 as an Investigator I. During the course of my employment at OCC, I have also held the positions of Investigator II, Utility Rate Analyst III, Utility Rate Analyst Supervisor, Regulatory Analyst and Senior Regulatory Analyst.

Q3. WHAT ARE YOUR RESPONSIBILITIES AS A SENIOR REGULATORY ANALYST?

A3. My duties include research, investigation and analysis of utility applications for increases in rates and gas cost recovery filings. I also participate in special projects and investigations and provide training on technical issues when necessary.

Q4. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE THIS COMMISSION?

A4. Yes. I submitted testimony in Establishment of an Appropriate Recovery Method for Percentage of Income Payment Plan Arrearages, Case No. 87-244-GE-UNC; Eastern Natural Gas Company, Case No. 89-1714-GA-AIR; Columbia Gas of Ohio, Inc., Case No. 91-195-GA-AIR; Monongahela Power Company, Case No. 91-1610-EL-AIR; Columbia Gas of Ohio, Inc., Case No. 92-18-GA-GCR; Ohio American Water Company, Case Nos. 92-2299-WW-AIR, 95-935-WW-AIR and 01-626-WW-AIR; East Ohio Gas Company, Case No. 93-2006-GA-AIR; Consumers Ohio Water Company, Case No. 95-1076-WW-AIR; and Cincinnati Gas and Electric Company, Case No. 95-656-GA-AIR.

II. PURPOSE OF TESTIMONY

Q5. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A5. The purpose of my testimony is to address the appropriateness of The East Ohio Gas Company d/b/a Dominion East Ohio's (hereinafter "Dominion" or "Company") recovery of costs related to functions performed by the Gas Supply Group through the Gas Cost Recovery (GCR) rate.

Q6. WHAT DOCUMENTS HAVE YOU REVIEWED IN THE PREPARATION OF YOUR TESTIMONY?

A6. From the current case, I have reviewed the Financial Audit Report and associated workpapers and the Company's responses to OCC's discovery. I have also reviewed several of the Company's Annual Reports (Form No. 2) to the Federal Energy Regulatory Commission (FERC), prior audit reports, and relevant documents from other proceedings.

III. TREATMENT OF COSTS RELATED TO GAS SUPPLY GROUP FUNCTIONS

Q7. COULD YOU PLEASE DESCRIBE THE GAS SUPPLY GROUP FUNCTIONS THAT YOU REFER TO IN YOUR TESTIMONY?

A7. Yes. When I refer to the "Gas Supply Group," I am referring to the functions formerly performed by the CNG Gas Supply Group. As a result of the merger with Dominion, these functions are now performed under Dominion LDC Gas Supply, Dominion Services, Dominion Field Services and Dominion Peoples Pricing and Regulatory Affairs Department. According to the Management Performance Audit Report in Case No. 01-219-GA-GCR, the CNG Gas Supply Group functions included gas supply planning, interstate gas supply and capacity acquisition, local production gas acquisition, gas accounting, contract administration and FERC activity functions (see Attachment SBH-A).

Q8. DOES THE COMPANY CURRENTLY RECOVER COSTS RELATED TO GAS SUPPLY GROUP FUNCTIONS THROUGH THE GCR?

A8. Yes.

Q9 IS THE COMPANY CURRENTLY RECOVERING COSTS RELATED TO GAS SUPPLY GROUP FUNCTIONS THROUGH BASE RATES?

A9. Yes.

Q10. IS IT APPROPRIATE FOR THE COMPANY TO RECOVER COSTS RELATED TO THE SAME GAS SUPPLY GROUP FUNCTIONS THROUGH BOTH THE GCR AND BASE RATES?

A10. No. By recovering the costs related to the Gas Supply Group functions through both the GCR and base rates, the Company is recovering these costs twice.

Q11. WHAT IS THE BASIS FOR YOUR BELIEF THAT THE COMPANY IS CURRENTLY RECOVERING COSTS RELATED TO GAS SUPPLY GROUP FUNCTIONS THROUGH THE GCR?

A11. In response to OCC Interrogatory No. 3, the Company stated that it has been recovering costs related to the Gas Supply and Gas Supply Accounting functions through the GCR since July 1, 1997 (see Attachment SBH-B). The Company subsequently disclosed the actual amount of costs recovered through the GCR in response to OCC Interrogatory No. 20 (see Attachment SBH-C). The financial auditor in the current proceeding also indicated in its "Independent Accountants' Report on Applying Agreed Upon Procedures," filed April 24, 2003, that during the audit period under review (October 26, 2001 to October 28, 2002) the Gas Supply Group costs incurred were $2,921,209. This amount, however, is the total of all three Dominion Local Distribution Companies. The portion of this cost allocated to the Company is $1,969,656 as shown on a financial audit workpaper.

Q12. WHAT IS THE BASIS FOR YOUR BELIEF THAT THE COMPANY IS CURRENTLY RECOVERING COSTS RELATED TO GAS SUPPLY GROUP FUNCTIONS THROUGH BASE RATES?

A12. According to the "Independent Accountants' Report" filed on April 24, 2003 in this case, the auditor noted that the costs of the Gas Supply Group functions would have been included in test year expenses used to set base rates in Case No. 93-2006-GA-AIR. On pages 3 and 4 of Schedule S-4.2 filed on March 21, 1994 in Case No. 93-2006-GA-AIR (see Attachment SBH-D), the Company discusses the benefits of the then proposed merger with The River Gas Company in terms of supply procurement staffing and expertise. The Company states that "Perhaps the most important benefit to be gained by the proposed merger is the ability of River's present customers to directly and continuously benefit from the extensive staffing in place at East Ohio that is solely devoted to the acquisition and management of system supply volumes." This shows that The East Ohio Gas Company, now Dominion, was incurring labor costs related to the gas supply function at the time of its last rate case. Since the Company was not recovering these costs through its GCR mechanism at that time, it had no other method to recover these costs other than through base rates. The Management Performance

Audit Report in Case No. 95-219-GA-GCR, which covered the period from August 1, 1993 through July 31, 1995, also notes that the gas supply acquisition activities were performed by East Ohio's Gas Supply Acquisition Division, which had a staff of 52 employees during that time (see Attachment SBH-E). This audit report coincides with the test period in the Company's last rate case, which was the twelve-month period ending September 30, 1994. As discussed in a subsequent section of my testimony, these are essentially the same functions as those performed by the Consolidated Supply Group, a unit of the Regulated Business Support Group (of Consolidated Natural Gas), which was established on July 1, 1997 (see Attachment SBH-F).

Q13. HOW WAS THE ISSUE CONCERNING DUPLICATE COST RECOVERY OF GAS SUPPLY GROUP FUNCTIONS DISCOVERED?

A13. This issue came to light after OCC reviewed a letter included in the financial auditor's workpapers supporting the Financial Audit Report filed in Case No. 01-219-GA-GCR. This letter was included again in the financial auditor's workpapers in the current case (see Attachment SBH-G) (filed under seal). However, the recovery of costs related to the Gas Supply Group functions have taken place since 1997 and had not been identified in previous financial or management performance audit reports. Accordingly, through a Stipulation and Recommendation in Case No. 01-219-GA-GCR, filed December 13, 2002 ("Stipulation"), the parties agreed that the financial auditor for the current case should examine and report on the GCR recovery of the Gas Supply Group costs to determine if there has been any duplicate recovery relative to any costs currently existing in base rates (*see* Stipulation at 2, section C1).

Q14. PRIOR TO JULY 1, 1997, WHEN THE COMPANY FIRST BEGAN RECOVERY OF COSTS RELATED TO GAS SUPPLY GROUP FUNCTIONS THROUGH THE GCR, DID THE COMPANY FILE AN APPLICATION WITH THE COMMISSION TO REQUEST RECOVERY OF SUCH COSTS THROUGH THE GCR?

A14. No, not that I am aware of.

Q15. SINCE CASE NO. 93-2006-GA-AIR, HAS THE COMMISSION ISSUED ANY SPECIFIC RULINGS THAT ALLOWED THE COMPANY TO RECOVER COSTS RELATED TO GAS SUPPLY GROUP FUNCTIONS THROUGH THE GCR?

A15. No, not to my knowledge.

Q16. SINCE CASE NO. 93-2006-GA-AIR UP UNTIL THE PRESENT PROCEEDING, HAS ANY GCR AUDITOR, EITHER FINANCIAL OR MANAGEMENT PERFORMANCE, ADDRESSED THE ISSUE OF THE RECOVERY OF COSTS RELATED TO GAS SUPPLY GROUP FUNCTIONS THROUGH THE GCR IN THEIR RESPECTIVE AUDIT REPORTS?

A16. Not to my knowledge.

Q17. WHAT DO YOU RECOMMEND?

A17. In response to OCC Interrogatory No. 20 (see OCC Attachment SBH-C), the Company provided the amount of Gas Supply Group costs recovered through the GCR from July 1997 to date. According to this discovery response, Gas Supply Group costs recovered through the GCR totaled $12,248,453.64. Since the Company has not demonstrated why it should recover Gas Supply Group costs through the GCR when it is already recovering these same costs through base rates, I recommend that these costs, in the amount of $12,248,453.64, should be refunded to GCR customers since they are duplicative of costs already recovered through base rates. Also, any recovery of additional Gas Supply Group costs through the GCR over and above the $12,248,453.64 should likewise be refunded. The refund should be accomplished through the Reconciliation Adjustment component of the GCR mechanism in the first quarterly GCR filing following the Commission's Order in this case and the recovery of the Gas Supply Group costs through the GCR should cease at that point. In addition, the financial auditors in the next two GCR cases should ensure that these costs were properly refunded through the GCR to customers. The costs related to the Gas Supply Group functions should continue to be recovered through base rates until the Commission deems otherwise.

Q18. IS THE AMOUNT OF GAS SUPPLY GROUP COSTS CURRENTLY EMBEDDED IN BASE RATES RELEVANT TO THE DOUBLE RECOVERY ISSUE?

A18. No, the amount in base rates is irrelevant to the issue of whether the duplicative recovery through the GCR for the same costs should cease. The Gas Supply Group costs recovered through base rates were determined in Case No. 93-2006-GA-AIR. The amount of Gas Supply Group costs to be set and recovered in base rates can only be determined in the next base rate case. Otherwise, to determine the amount of Gas Supply Group costs outside of a base rate case would be single issue ratemaking. Therefore, as stated previously, the Gas Supply Group costs should continue to be recovered through base rates, but recovery through the GCR should be eliminated.

Q19. DOES THIS CONCLUDE YOUR TESTIMONY?

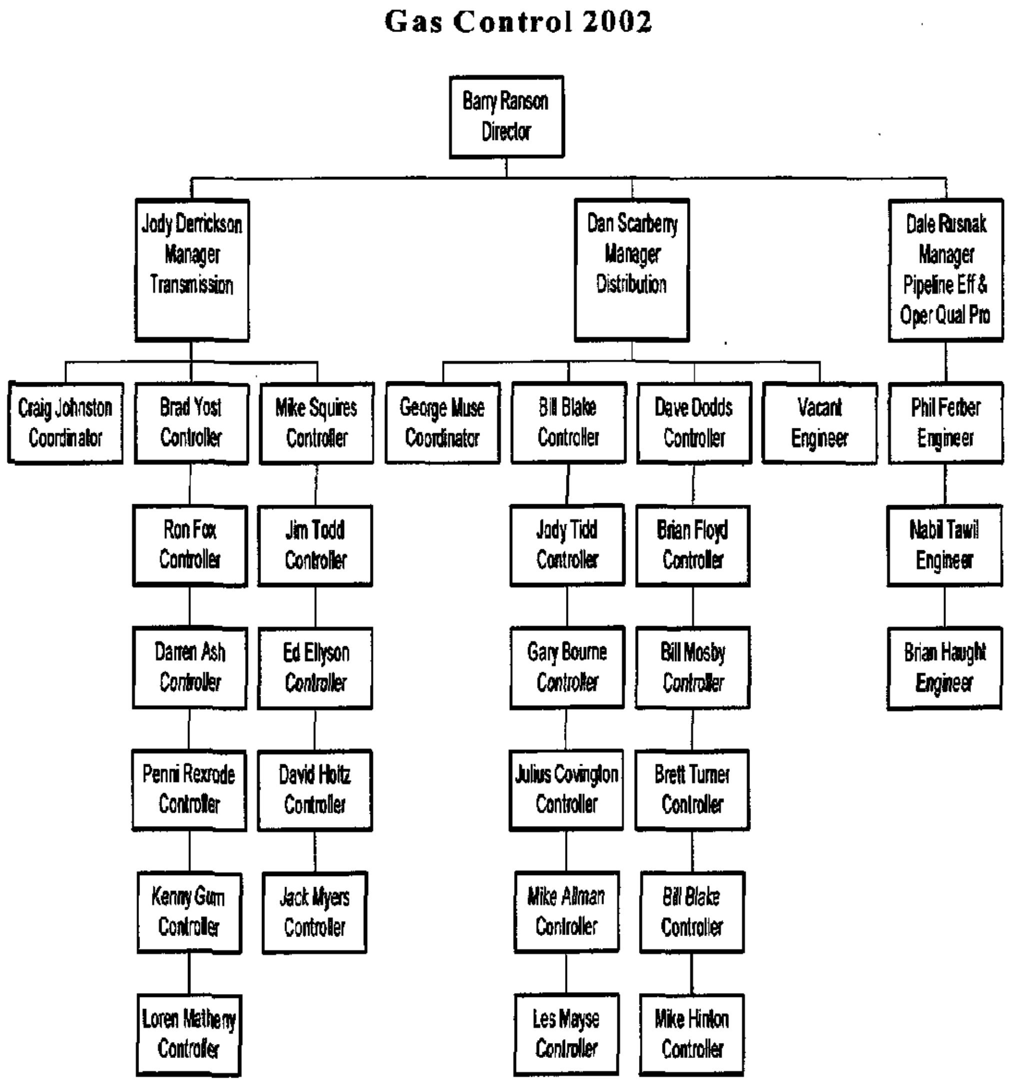
A19. Yes. However, I reserve the right to incorporate new information that may subsequently become available through outstanding discovery or otherwise.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the Testimony of Steven B. Hines *(Confidential Version)* On Behalf of the Ohio Consumers' Counsel, have been filed under seal on this 13th day of June, 2003.

Ann Hotz
Assistant Consumers' Counsel

Figure IV-6



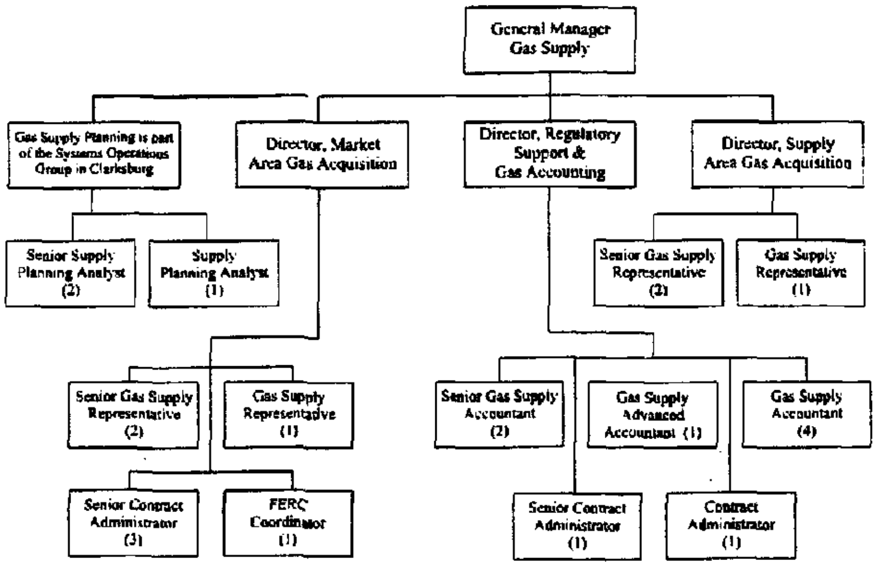
Gas Supply Group

Prior to the merger with Dominion, the CNG Gas Supply Group (GSG) reported to the Senior VP – Commercial and conducted gas supply activities on behalf of all four LDC's (The East Ohio Gas Company, The Peoples Natural Gas Company, Hope Gas, Inc. and Virginia Natural Gas Inc. (VNG). The GSG, then headquartered in Pittsburgh, included gas supply planning, interstate gas supply and capacity acquisition, local production gas acquisition, gas accounting, contract administration and Federal Energy Regulatory Commission (FERC) activity functions.

The pre-merger Gas Supply Group organization chart is as follows:

Figure IV-7

CNG LDC Gas Supply Group



As part of the merger, Dominion was required to divest itself of Virginia Natural Gas effective October 1, 2000. After the Dominion/CNG merger, the gas supply related functions remain centralized for the three remaining Dominion gas LDC's, but they have been reorganized within the Dominion organization for reporting purposes on the basis of common functional areas. They are now organized as follows:

- The core interstate gas supply planning and interstate gas supply and capacity functions are the responsibility of Dominion LDC Gas Supply (still referred to as the Gas Supply Group, or GSG), which is now part of Dominion Energy reporting through Dominion Energy Clearinghouse and located in Richmond, Virginia.

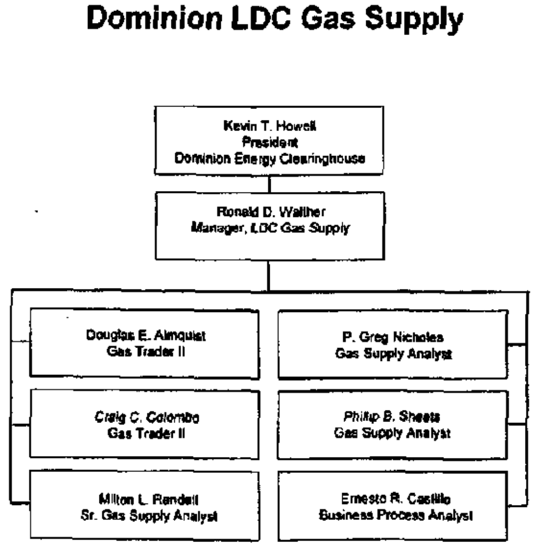
- The gas accounting and interstate transactions contract administration functions are now also part of Dominion Services, reporting through Delivery Accounting and Enterprise Risk Management, respectively, and are located in Richmond.

- The local gas acquisition function and the local gas transactions contract administration function are now part of Dominion Field Services and are located in Pittsburgh.

- The FERC regulatory activity function remains intact, but continues to be located in Pittsburgh and, accordingly, reports up through the Dominion Peoples Pricing and Regulatory Affairs Department.

The new, post-merger organization chart for the core, remaining Gas Supply Group is as follows:

Figure IV-8



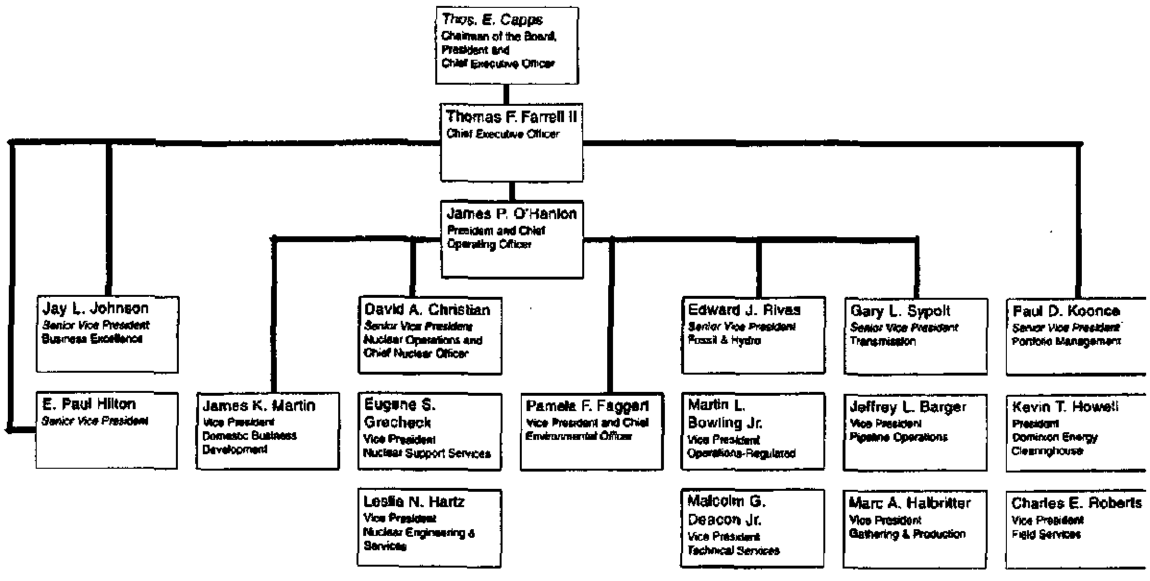
As mentioned above, we are concerned that there is no longer always a separation between regulated and unregulated activities under the new Dominion organizational structure. The Gas Supply Group (GSG) is a prime example of this, given that it is now part of Dominion Energy as opposed to being part of Dominion Delivery along with the rest of the LDC operations. As part of Dominion Energy, the GSG reports to the same CEO that Dominion's unregulated energy trading and marketing companies do.

Stone & Webster does not have the same concern regarding Gas Supply Operations, the majority of which is also part of Dominion Energy now, as mentioned above. Gas Supply Operations is more focused on the flow of volumes, whereas the GSG is focused on purchases and price. While we understand the synergy of having similar groups in one location, we believe there is potential for abuse here in terms of affiliate relations.

The Dominion Energy organization chart is as follows:

Figure IV-9

Dominion Energy



Although its structure has changed and been dispersed under the new organization, the Gas Supply Group's responsibilities continue as noted in the previous audit. These responsibilities include:

- Participating in the development of comprehensive short- and long-term gas supply plans dealing with the appropriate level of gas supply assets to reliably meet customer needs, including pipeline contracts, gas commodity contracts, storage, production and gathering assets.
- Overseeing all gas accounting and contract administration functions including the timely processing and payment of supplier invoices for all interstate and local gas purchases for the Dominion LDCs.
- Supporting Dominion's gas procurement policies and practices before various state and federal regulatory commissions; providing assistance to the Legal and Rates departments concerning gas supply matters; and representing the LDCs at industry association gas supply meetings.
- Participating in corporate planning teams to develop organizational vision, goals and long-term strategies for Dominion.

Gas Supply Planning Committees and Groups

As discussed in prior audits, Dominion East Ohio Gas and the Dominion Gas Supply Group have created various communications tools to ensure effective and frequent communication between the two entities, and to address gas supply planning issues. Upon questioning, DEO personnel have indicated that the composition and purpose of these meetings have remained largely unchanged from these previous descriptions, a summation of which is set forth below.

Daily Operational Planning Meeting

This group meets daily to develop a gas supply plan for the following day as well as for the next four days. The issues typically include a review of weather forecasts, an assessment of both prior day sendout and projected sendout, sales and transportation demand forecasts, market prices, storage deliverability and dispatching sequence. The participants include representatives from the Dominion Gas Supply Group and from DEO.

Gas Supply Planning Committee

This group meets monthly to discuss issues that may impact DEO's gas supply situation. The issues typically include gas supply-related activities and decisions and related operational policies and strategies, prior- and current-month gas supply, storage position, gas market conditions, end-user market conditions, transportation services issues and regulatory issues. The participants include representatives from the Dominion Gas Supply Group and from DEO.

Monthly Supply Planning Meeting

This group meets monthly to discuss gas supply activities for the upcoming month. They assess options and develop recommendations for first-of-the-month purchases and storage operations. The meetings typically occur during the third week of each month in order to develop the forthcoming month's supply plan prior to bid week. Typical topics include gas market conditions, anticipated weather conditions, planned storage operations, expected local production, interstate purchases, end-user deliveries and the potential for capacity release. The participants include representatives from the Dominion Gas Supply Group and from DEO.

Stakeholder Group

This group meets every other month to discuss supply-related issues that may affect any or all of the Dominion LDCs. Typical topics include general supply and market issues, operation of the Dominion Gas Supply Group including strategies, budgets, policies, procedures, supply plans and staffing levels, and LDC-specific issues that may affect the future activities of the GSG. The participants include representatives from the Dominion Gas Supply Group and from all of the Dominion LDC's.

Winter Supply Planning Meeting

This group typically meets once a year each October to establish a long-range plan for the coming winter's gas supply operations. The issues under discussion typically include the following: key assumptions underlying both demand and supply projections, normal, design warmer-than-normal and design colder-than-normal weather scenarios of daily, monthly and seasonal demand, design day review, base and peak storage planning, storage migration control, interstate firm contract utilization, portfolio of local deliveries and interstate term, swing and spot supplies, and potential capacity release scenarios. The participants include representatives from the Dominion Gas Supply Group and from DEO.

Shared Services

In addition to taking over the GSG-related gas accounting and interstate transactions contract administration functions mentioned in the Gas Supply Group section above, Dominion Services provides additional shared services to all Dominion subsidiaries and business units under the new organization. Functions within Dominion Services include corporate secretary's; external affairs; shared services (processing services, payroll, fleet, facilities management, procurement); information technology and telecommunications; human resources; law; and treasury and financial.

Costs associated with operation of the GSG in the current calendar year are allocated to ach of the Dominion LDCs based upon the volume of gas purchased on behalf of each LDC during the prior calendar year as a percentage of the total volume of gas purchased on behalf of all three of the LDCs during the prior calendar year. In addition, actual costs that can be identified and quantified may be direct billed during the current calendar year to the individual LDC on whose behalf the cost were incurred.

Additional Management Restructuring

Additional management restructuring has occurred subsequently to the original organizational changes that resulted from the Dominion-CNG merger. However, these additional management changes have not further altered Dominion's business unit structure and operating units. No additional changes to the gas supply related functions or to the pricing and regulatory affairs functions are known or planned in the next twelve months.

B. Staffing and Controls

Since the general LDC gas supply function (gas supply planning, interstate gas supply and capacity acquisition, local gas acquisition, gas accounting, contract administration and FERC activity) was already conducted on a centralized basis, the organizational changes outlined above have not significantly impacted the gas supply related processes used by DEO. Essentially, various functional area interface and coordinate with one another as they did prior to the Dominion/CNG merger.

As the regulated distribution company serving its customers, DEO is ultimately responsible for all activities conducted on its behalf by the GSG. As noted in the Service Level Plan, the mission statement of the GSG is to "provide reliable, competitively priced gas supplies, capacity and related services to satisfy the physical needs of the CNG LDC Companies. The management approach and organization structure of the GSG will emphasize customer services and efficiency." In order to perform its duties properly, the GSG must provide services in a wide variety of areas related to its mission statement, as would DEO employees responsible for obtaining gas supplies, capacity and related services. The GSG essentially acts as an arm of DEO, and the relationship between the GSG and DEO senior management is the same as that which existed between senior management and the DEO employees that carried out that gas supply function before it was transferred to the GSG.

However, as mentioned above, the core interstate gas supply planning and interstate gas supply and capacity functions are the responsibility of Dominion LDC Gas Supply (still referred to as the Gas Supply Group, or GSG), which is now part of Dominion Energy reporting through Dominion Energy Clearinghouse and located in Richmond, Virginia. The Manager of Gas Supply reports to the President – Dominion Energy Clearinghouse, who reports in turn to the CEO of Dominion Energy, the business unit that is responsible for competitive power production and energy trading. As indicated above, we have concerns with the potential for abuse here in terms of affiliate relations.

Changes in Staffing Within the Gas Supply Group

The total staff associated with the original GSG functions (gas supply planning, interstate gas supply and capacity acquisition, local gas acquisition, gas accounting, contract administration and FERC activity) has been reduced from 27 prior to the Dominion-CNG merger to a current level of 19 as follows:

	Pre-Merger	Current
Gas Supply Planning and Acquisition	9	7
Local Gas Acquisition	4	2
Gas Accounting	8	6
Contract Administration	5	3
FERC Activity	1	1
Total	27	19

The changes in the structure of the gas supply related functions as a result of the merger were implemented in mid-2000. The headcount changes were the result of the following:

Gas Supply Planning and Acquisition: The reduction of two persons resulted from the elimination of the General Manager position and of a director-level position when the planning function was combined with gas acquisition. Two other director-level positions were retitled as managers. These changes were made in accordance with the flattening of the hierarchical structure as part of the merger reorganization.

Local Gas Acquisition: There was a reduction of two positions from this function as non-local gas supply responsibilities were reassigned as part of the reorganization and the remaining responsibilities were redistributed. The director position was re-titled manager and has more direct local gas purchasing responsibility.

Gas Accounting: The reduction of one position resulted from the divestiture of VNG. Another position was eliminated and the remaining staff absorbed its work. The director position was eliminated and replaced by a supervisor who reports as a director in the Delivery Accounting organization.

Contract Administration: One position related to interstate gas purchases was eliminated due to efficiencies gained when this function was combined with a centralized contract administration group. In the local gas acquisition group, one position was eliminated and the remaining responsibilities were redistributed.

Changes in Staffing Within the Pricing and Regulatory Affairs Group

No changes to the gas supply related functions or to the Pricing and Regulatory Affairs function are known or planned in the next 12 months.

GSG Staff Experience

The Gas Supply Group has a significant amount of both general energy industry and specific LDC gas supply experience. The average energy industry experience is 21.8 years. The average LDC gas supply experience is 13.8 years. Staff utility and gas industry related experience are as follows:

	Number of Years Energy Industry Experience	Number of Years LDC Gas Supply Experience
LDC Gas Supply Management		
Ron Walther	23	22
Interstate Gas Supply and Capacity Acquisition		
Doug Almquist	16	16
Craig Colombo	18	14
Local Gas Acquisition		
Jim Wojcik	31	20
Chuck Rothermel	23	6
Gas Supply Planning		
Ernie Castillo	18	1
Greg Nicholes	23	17
Milt Randall	27	23
Phil Sheets	17	5

C. Affiliates Engaged in Ohio Gas Operations

DEO affiliates engaged in Ohio gas operations include Dominion East Ohio Energy and Dominion Transmission. In addition, as detailed below, DEO has several affiliates from which it may from time to

**Financial Audit of Dominion East Ohio for
The Public Utilities Commission of Ohio
Case No. 02-219-GA-GCR**

**Response to OCC Interrogatories
and Request for Production of Documents
First Set – December 5, 2002**

INTERROGATORIES

1. **Given that costs related to the Gas Supply Department (or Gas Supply Group) of the Regulated Business Support Group are now recovered through the GCR as gas costs, are any of the costs to perform the following Gas Supply Department functions still included in current base rates which were set in Case No. 93-2006-GA-AIR:**
   a. **Buying, scheduling and arranging for gas supplies and pipeline capacity from the gulf coast, mid-continent, and Appalachian regions;**
   b. **Planning for short-term, seasonal, and long-term gas supply and capacity;**
   c. **Providing state regulatory support in connection with both commodity and transportation acquisition; and,**
   d. **Providing gas accounting and contract administration for both local and interstate gas supplies?**

   Case No. 93-2006-GA-AIR was resolved via a Stipulation and Recommendation that did not specify the costs associated with specific activities that were included in the resulting base rates.

2. **If the response to OCC Interrogatory No. 1 is affirmative, what are the dollar amounts by account for each function listed in OCC Interrogatory No. 1 that was built into base rates in Case No. 93-2006-GA-AIR?**

   Not applicable.

3. **Referring to OCC Interrogatory No. 1, when did the Company begin flowing the costs for each of these functions through the GCR?**

   The Gas Supply and Gas Supply Accounting functions were centralized as of July 1, 1997. Costs incurred by DEO for these functions since inception of the centralized group have been included in the GCR.

4. **What methodology was used during the audit period to allocate the Gas Supply Department costs among the three Dominion local distribution companies?**

   Costs associated with operation of the Gas Supply Group in the each calendar year are allocated to each of the Dominion LDCs based upon the volume of gas purchased on behalf of each LDC during the prior calendar year as a percentage of the total volume of gas purchased on behalf of all three of the LDCs during the prior calendar year. In addition,

**Financial Audit of Dominion East Ohio for
The Public Utilities Commission of Ohio
Case No. 02-219-GA-GCR**

**Response to OCC Interrogatories
and Request for Production of Documents
Third Set – May 30, 2003**

INTERROGATORIES

15. At the point that the Company suspended recoveries through the *Transportation* Migration Rider Part B (a.k.a. "Energy Choice Rider"), what was the balance remaining in Account 1242160?

The balance in account 1242160 at January 31, 2003 was $(1,279,497.85). The Energy Choice rider was suspended effective with bills rendered on or after February 3, 2003.

16. Referring to the OCC Interrogatory No. 15, what was the balance in this account at the time recovery through the Energy Choice Rider ceased?

Please see the response to #15.

17. Referring to the OCC Interrogatory No. 15, what is the balance in this account currently?

The balance in this account is $(1,318,287.46) as of May 31, 2003.

18. At the point that the Company suspended recoveries through the Energy Choice Rider, how much had the Company recovered in costs related to the compliance with House Bill No. 9?

As of January 31, 2003, DEO had deferred a total of $59,220.29 related to the compliance with House Bill No. 9. Additional costs have been incurred subsequently and will continue to be incurred through the remainder of 2003 as a result of the remaining programming changes needed to reach full compliance with House Bill No. 9.

19. Referring to OCC Interrogatory No. 18, during what months were these particular expenses recovered?

These costs were fully recovered during the period September through December 2002.

20. Referring to financial audit workpaper No. 1008, December 30, 1998 letter from *[sic]* Michael G. Bartels regarding Gas Cost Recovery, for each GCR quarter since July 1997, what is the dollar amount of Gas Supply Department costs that have been recovered through the GCR to date?

Please see Attachment OCC-20.

DOMINION EAST OHIO
Case No. 02-219-GA-GCR
Attachment OCC-20

RBSG Gas Supply Costs
General Ledger Account 5205340 (formerly 81302010)

			GCR Filing		
Dec-98		(a)	$ 3,194,507.00	May 1999	#83, 99-2
Dec-99			$ 2,842,870.00	May 2000	#87, 00-2
Dec-00			$ 2,860,340.10	May 2001	#92, 01-2
Jan-01	94,630.02		$ 94,630.02	May 2001	#92, 01-2
Feb-01	113,088.61				
Mar-01	301,423.00				
Apr-01	181,231.98		$ 595,743.59	August 2001	#93, 01-3
May-01	312,263.90				
Jun-01	178,189.15				
Jul-01	177,215.74		$ 667,668.79	November 2001	#94, 01-4
Aug-01	169,362.93				
Sep-01	159,504.67				
Oct-01	167,618.99		$ 496,486.59	February 2002	#95, 02-1
Nov-01	147,845.43				
Dec-01	152,292.93				
	$ 2,154,667.35				
Jan-02	168,713.32		$ 468,851.68	May 2002	#96, 02-2
Feb-02	180,163.56				
Mar-02	69,249.00				
Apr-02	87,237.75		$ 336,650.31	August 2002	#97, 02-3
May-02	(23,789.66)	(b)			
Jun-02	93,284.52				
Jul-02	104,760.91		$ 174,255.77	November 2002	#98, 02-4
Aug-02	100,827.97				
Sep-02	61,200.96				
Oct-02	100,000.00		$ 262,028.93	January 2003	#99, 03-1
Oct-02 true up	(6,613.10)				
Nov-02	107,113.54				
Dec-02	103,203.46				
	$ 1,145,352.23				
Jan-03	50,716.96		$ 254,420.86	May 2003	#102, 03-4
Feb-03	79,194.58				
Mar-03	35,244.67				
Apr-03	206,172.39				
			$12,248,453.64	Total run through GCR to date	
			$12,569,065.28	Total deferred to date	
			$ 1,802,485.00	2002 GCR Audit Period (b)	

(a) Includes gas supply costs from the time of centralization in July 1997.
(b) In May 2002, and adjustment was made to reverse a total of $167,172.37 charged in January - March 2002.

EXECUTIVE SUMMARY OF THE MANAGEMENT POLICIES, PRACTICES AND ORGANIZATION OF THE COMBINED EAST OHIO GAS COMPANY AND THE RIVER GAS COMPANY

The management policies, practices and organization of The East Ohio Gas Company ("East Ohio") are detailed in the Schedule S-4.2 submitted for East Ohio as a stand-alone company. That information is directly applicable to the policies, practices and organization of the combined company that will be formed when The River Gas Company ("River") merges into East Ohio. As such, East Ohio's Schedule S-4.2 and its appendices are incorporated herein by way of reference rather than being copied verbatim and included in their entirety. The following discussion of the combined companies' management practices focuses on the implications of the merger and, specifically, how it affects the operations of the currently separate organizations.

Rationale for the Merger

The primary motivation for the proposed merger of River into East Ohio is the industry-wide changes imposed by the Federal Energy Regulatory Commission's (FERC's) Order 636. These changes have moved many of the gas procurement and supply management responsibilities formerly borne by interstate pipeline companies to local distribution companies (LDCs). Among the major implications of the Order 636-mandated unbundling are the following:

- LDCs no longer have access to bundled no-notice sales service and, thus, have to increase their supply procurement sophistication and operate within much tighter balancing parameters in order to avoid daily imbalance penalties imposed by pipelines.
- LDCs with poor load factors for interstate pipeline supplies will pay higher average rates under the straight fixed-variable rate design which shifts more of the pipelines' revenue recovery into peak day demand charges.

The LDCs likely to perform well in the post-Order 636 environment are those that have substantial experience in procuring large portions of their system supply in the spot or other non-sales market for gas, have proprietary storage or another means of maintaining a high load factor for pipeline volumes and can actively dispatch their systems in such a manner that imbalance penalties can be avoided, or at the least, minimized.

River's system is typical of those LDCs that industry observers believe will have the most difficulty coping with the supply management environment mandated by Order 636. Specific supply issues faced by River include the following:

- River's historical load factor usage on pipelines is quite poor due to the large portion of its system supply needs met by local Ohio production.
- The lack of proprietary storage constrains River's flexibility to react to unanticipated swings in usage or supply, a situation that is somewhat aggravated by the lower degree of flexibility inherent in purchases of local production.

- While adequate in pre-636 supply procurement, River would have to expand its resources in the area of supply procurement in order to cope effectively with the daily balancing limitations, operational flow orders, more complex contractual issues and other aspects of the post-636 supply environment.
- River does not actively dispatch its system, and thus is not capable of extensively monitoring and controlling flows on a daily basis - an activity that is vital if imbalance penalties are to be avoided or minimized.

The proposed merger is intended to address these issues by utilizing East Ohio's supply procurement staffing and expertise, proprietary storage and gas control capabilities directly for the benefit of River's system supply needs. Directly incorporating River's present supply procurement into East Ohio's efforts on an ongoing, daily basis via merged operations provides a number of benefits that cannot be readily achieved under the present, separate organizational structures.

Perhaps the most important benefit to be gained by the proposed merger is the ability of River's present customers to directly and continuously benefit from the extensive staffing in place at East Ohio that is solely devoted to the acquisition and management of system supply volumes. East Ohio's experience and staffing in such areas as procurement of local production, interstate pipeline transportation and exchange operations, construction and procurement of spot and term supply portfolios and contract administration can be best applied to River's present system supply needs as an integral part of East Ohio's operation. By fully integrating River supply procurement activities into East Ohio's existing structure, the increase in resources needed for that procurement effort can be effectively met without the need for additional personnel at River.

In addition to the above staffing advantages, a merger of the two companies will significantly increase the gas supply management flexibility for volumes procured on behalf of River's current customers. Direct access to East Ohio's storage capabilities without the limitations of a contractual relationship (which currently exists in the form of a storage contract between East Ohio and River) will afford the balancing ability needed to better match River's customer usage and available supply on a daily basis. A crucial link to East Ohio's storage function is provided by East Ohio's Fearing compressor station located near Marietta. This station physically links River's system into East Ohio's and has been used successfully over the past few years as a means by which storage-related movement of gas can be accomplished.

Under the daily transaction environment mandated by Order 636, LDCs with passive gas dispatching capability will have to improve their gas control capability and expertise in order to avoid the incurrence of imbalance penalties from the interstate pipelines. Under merged operations, River's present system will be dispatched by East Ohio's Gas Control area. This will make it unnecessary to develop another gas control function and capability at River and facilitate the timely implementation of daily electronic gas measurement and control technologies for its larger customer accounts.

In summary, the proposed merger is first and foremost a response to the additional supply procurement and management complexities created by FERC Order 636. As a result, the major changes resulting from combining East Ohio's and River's operations will be in the area of gas supply procurement. Those changes will greatly enhance the ability to render cost effective and reliable service to River's current customers in the post-636 environment. Without such a combination, River would be forced to procure and devote substantially more resources to its supply management efforts. Ultimately, those costs would be reflected in higher rates for those customers in the form of a base rate increase to collect those additional staffing costs or a higher Gas Cost Recovery rate resulting from River's lower interstate pipeline load factor and/or lessened ability to avoid imbalance penalties or other gas costs associated with more complex gas procurement practices.

Impact on River Gas Operations

As indicated in the prior section, the primary impact of the merger on River Gas operations will occur in the area of supply procurement. At this point in time, no organizational changes are expected to take place as a result of the merger. This is a function of several conditions, of which the more important ones are the following:

- River's General Manager currently reports to the Vice President, Operations, of East Ohio. There are no plans to change that reporting relationship as a result of the merger. River's General Manager will simply become the General Manager of an East Ohio operating division based in Marietta.

- River's *senior management team* (i.e., those above the position of General Manager) is comprised of those individuals at East Ohio in the identical senior management positions. Thus, while the listing of officers of River Gas will cease to exist, those same individuals will exercise their duties related to former River operations in their capacity as an officer of East Ohio.
- Virtually all of the staff functions related to work performed for River in areas outside operations, credit and marketing have been, and will continue to be, performed by East Ohio personnel. In the past, those functions and their necessary management have been provided under the terms of a service agreement between the two companies. After the merger, the functions will simply be provided as part of East Ohio's scope of activities. As a result, there will be no impact on those individuals at River that have historically contacted East Ohio personnel regarding specific services rendered to River.
- No formal decision by members of River's Local 999 of The Allegheny Mountain Gas Workers Union, Service Employees International Union, AFL-CIO, regarding post-merger union representation has yet been requested. However, preliminary discussions indicate that there are no plans by those union members to seek representation by East Ohio's Local 555 of The Natural Gas Workers Union, Service Employees International Union, AFL-CIO. As such,

River union employees would continue to operate under the same wages and working conditions as specified in their current labor agreement.

Under current plans, River will essentially become an operating division of East Ohio, much like those located in Cleveland, Akron, Canton and Youngstown. The broad non-gas supply functions currently performed at River are very similar to those performed at East Ohio's divisions. Thus, no changes in general functional activities are needed for River to make the transition from a stand-alone corporation to an operating division of East Ohio. Those few issues that may have an impact on River Gas operations are currently being reviewed by appropriate personnel from both companies to ensure consistency across operations once the merger has been completed. Among the tasks to be performed is a complete review of all River standard operating procedures and other associated terms and conditions to ensure conformity with those of East Ohio. Although any differences between the two companies' practices, policies and procedures are expected to be minor, it is essential that they be reconciled in an appropriate manner.

In summary, the transformation of River from a stand-alone company extensively supported by East Ohio management and personnel to an operating division extensively supported by the same East Ohio management and personnel will result in few changes to daily activities. This is largely due to the historical and extensive interaction between the two companies on a wide variety of issues as well as a management structure that effectively has River being managed by the same officers as those responsible for East Ohio's operations.

Impact on East Ohio Operations

As indicated in the preceding sections, the impact of the proposed merger on East Ohio will be predominantly felt by those employees responsible for the procurement and management of gas supplies. As a result, it is largely employees within the Gas Supply Acquisition area who will be affected. It is important to note that, although they will be performing tasks for a broader set of customers, the nature of their work will be virtually identical to that currently being done. Thus, while the gas buyer will purchase more volumes and the transportation and exchange analysts will monitor additional delivery points and the gas supply planning analysts will consider additional load profiles, the general approach to their duties will be identical. That is not to imply that there will be no incremental time and effort involved: the affected employees will clearly have to expend some additional effort in accomplishing their assigned duties in the short term. However, the extra effort is not expected to significantly alter the way in which the affected departments will operate. Furthermore, it is likely that the incremental effort will lessen over time as those employees become accustomed to the additional volumes and other issues that must be handled.

For the vast majority of employees at East Ohio, the merger with River will impose no change whatsoever. Among the non-supply areas likely to feel some impact are those involved in financial and regulatory reporting. Currently, these areas are required to perform similar reporting tasks for both River and East Ohio. Examples include reporting of income to the parent for consolidation, development of income and balance sheet estimates and the preparation of regulatory reports. Typical of the latter are such items as the FERC Form #2, monthly SG forms, and the Long-Term Forecast Report. In addition, activities related to the regulatory approval process such as the preparation of Gas Cost Recovery filings, agency gas service contract approvals and financing applications will also be affected since they will be performed on behalf of only one company after the merger is completed. However, as will be discussed in the following section, a 50% reduction in the number of some reports does not mean a reduction of 50% of the time and effort involved in their preparation.

Most of the areas affected by the above reporting changes are functionally located in the Controller, Treasurer and Rates areas of East Ohio. When preparing reports on behalf of both companies, the responsible individuals in those areas must take into consideration the need for consistent reporting practices. As a result, report formats and data references are typically prepared for one company and then, in essence, re-used for the other. A good example of that process is found in the development of consolidated income statements. Both East Ohio's and River's source data is contained in a variety of systems, of which the most important for consolidation purposes is the Accounting

Information System (AIS). This system contains all of the transaction records in the level of detail necessary to generate complete financial statements for purposes of corporate consolidation. When a particular accounting or reporting change is identified, the accountant responsible for developing the consolidation report essentially modifies one report only, for example, the program needed to generate the monthly financial statement for East Ohio. This same program is then used to generate a similar report for River by simply changing the data set referenced. By using the same process in many of their reports, the personnel in Controller, Treasurer and Rates areas are able to minimize the incremental effort involved in generating information for a second company.

The merger of River into East Ohio will thus involve very little change to an individual's responsibilities for month-end closing despite the fact that, on the surface, he is generating *only one-half* the number of reports. While a particular individual's or department's reporting procedures vary according to the type of report being generated, the extensive utilization of identical mainframe and personal computer programs for both companies has historically meant that the preparation of an incremental document for River involves considerably less effort than that expended to prepare the initial East Ohio version. As a result, the reduction in the number of reports being generated by an area will by no means entail a commensurate reduction in the number of man-hours needed for their completion. Thus, while certain economies of scale will be achieved in the merger, it is unlikely that they will be substantive enough to afford an opportunity for reducing head-count in the near-term. This is due to the fact that the primary impetus for the merger is to enable reliable and cost effective gas supplies to be procured and managed on River's customers' behalf in the post-636 environment.

Merger Process

To facilitate a smooth transition, several task forces have been developed to address issues related to the merger of River into East Ohio. The primary role of one such task force, led jointly by River's General Manager and East Ohio's Manager of Gas Supply Services, is to ensure the timely and efficient transition of River's gas supply procurement and management function to East Ohio with no loss in supply reliability or cost-effectiveness over the intervening period. Among the specific issues to be addressed by that task force are clearly delineating the responsibilities for managing interstate and local production volumes and assessing the resulting impact on contract administration and gas dispatching functions. This task force will thus have the key role of implementing the combined companies' response to the post-636 supply environment.

Another task force, led by several members of East Ohio's senior management team, has been established to oversee the administrative, legal, financial and regulatory aspects of the merger. That group's primary responsibility is to ensure the timely regulatory approval of the merger and the full coverage of all other administrative facets of combining operations. The latter task force will be relying extensively on several corporate departments of the parent to facilitate or conduct activities related to securing

Securities and Exchange Commission approval under the Public Utilities Holding Company Act of 1935 and making and accounting for the appropriate financial transactions. There will be a number of other groups involved in facilitating the combination such as ones responsible for reviewing standard operating procedures for consistency and addressing the myriad financial and regulatory reporting issues. Finally, as part of the base rate proceeding process, the Companies will afford personnel from the Public Utilities Commission of Ohio with an opportunity to assess the process and implications of the proposed merger.

- **The gas supply goals and objectives are contained late in the Long-Term Strategic Supply Plan.**

The gas supply goals and objectives are not discussed in the Long-Term Strategic Supply Plan until the sixth page of the plan, after the introduction and the discussion of the organizational structure. As recommended earlier, the Long-Term Strategic Supply Plan should be revised and updated annually, instead of every two years. It then would become the annual planning document for gas supply. As such, the overall objectives and goals would be the basis for all activities contained in the plan, and should be stated as early as possible in the document.

3.7.3 Recommendations

- **The gas supply goals and objectives should be explicitly stated in the Gas Supply Acquisition portion of the company business plan.**

- **The gas supply goals and objectives should be at the front of the Long-Term Strategic Supply Plan.**

3.8 ORGANIZATIONAL STRUCTURE

3.8.1 Background

We analyzed the structure of the Gas Supply Acquisition division as contained in the 1994 Long-Term Forecast Report, and as it currently exists. We also reviewed information regarding the Activity Based Planning process that the Gas Supply Acquisition used in determining the appropriate structure and staffing levels. All position descriptions were also reviewed.

Currently, the Gas Supply Acquisition division comprises three distinct business units: Appalachian Gas Supply, Gas Supply Services, and Interstate Gas Supply. Figure 3-1 contains the current organization chart for the division. The Appalachian Gas Supply unit is responsible for acquiring gas supplies in the Appalachian Basin, including Ohio, West Virginia, New York, and Pennsylvania. Figure 3-2 contains the Appalachian Gas Supply organization chart. The Gas Supply Services unit is responsible for managing and directing the control of all gas supplies, including off-system deliveries for the company. Figure 3-3 contains the Gas Supply Services organizational chart. The third unit within the Gas Supply Acquisition division, the Interstate Gas Supply unit, is responsible for managing the company's overall gas supply planning function, and developing and implementing strategies for acquiring gas produced in the southwest, including Texas, Louisiana, and Oklahoma. The Interstate Gas Supply organizational chart is contained in Figure 3-4.

Figure 3-1
Gas Supply Acquisition

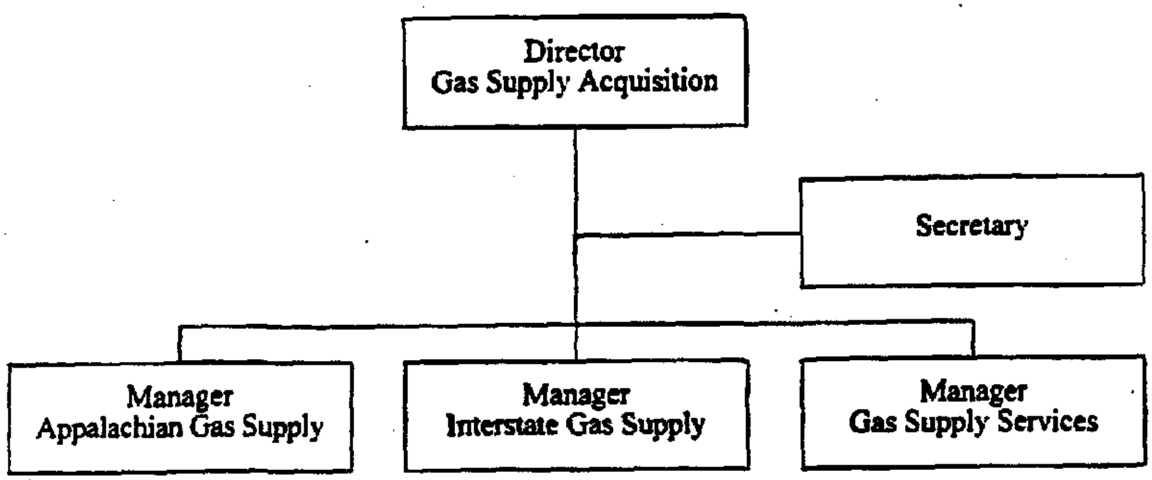
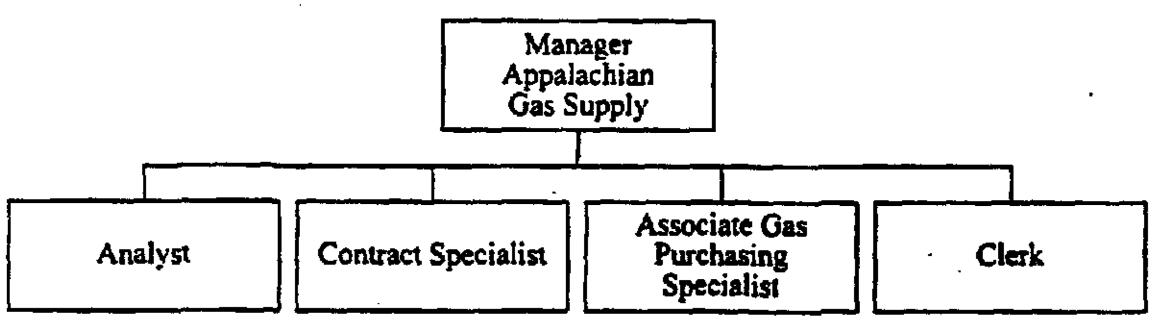


Figure 3-2
Appalachian Gas Supply



In 1993, East Ohio retained Deloitte & Touche to assist it in reviewing company-wide staffing and organizational issues. The tool utilized to assist in the analysis was called Activity Based Planning (ABP). The Gas Supply Acquisition division was the first area in the company to go through the ABP analysis. The project identified the division's key responsibilities and critical success factors. It also reviewed the organizational structure and the amount of resources being expended of various activities. Employees were surveyed to determine their perception of the value of the service being provided. The customers who received these services were also surveyed, to determine if there was a gap between the providers' perceived value and the customers' perception.

Figure 3-3
Gas Supply Services

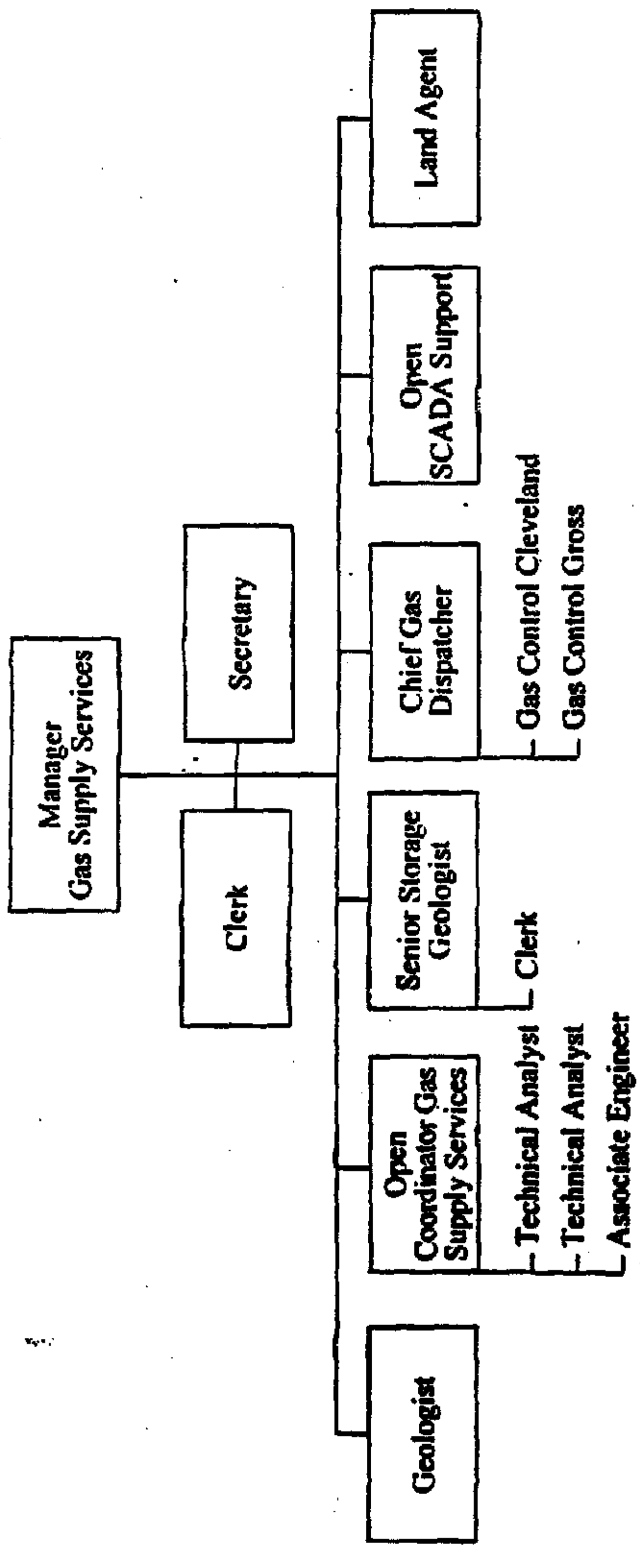
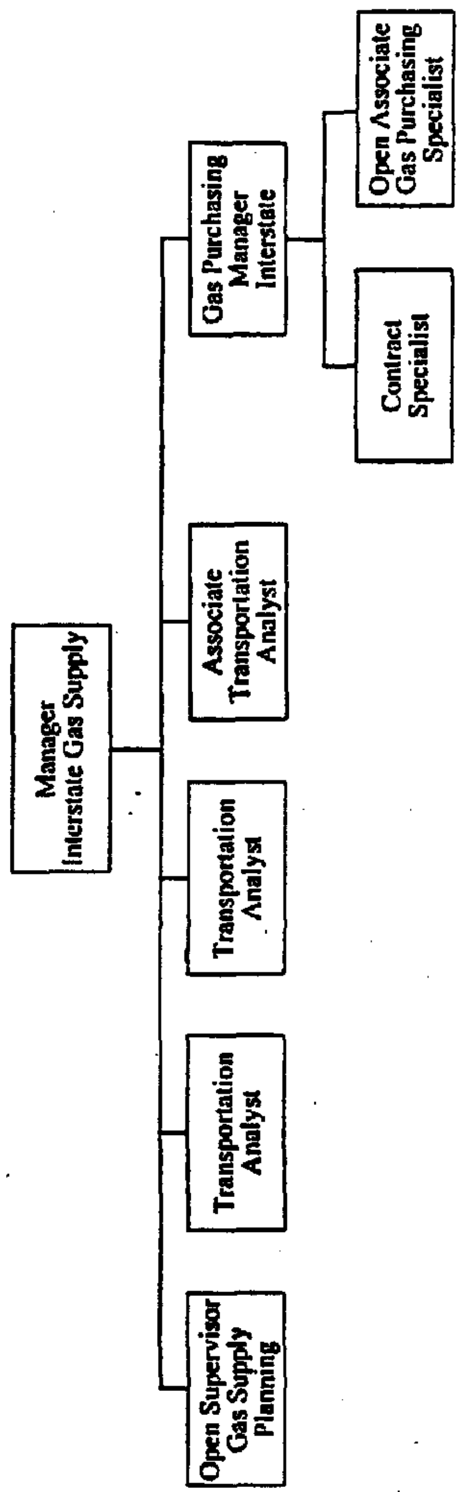


Figure 3-4
Interstate Gas Supply



As a result of the ABP analysis, various positions were eliminated, consolidated, or transferred. During this period the company also offered an early retirement program. Eleven Gas Supply Acquisition division employees accepted the early-out offer. As a result of all these changes, the number of approved positions within the Gas Supply Acquisition division was reduced from 52 to 45. Currently, there are five positions that are vacant.

Because there were a number of personnel changes, we also reviewed the division's training plans. The division has no formal training program except in the gas control area, in which there is a specific, detailed program established. As far as the rest of the division, there are cross-training opportunities. Employees may also attend several company courses, and industry seminars, courses, and fairs, sponsored, for example, by IGT and GRI. Development plans for individual employees are a part of the employee's job evaluation.

3.8.2 Findings and Conclusions

- **Activity Based Planning project evaluated the structure and staffing level for the Gas Supply Acquisition division.**

ABP appears to bring a structured approach to analyzing staffing levels and organizational structure. Based on the ABP analysis, it appears that staffing levels in the Gas Supply Acquisition division are appropriate. However, it should be pointed out that there are still changes occurring in the gas industry. The functional responsibilities, staffing levels, and organizational structure of the Gas Supply Acquisition division should not be considered quiescent. Changes in the industry will continue, and the responsibilities, structure, and staffing levels with the Gas Supply Acquisition division will continue to evolve.

- **There is no comprehensive training and development strategy for the various positions within the Gas Supply Acquisition division.**

In the past few years there have been significant changes in the functions and responsibilities performed by the Gas Supply Acquisition personnel. In addition, there have been significant changes in personnel within the division, including over 20% accepting the early retirement offer. The division does include individual development goals in each employee's performance evaluation. However, without a guideline or strategy as to the skills and knowledge that needs to be developed for specific positions, the training and development provided may be inappropriate or not required at all.

III. MANAGEMENT AND ORGANIZATION

This chapter details East Ohio's organizational structure as it relates to the Company's natural gas procurement and supply management functions. The first section of this chapter discusses the Consolidated Supply Group, the entity with primary responsibility for the Company's gas procurement function. The following section discusses the organization and activities of the Gas Supply Operations, Gas Supply Services, and the Rates and Gas Transportation Departments which assist in the gas supply procurement and management functions. The next section discusses the various committees and groups which meet to discuss gas supply planning issues. The fourth section discusses CNG Energy Services, an East Ohio affiliate also engaged in the sale of gas in Ohio. The final section presents our conclusions and recommendations.

A. Consolidated Supply Group.

Established July 1, 1997, as part of a corporate reorganization, the Consolidated Supply Group ("CSG") is a unit of the Regulated Business Support Group, which is part of the Regulated Businesses division of Consolidated. CSG's mission is to provide reliable, competitively priced gas supplies, capacity and related services to satisfy the physical gas needs of the four Consolidated Natural Gas LDC companies, including East Ohio. CSG personnel are located at the Park Ridge Center in Pittsburgh, Pennsylvania. Senior Management at Consolidated combined the procurement activities of its various LDCs to share costs, implement new technologies and facilitate future growth. CSG provides the following to East Ohio:

- supply and capacity planning services for daily (operational), short-term (weekly and monthly), seasonal and multi-year planning horizons through the development and maintenance of supply planning models and scenario analysis;

- gas supply and capacity management services as needed to meet requirements at competitive costs in both the interstate and local gas marketplace;

- monthly a complete and accurate record of all gas supply and capacity transactions;

- data responses and testimony as requested by East Ohio's state regulatory section;

- leadership and coordination of FERC activity on issues affecting East Ohio such as tariff charges, operational concerns, cost of service, cost allocation and rate design; and

- complete and accurate data base of all contracts and transactions entered into for supply and capacity and notice of pending expiration and evergreen clauses in order to trigger appropriate action.

Figure III-1 presents the corporate organizational structure of the Consolidated Natural Gas Company and the position of Regulated Businesses and the Regulated Business Support Group (May 1998), the operational group in which the CSG is located.[1] Figure III-2 presents the organizational structure of CGS. As shown in Figure III-2, the CSG is structured along functional lines which include Supply Area Acquisition (Gulf Coast and Mid-Continent purchases), Market Area Acquisition (Appalachian and local Ohio purchases), Regulatory Support and Accounting (including FERC participation and contract administration) and Gas Supply Planning. In addition to the gas procurement responsibilities of CSG, the Regulated Business Support Group is also responsible for

[1]During the period July 1997 through April 1998, the corporate organization of the Consolidated Natural Gas Company differed slightly, however, these differences were not materially related to the gas procurement function.

Figure III-1

Organizational Structure of Consolidated Natural Gas Company

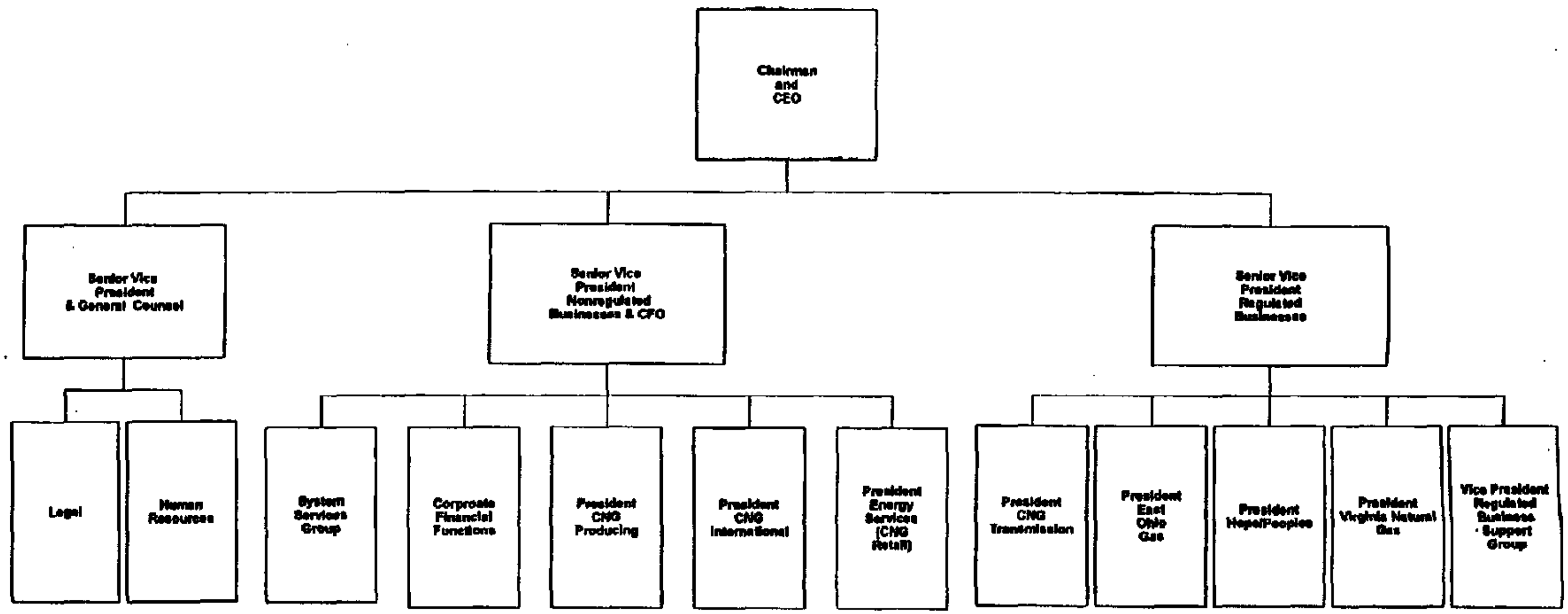
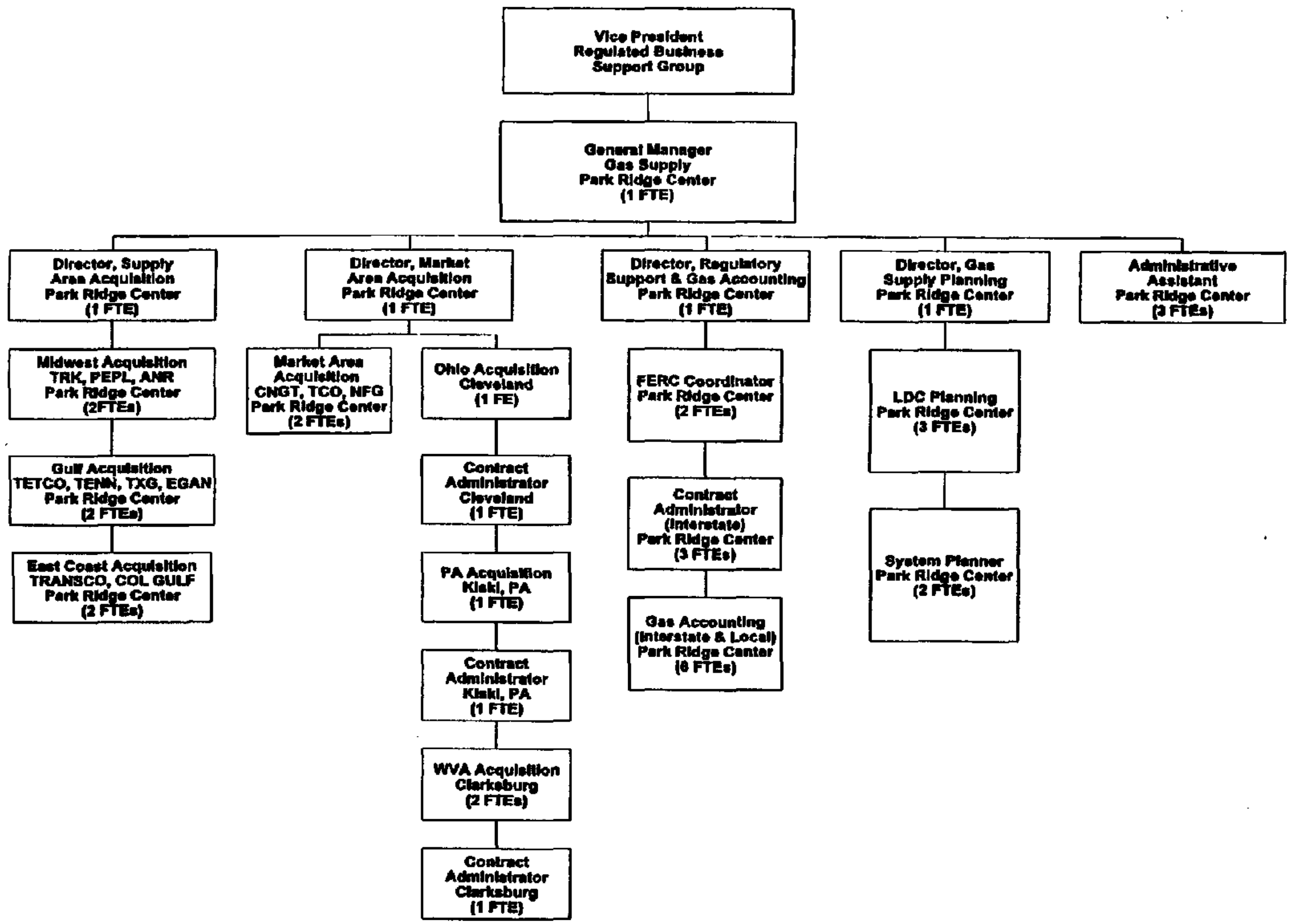


Figure III-2

Organizational Structure of the Consolidated Supply Group



materials control, marketing, process improvement, and certain engineering activities for all Consolidated LDCs.

Prior to July 1997, gas supply and capacity acquisition activities were performed by East Ohio's Gas Supply Acquisition Division and its Rates and Appalachian Gas Supply Division. These divisions which consisted of four distinct businesses units: Rates and Appalachian Gas Supply, Gas Supply Services, Interstate Gas Supply and Gas Supply Operations. The Rates and Appalachian Gas Supply unit was responsible for acquiring local and Appalachian gas supplies in Ohio, West Virginia, Virginia, New York and Pennsylvania. The Gas Supply Services unit, which continues to reside at East Ohio, is responsible for managing and directing the control of all gas supplies. The Interstate Gas Supply unit was responsible for managing the Company's overall gas supply planning function, and developing and implementing strategies for acquiring gas produced in the Southwest (i.e., Texas, Louisiana, Oklahoma, etc.). The Gas Supply Operations unit, which also continues to reside at East Ohio, is responsible for operations dealing with East Ohio's storage fields. Gas Supply Services and Gas Supply Operations are discussed further in the next section of this Chapter.

In addition to the Gas Supply Acquisition and Rates and Appalachian Gas Supply divisions, East Ohio maintained a Gas Supply Planning Committee ("GSPC") that developed annual and strategic gas supply goals and objectives. These goals and objectives were reviewed and approved by the Company's President and senior management. GSPC membership included senior management representatives of the gas supply planning and operating groups, and the marketing, rates, corporate planning and legal departments.

DP 11/12/2002 1008 8 10/01

Confidential Treatment Requested by Deloitte & Touche, 2500 One PPG Place Pittsburgh, PA 15222, 412-338-7910

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Note: Workpaper Has Been Carried Forward From The Prior Year and Remains Applicable In The Current Year

PTR/mab
276240-071153

December 30, 1998

Mr. Michael G. Bartels
Vice President
The East Ohio Gas Company
1717 East Ninth Street
P. O. Box 5759
Cleveland, Ohio 44101-0759

Re: Gas Cost Recovery

Dear Michael:

You have inquired about the appropriateness of including in the gas cost recovery process established by Ohio Revised Code Section 4905.302 the costs East Ohio has been billed for the services rendered by the Gas Supply Department of the Regulated Business Support Group ("RBSG") of Consolidated Natural Gas. You indicated that the Gas Supply Department provides East Ohio with a variety of services, including: buying, scheduling, and otherwise arranging for gas supplies and pipeline capacity from the gulf coast, mid-continent, and Appalachian regions; planning for short-term, seasonal, and long-term gas supply and capacity; providing state regulatory support in connection with both commodity and transportation acquisition; and providing gas accounting and contract administration for both local and interstate gas supplies. The costs billed to East Ohio for the period July 1997 to October 1998 were approximately $2.7 million.

Under Ohio Revised Code Section 4905.302(A)(1)(a), a natural gas company may recover through a gas cost recovery mechanism (the "GCR") "the cost to the company of obtaining the gas that it sells." Chapter 4901:1-14 of the Ohio Administrative Code ("O.A.C."), which amplifies Section 4905.302, contains the rules pertinent to the operation and review of the GCR. Rule 4901:1-14-01(I), O.A.C., defines "gas costs" or "cost of gas" to include

> demand, capacity reservation or use, transportation, storage, balancing, gathering and other related costs to the company for services rendered or supplies provided by others prior to and including the physical delivery of the gas to the company.

(Emphasis supplied.) As set out in the formulas for the calculation of the GCR rate, Appendix A to Rule 4901:1-14-05, O.A.C., the expected gas cost portion of the GCR includes "demand and service charges," which are defined as

> the portion of gas costs billed by a gas or natural gas company's suppliers or other service providers . . . , which relates to the cost of demand, capacity reservation or use, transportation, storage, balancing, gathering and other related services which are costs to the company of obtaining the gas that it sells . . . .

(Emphasis supplied.) Rule 4905:1-14-01(X), O.A.C.

The Public Utilities Commission of Ohio has not, to my knowledge, addressed the issue of whether the RBSG costs billed to you for the enumerated services, or similar costs, are appropriately included in the GCR calculations. While the matter is not free from doubt, and the Commission might find to the contrary, I believe the better view is that the costs billed to East Ohio are "related" costs "for services rendered" or costs for "other related services" in connection with obtaining gas supplies and pipeline capacity. Such costs appear to satisfy the definition of "demand and service charges" and "gas costs," and are therefore recoverable through the GCR mechanism.

Of course, only prudent and reasonable costs may be recovered, whether through the GCR or base rates. The costs incurred over any particular period would have to be shown to have been reasonable in relation to the services provided, and the Commission would no doubt carefully review the costs, given the relationship between the RBSG and East Ohio. The underlying issue relating to the prudence of having the gas procurement function performed by the RBSG has been reviewed -- at least implicitly -- by the management/performance auditor in East Ohio's 1997 GCR case, Case No. 97-219-GA-GCR. The auditor reviewed the organization of, and the functions performed by, the RBSG and did not challenge the reasonableness of either the arrangement or the services rendered.

Please do not hesitate to call me if you have any questions.

Very truly yours,

Paul T. Ruxin

cc: Bruce C. Klink
Jeffrey Murphy