

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

In the Matter of the Regulation of the	:	
Purchased Gas Adjustment Clauses	:	Case No. 12-0209-GA-GCR
Contained within the Rate Schedules of	:	Case No. 12-0212-GA-GCR
Northeast Ohio Natural Gas Corporation	:	
and Orwell Natural Gas Company.	:	
In the Matter of the Regulations of the	:	
Purchased Gas Adjustment Clauses	:	Case No. 12-0309-GA-UEX
contained within the Rate Schedules of	:	
Northeast Ohio Natural Gas Corporation	:	
and related matters.	:	
		Case No. 12-0312-GA-UEX
In the Matter of the Uncollectible	:	
Expense Rider of Orwell Natural Gas	:	
Company.	:	

**POST HEARING BRIEF
SUBMITTED ON THE BEHALF OF THE STAFF OF
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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INTRODUCTION

Staff witness Roger Sarver was the supervisor for all four of the audits that are the subject of these cases.¹ In his more than 20 years of experience performing Gas Cost Recovery (GCR) audits, he has never seen an instance where a company has been so slow to respond to the Commission's findings and recommendations.² Nor has he seen such

¹ Tr. III at 663. At the outset, Staff notes that no objection has been raised with respect to any of the findings in the uncollectible expense rider dockets, Nos. 12-309-GA-UEx or 12-312-GA-UEx.

² *Id.* at 822.

high levels of employee turnover.³ The plain fact, painfully evident from the record in this case, is that the steps taken by these companies to address issues of self-dealing raised over the course of numerous audits have been woefully inadequate to address concerns raised both by Staff and by this Commission. Staff believes that the time has come for more incisive investigation, and more decisive action.

ARGUMENT

I. Staff's recommended actual adjustment should be adopted by the Commission.

A. The Commission should adopt Staff's re-pricing of local production.

In this audit, Staff determined that the prices the Companies paid for local production were unreasonable. For the majority of the audit period, the Companies paid more for local production than they did for interstate gas. As explained by witnesses for Staff and OCC, it was inexplicable for the Companies to repeatedly pay such high prices for local production. Because it would be unreasonable for GCR customers to pay these inflated local production prices, Staff proposes an alternative pricing mechanism.

³

Tr. III at 822.

1. When using in-house employees, the Companies were previously able to purchase lower priced local production.

The Companies have historically reduced their purchase gas cost by purchasing local production gas.⁴ This is because local production is typically less expensive than interstate gas.⁵ By purchasing gas directly from local producers, NEO and Orwell previously reduced their dependence on interstate purchases, which also reduced the amount customers paid in purchased gas costs.⁶

Before 2008, Orwell and NEO used in-house employees to purchase gas directly from local producers. NEO witness Marty Whelan testified regarding his prior role as a gas purchaser for NEO.⁷ Mr. Whelan testified that he purchased gas from local producers for NEO before 2008.⁸ Mr. Whelan stated that as long as he was involved in

⁴ Staff Ex. 2 (Direct Testimony of Roger L. Sarver) (Sarver) at 15; OCC Ex. 12 (Direct Testimony of Gregory Slone) (Slone) at 1. OCC witness Slone testified that from 2000 to 2008, local production for NEO and Orwell was priced lower than interstate supplies. OCC Ex. 12 (Slone) at 17.

⁵ There are a number of reasons why local production cost less than interstate supplies. Local producers are often located in isolated markets and have limited supply options. Commission-Ordered Ex. 1 (Staff Report) at 22. Also, local production is an interruptible supply source. This means it is less reliable than interstate supplies, which are typically firm supply sources. *Id.* at 22; OCC Ex. 12 (Slone) at 17.

⁶ Commission-Ordered Ex. 1 (Staff Report) at 11.

⁷ Tr. I at 75-76.

⁸ *Id.*

purchasing gas for NEO, local production cost less than interstate gas.⁹ Mr. Whelan also testified that nothing occurred over the past few years that would change this trend.¹⁰

Orwell also had an in-house employee experienced in purchasing local production. In the 2010 Audit Hearing, Orwell's witness Steve Rigo testified that he used to be responsible for purchasing local production gas for Orwell.¹¹ Mr. Rigo testified that he performed this function while serving as President and Executive Vice President for Orwell.¹² This was before ONG Marketing/JDOG Marketing¹³ started purchasing local production as a middleman.¹⁴ In March of 2007, Mr. Rigo resigned as an employee of Orwell and started purchasing local production as an agent of Orwell while employed by ONG Marketing.¹⁵

⁹ Tr. I at 42-42.

¹⁰ *Id.* at 43.

¹¹ 2010 Hearing (Direct Testimony of Steve Rigo) at 1.

¹² 2010 Hearing, Tr. III at 400-401, 404-405. Although Mr. Rigo was an "employee" of both ONG Marketing and Orwell at the same time, his paycheck came from Orwell. *Id.* at 428. As Mr. Rigo explained, "it really didn't make any difference who my paycheck was with. Mr. Osborne owned all these companies and he wanted me to have Orwell buy gas." *Id.* at 428-429.

¹³ In the 2010 hearing, Mr. Rigo testified that ONG Marketing eventually became JDOG Marketing. *Id.* at 425.

¹⁴ *Id.* at 404, 418.

¹⁵ *Id.* at 418.

2. The prices the Companies paid for local production increased after JDOG Marketing was inserted as middleman.

In 2008, NEO stopped using in-house employees to purchase local production and began using JDOG Marketing as a middleman.¹⁶ Companies' witness Whelan testified that in 2008, Tom Smith told him that NEO was going to hire JDOG Marketing to purchase gas for NEO.¹⁷ Tom Smith was the President of NEO at this time.¹⁸ Mr. Smith did not explain to Mr. Whelan why NEO was transferring gas procurement responsibility to JDOG Marketing.¹⁹ As Mr. Whelan explained, he always met NEO's gas supply needs when he was purchasing local production for NEO.²⁰ He always attempted to purchase as much local production as possible, which reduced NEO's purchase gas costs.²¹ In addition, Mr. Whelan testified that inserting JDOG Marketing into the gas purchasing role would result in additional cost to GCR customers.²² Regardless, management at NEO ceded responsibility of purchasing local production to JDOG Marketing without explaining to Mr. Whelan why this change was necessary.

¹⁶ Tr. I at 75-76.

¹⁷ *Id.* at 75-77.

¹⁸ *Id.*

¹⁹ *Id.* at 77.

²⁰ *Id.* at 77- 78.

²¹ *Id.*

²² *Id.* at 78.

After JDOG Marketing began purchasing local production for NEO, NEO started paying much more for local production. In fact, the amount NEO was paying for local production increased so much that local production was eventually more expensive than interstate gas.²³ OCC witness Slone testified that from 2000 to 2007, NEO purchased local production at an average rate that was \$1.03 per Mcf less than the average cost of interstate supplies.²⁴ However, starting in 2008, when JDOG Marketing began purchasing local production for NEO, the amount NEO paid for local production averaged \$.85 per Mcf more than interstate gas.²⁵ This unexplained increase of \$1.88 per Mcf occurred in just a few years.²⁶ This increase was not due to an increase in the cost of gas. While JDOG Marketing was charging NEO more for local production, Staff determined that JDOG Marketing was *not* paying local producers more.

To determine the amounts JDOG Marketing was paying local producers, Staff reviewed the pricing provisions of contracts between JDOG Marketing and local producers provided in the 2010 Audit. These contracts were still in effect for a portion of the 2012 Audit. Staff first analyzed the prices paid on NEO's Cobra system and found that JDOG Marketing paid local producers the following prices on the three Cobra systems:

²³ Commission-Ordered Ex. 1 (Staff Report) at 13, 21.

²⁴ OCC Exhibit 12 (Slone) at 18.

²⁵ *Id.*

²⁶ *Id.*

Cobra Churchtown = (NYMEX less \$0.45) * (.9637)

Cobra Holmesville = (NYMEX less \$0.20) * (.9637)

Cobra North Trumbull = (NYMEX plus \$0.10)* (.9637)²⁷

While JDOG Marketing was paying local producers these prices on Cobra, it was charging NEO a substantially higher price for each unit of gas. For the period September 2009 through July 2011, JDOG Marketing billed NEO the following amounts for local production:

Cobra Churchtown = (NYMEX plus \$1.05) * (1.0377)

Cobra Holmesville = (NYMEX plus \$1.00) * (1.0377)

Cobra North Trumbull - (NYMEX plus \$1.20)* (1.0377)²⁸

JDOG Marketing increased the NYMEX price by a least dollar on each of the Cobra systems. A portion of this price increase was allegedly to account for transportation costs and shrinkage. But JDOG Marketing had already reduced payments to local producers to account for these costs.²⁹ By accounting for transportation costs and shrinkage twice, JDOG Marketing inflated the cost of local production so much that the Companies were paying more for local production than interstate supplies.³⁰

²⁷ Commission-Ordered Ex. 1 (Staff Report) at 11.

²⁸ *Id.* at 12.

²⁹ *Id.*

³⁰ *Id.*

Staff also determined that the premiums NEO paid JDOG Marketing for non-Cobra local production purchases were unreasonable.³¹ NEO paid JDOG Marketing approximately \$368,000 in premiums for non-Cobra purchases from local producers and Gatherco.³² Staff was unable to determine what, if any, services JDOG Marketing performed to justify these payments. In fact, Staff believes in-house employees were performing most of the functions necessary to obtain gas from non-Cobra and Gatherco sources.³³

Orwell paid exorbitant premium amounts to JDOG Marketing also. JDOG Marketing charged Orwell the TCO Appalachian index price plus \$1.50 for local production. JDOG Marketing included this \$1.50 premium until July 2011.³⁴ Beginning in August 2011, the amount JDOG Marketing charged for local production varied on a monthly basis. Staff determined that Orwell paid JDOG Marketing approximately

³¹ Commission-Ordered Ex. 1 (Staff Report) at 13.

³² Staff did not re-price Gatherco purchases. Staff Ex. 2 (Sarver) at 21. Rather, Staff simply removed the \$.15 per unit premium added by JDOG Marketing. *Id.* Staff witness Sarver explained that Gatherco simply reads the local producers' meters then submits the bill directly to NEO. Tr. III at 812. NEO verifies the all the information regarding the volume and usage of the gas. JDOG Marketing provides absolutely no service regarding this gas. *Id.* Thus, no premium payment is justified. *Id.*

³³ Commission-Ordered Ex. 1 (Staff Report) at 13.

³⁴ *Id.* at 13-14.

\$86,400 in premiums for the purchase of 63,700 Mcf of local production gas.³⁵ These premiums paid to JDOG Marketing by Orwell are more than a dollar per Mcf.³⁶

3. The premium payments to JDOG Marketing are unjustified because JDOG Marketing provided little value to the Companies when purchasing local production.

Staff determined that the Companies paid JDOG Marketing approximately \$1.2 million in premiums to purchase local production. There is no evidence, however, that shows that JDOG Marketing provided any service justifying these premium amounts. The record shows that, before Mr. Whelan was removed from his role in purchasing gas, he was consistently purchasing local production at prices below interstate gas. The Companies, at some point, should have questioned why JDOG Marketing was charging them more for local production than the cost of interstate gas. This never happened. The Companies never attempted to independently verify that the premiums they were being billed by JDOG Marketing were justified. The Companies had no process to determine the effectiveness of JDOG Marketing's gas purchasing practices.³⁷ Although the Companies hired GNS to act as a gas procurement manager, Staff found that GNS simply verified the rates and quantities billed by JDOG Marketing and then passed the bills

³⁵ Commission-Ordered Ex. 1 (Staff Report) at 13-14.

³⁶ *Id.* at 21.

³⁷ OCC Ex. 12 (Slone) at 25.

along to the companies.³⁸ GNS never questioned why local production began to costs more than interstate gas and did not question JDOG Marketing regarding the prices it was paying local producers. In addition, neither GNS nor the Companies attempted to solicit offers from other marketers.³⁹

The record indicates that the Companies previously had the ability to purchase reasonably priced local production gas using in-house employees. Staff believes JDOG Marketing can easily be removed from middleman position and local production costs can be reduced by using in-house employees to purchase gas in the local production market.⁴⁰ Considering the lack of evidence justifying the premium payments made to JDOG Marketing, Staff recommends that the Commission disallow the excessive premium amounts sought by the Companies.

4. Staff's Recommended Adjustment

Because Staff found no reasonable basis for the premiums NEO and Orwell paid JDOG Marketing, Staff proposed an alternative pricing mechanism. Although Staff found that JDOG Marketing provided very little value while purchasing local production for the Companies, it may have been appropriate for the Companies to pay JDOG Marketing some premiums for its services. To determine a more reasonable premium

³⁸ Staff Ex. 2 (Sarver) at 5-6.

³⁹ *Id.*

⁴⁰ Commission-Ordered Ex. 1 (Staff Report) at 23.

level, Staff developed its “alternative premiums.”⁴¹ The following table contains the actual premiums paid to JDOG Marketing per unit during the 2012 audit period and the “alternative premiums” developed by Staff:

Local Producers	Staff Alternative Premium NYMEX Plus	JDOG Marketing Premium NYMEX Plus	Difference
Cobra	\$0.50	\$1.091	\$0.591
NEO non-Cobra	\$0.70	\$1.61	\$0.91
Orwell	\$0.25	\$1.46	\$1.21

Staff developed its alternative premium payments by first examining local production purchase agreements that were provided in the 2010 Audit. Staff asked the Companies to provide all the relevant local production agreements from the 2012 audit period. Despite having the burden of proof in this case, the Companies refused to provide these agreements to Staff.⁴² Therefore, the 2010 local production agreements were the most reasonable alternative considering the Companies refusal to provide the requested documentation.

When examining the local production prices, Staff performed a separate analysis for NEO and Orwell. Staff also subdivided local production for NEO into two categories: Cobra purchases and non-Cobra purchases. Staff was able to determine that weighted average NYMEX prices for NEO Cobra, NEO non-Cobra, and Orwell.⁴³ Staff

⁴¹ Staff Ex. 2 (Sarver) at 7.

⁴² Tr. III at 730-731.

⁴³ Staff Ex. 2 (Sarver) at 15-18.

then determined the average weighted prices paid to producers for each one these three categories. Staff determined the basis associated with units of local production sold on each system by subtracting the average price JDOG Marketing paid to local producers from the average NYMEX price.

While accounting for the location of specific producers, transportation cost, processing fees and shrinkage related to each of the three categories, Staff was able to determine premium amounts payable to JDOG Marketing that are reasonable:

Local Producers	Staff Alternative Premium NYMEX Plus
Cobra	\$0.50
NEO non-Cobra	\$0.70
Orwell	\$0.25

The alternative premium amounts recommended by Staff would allow JDOG Marketing to recover all costs incurred for purchasing and transporting local production and reasonably compensate JDOG Marketing for its gas procurement function. For example, Staff witness Sarver testified that using Staff's alternative premium price for Cobra would have allowed JDOG Marketing to cover all of its costs for purchasing gas on the Holmesville and Churchtown system *and* provided JDOG Marketing with \$.21 of profit per unit. Rather than recommending a complete disallowance of all fees paid to JDOG Marketing, Staff believes its alternative premium amounts (as opposed to the approximately \$1.2 million in premiums sought by the Companies) are reasonable and

within the range of premiums being charged by JDOG Marketing and other marketers for non-local production.

5. Mr. Overcast's criticism of Staff's re-pricing methodology is fundamentally flawed.

The only witness the Companies presented to counter Staff's alternative pricing recommendation was H. Edwin Overcast. Mr. Overcast's testimony is devoted largely to proving that the Companies did not pay more for intrastate gas than interstate gas.⁴⁴ Mr. Overcast relies upon an exhibit he created (Schedule 1) to support his conclusion.⁴⁵ As Staff witness Sarver explained, Mr. Overcast's Schedule 1 is inaccurate and drastically inflates the true costs of interstate gas.⁴⁶ The Companies did not rebut Mr. Sarver's testimony about the flaws in Mr. Overcast analysis. Once these inaccuracies are accounted for, Schedule 1 actually disproves the central point of Mr. Overcast's testimony and shows that the Companies paid more for intrastate gas than interstate gas.⁴⁷

Mr. Overcast raises two other issues with Staff's re-pricing methodology: (1) Staff used the NYMEX as the pricing index for developing Staff's alternative premium amounts and (2) Staff relied upon local purchase agreements provided in the 2010

⁴⁴ Companies Ex. 5 (Direct Testimony of H. Edwin Overcast) (Overcast) at 11-14.

⁴⁵ *Id.* at Schedule 1.

⁴⁶ First, Mr. Overcast incorrectly included the costs of transporting gas across Dominion East Ohio's (DEO) system. Staff Ex. 2 (Sarver) at 23-24. These costs would have applied to intrastate and interstate gas. Second, Mr. Overcast incorrectly included TCO demand charges in Schedule 1. *Id.* These costs also applied to both intrastate and interstate supplies.

⁴⁷ *Id.* at 24.

Audit.⁴⁸ Each critique can be easily rebuffed. First, the reason Staff used NYMEX as a pricing index is quite simple – *all of the Companies' local production purchases were actually based on NYMEX.*⁴⁹ Second, Staff asked the Companies to provide copies of all the contracts JDOG Marketing had with local producers relevant to the 2012 Audit period.⁵⁰ The Companies, however, refused to provide this information despite the fact it provided the same type of information in the 2010 Audit.⁵¹ It is ridiculous for the Companies to criticize Staff for not using updated local production prices when the Companies refused to give this information to Staff. Further, the Companies failed to provide any evidence or analysis that proves NYMEX was not the basis for local production pricing during the 2012 Audit period.

Finally, not only did the Companies use NYMEX as a pricing point in their local production agreements, but most local producers in Ohio do the same.⁵² But as Staff witness Sarver explained, local production prices are based upon the market and not merely

⁴⁸ Companies Ex. 5 (Overcast) at 7.

⁴⁹ Staff Ex. 2 (Sarver) at 22, Exs. RS-9, RS-10.

⁵⁰ Commission-Ordered Ex. 1 (Staff Report) at 12.

⁵¹ *Id.*

⁵² Tr. III at 691, 790.

the NYMEX index price.⁵³ The important question is whether there has been a substantial change in the local production market since JDOG Marketing entered into the local production contracts examined by Staff. Prices in the local production market have dropped since the JDOG Marketing entered into these local production agreements.⁵⁴ This drop in local production prices would allow JDOG Marketing to pay local producers less and extract even greater premium payments from the Companies.⁵⁵ When considering the change in the market, Staff's calculation is conservative because it did not account for a pricing shift that almost assuredly worked in JDOG Marketing's favor.⁵⁶

B. Staff's other actual adjustment recommendations were not contested by the Companies, and should be adopted by the Commission.

Staff made a number of other recommendations regarding its proposed actual adjustment:

⁵³ Tr. III at 791. NYMEX is used to price the gas commodity. The cost to deliver gas to a particular market or location is the "adder" or "basis differential." *Id.* at 692. This "basis differential", which can be positive or negative, determines the market price of gas.

⁵⁴ *Id.* at 729-730. Staff witness Sarver testified that the local purchase agreements reviewed by Staff were executed in years ranging from 2007 through 2010. Staff Ex. 2 (Sarver) at 21-22. Under these contracts, local producers were receiving the benefit of a favorable NYMEX to TCO Appalachian basis differential of as high as thirty-five cents in 2008. *Id.* This differential has dropped over the past few years significantly, reaching a low in 2012 of four tenths of a penny. *Id.* This recent drop in the value of local production is due to a substantial increase of gas supply in Ohio markets.

⁵⁵ Staff Ex. 2 (Sarver) at 21-22.

⁵⁶ *Id.*

- Staff recommends increasing NEO's sales volumes for the months of March 2010 through May 2010 by 181,172 Mcf.⁵⁷ Staff also recommends that free gas be removed from the actual adjustment calculation for the companies.⁵⁸
- Staff recommends that the Commission disallow all agency/broker fees paid to JDOG Marketing for the purchase of interstate gas that the Companies are seeking to recover from GCR customers.⁵⁹

The Companies did not contest these recommendations during the hearing.

Therefore, the Commission should adopt Staff's recommendations.

II. The Commission should reject the results of the RFP Process, and order Management Performance and Forensic Audits of the Companies and their related pipeline companies in a new case docket.

Staff is recommending that the Commission order an investigation into the management practices of these companies for the reasons that follow. The investigation should not only inquire into these companies, but should also include their related and affiliated regulated companies, as well. Staff does not take this step lightly. This is, in fact, an unprecedented recommendation. It comes following a series of extremely frustrating audits of the companies rife with self-dealing that demonstrates a remarkable lack of control. While Staff believes that there is adequate reason to justify such an order on many different individual grounds, the actions of the companies' general management, taken as whole, evidences a clear need for sweeping action.

⁵⁷ Staff Ex. 2 (Sarver) at 25.

⁵⁸ Commission-Ordered Ex. 1 (Staff Report) at 24-25.

⁵⁹ *Id.* at 24.

The Commission has the necessary authority to make whatever changes are necessary to ensure that these companies operate in the best interests of their customers.

It has done so before under similar circumstances:

Columbia's loyalty should be not to its affiliates, but to its Ohio ratepayers. It appears to this Commission that Columbia's management is overly influenced by its parent and/or sister companies, and that some action is necessary to ensure the independence of Columbia's decision-making. An independent board of directors for Columbia Gas of Ohio, Inc. should be established; a majority of those directors should live or work in the company's service territory, and should not be employees of the company or associated with the Columbia Gas System. It is good, sound management practice to have an independent majority of outside directors. We will require Columbia to develop a plan for so reorganizing its board of directors within a reasonable time.⁶⁰

Staff urges the Commission to take a closer look to determine whether any, and what, changes should be made. That look should include, at a minimum, a management performance audit and a forensic financial audit to more clearly identify areas that should be corrected.

In the management section of its audit report in these cases, Staff focused on the stipulated request for proposal (RFP) process to which the parties had agreed. In the course of the hearing, many other areas of concern were also identified. Staff respectfully submits that, together, these concerns justify initiating a more thorough investigation.

⁶⁰

In the Matter of the Investigation into the Gas Purchasing Practices and Policies of Columbia Gas of Ohio, Inc., Case No. 83-135-GA-COI, *et al.* (Opinion and Order at 16) (Oct. 8, 1985).

A. The RFP process did not lead to competitive bids as required by the Stipulation and as ordered by the Commission.

In its audit report, Staff criticized the process used by the companies to solicit a supplier for gas purchases.⁶¹ As a result, Staff recommends that the Commission reject the results of the RFP process and order the companies to start a new RFP process that includes the input of Staff, the OCC, and the companies' technical and operational staff.

When the stipulation in the prior GCR cases was signed, the parties agreed to cooperate in the development of an RFP intended to result in the selection of a competitive bidder by November 1, 2011.⁶² But an initial draft of the RFP was not offered by the companies until nearly six (6) months later, and the ultimate RFP was not issued for more than a year after the stipulation was signed. As OCC witness Slone testified, a major problem was that it took over a year to put the RFP process into place.⁶³

Whether intended to or not, the delay directly advantaged the companies' marketing affiliate. In the absence of an awarded RFP, JDOG Marketing continued selling gas to the companies, while collecting unreasonably large premiums and agency / broker fees that the RFP process was intended to correct.

The mere fact of the delay was certainly one of the biggest problems with the process. But it was by no means the only concern that Staff had. The RFP itself was

⁶¹ Commission-Ordered Ex. 1 (Staff Report) at 54-59.

⁶² *Id.* at 54.

⁶³ Tr. I at 190.

severely flawed. As discussed more thoroughly in the audit report (pages 54-58), the RFP failed to define what services bidders were to provide; required bidders to account for local production currently under contract with an affiliated marketer without adequate information on how to do so, and to maintain existing marketer contracts; and it failed to provide other information vital to developing a bid.⁶⁴

These flaws could have been avoided. Although the companies did solicit input from Staff and OCC, they completely ignored Staff's input, including criticism of these very flaws.⁶⁵ Even the companies' own operations personnel were not included in the development of the RFP. Companies' witness Whelan, who addressed the RFP process, was not even involved with the RFP itself.⁶⁶ Although he testified that the companies coordinated with Staff and OCC, he admitted that he was not aware of the extent of the coordination because he was not involved in process.⁶⁷

The companies made no attempt to engage in a fair RFP process.⁶⁸ While the RFP may have been sent to a reasonable pool of potential bidders, the requirement that bidders pre-qualify, and do so in merely two (2) days, undoubtedly discouraged most of the

⁶⁴ Commission-Ordered Ex. 1 (Staff Report) at 55.

⁶⁵ *Id.* at 58.

⁶⁶ Tr. I at 121.

⁶⁷ *Id.* at 161.

⁶⁸ Tr. II at 473.

invitees from participating. As the companies acknowledged, only prequalified bidders were able to ask questions about the RFP.⁶⁹

Staff witness Donlon testified that the prequalifying responses were not indicative of any true interest in the RFP, but were likely merely an effort to get a foot in the door.⁷⁰ Further, the companies made no effort to determine why more of the potential bidders decided not to pre-qualify.⁷¹

Not surprisingly to Staff, only one of the pre-qualified prospects submitted a bid – the very affiliated marketer that was so heavily favored by the flawed terms of the RFP. OCC witness Slone testified that, in his opinion, there were no circumstances that he could think of where a single response to an RFP would be considered a competitive result.⁷² Staff witness Donlon was also questioned about accepting a single bid to an RFP. He explained his experience:

Q. So you don't know whether that the company you worked for, AEP, ever accepted the results of an RFP where there was only a single responder?

A. I don't -- I do recall one particular time where only one response came in, and then we had a lot of discussions of why. We contacted the companies that we sent RFPs to, asked what was going on, did a lot of research within the industry to figure out what the issue was, why that RFP came back as a single individual -- or single company. If that bid was accepted, I

⁶⁹ Tr. I at 161.

⁷⁰ Tr. II at 477.

⁷¹ Tr. I at 118.

⁷² *Id.* at 188.

don't recall but I want to say that I'm pretty sure we issued a second RFP with a broader scope and corrected some of those errors that were there.⁷³

The companies, by contrast, did none of these things. They did not follow up to determine why no other potential bidder participated.⁷⁴ They did no analysis to determine whether the bid was truly a competitive market price.⁷⁵ They could have rejected the bid, or issued a second RFP, but, instead, chose to do neither.

The failure to reject the bid is particularly egregious in light of the record developed in the 2010 GCR hearing. As Staff concluded in the audit report:

After Staff presented evidence in the 2010 case that demonstrated JDOG's practices were harming the companies' credit as well as inflating their customers [sic] GCR rates, Staff does not understand why the companies' management would agree to buy gas using such an ambiguous term that cannot be verified independently of invoices and/or contracts. The companies' management does not appear to be engaged in the process of procuring gas at least cost available for its customers.⁷⁶

B. Structural and Organizational Issues

The record shows a pattern of blurred lines of authority and responsibility, and a general lack of accountability. One need almost look no further than the fact that all of the companies' employees who testified in this proceeding changed jobs in the month

⁷³ Tr. II at 472.

⁷⁴ Tr. I at 119.

⁷⁵ *Id.* at 121.

⁷⁶ Commission-Ordered Ex. 1 (Staff Report) at 58.

that the hearing occurred. Two former employees, who testified at the behest of Staff, both lost their jobs for specious reasons, or no stated reason at all, literally within days of the filing of Staff audit reports.

The Osborne-related entities that are subject to the Commission's regulatory authority include both local distribution companies (Brainard Gas Corp., Northeast Ohio Natural Gas Corporation, and Orwell Natural Gas Company) and pipeline companies (Cobra Pipeline Co., LTD, Orwell-Trumbull Pipeline Co., LLC, and Spelman Pipeline Holdings, LLC). The list of unregulated, Osborne-related companies is not known. They include, at a minimum, Great Plains Exploration, LLC, Oz Gas Ltd., John D. Oil & Gas Co., John D. Oil & Gas Marketing, Gas Natural Service Company, LLC.

In the case of these companies, it can be difficult to tell the players even with a program. Companies' witness Smith, for example, was the president of NEO and Orwell during the audit period.⁷⁷ Initially hired to work for OsAir Securities⁷⁸, he is currently vice president of OsAir, a real estate developer that also operates an industrial gas business⁷⁹. He has been the president of Orwell-Trumbull Pipeline⁸⁰, Cobra Pipeline⁸¹, and Lightning Pipeline⁸². He was, and believes that he may still be, the president of

⁷⁷ Tr. IV at 838.

⁷⁸ *Id.* at 841.

⁷⁹ *Id.* at 853.

⁸⁰ *Id.* at 847.

⁸¹ *Id.* at 849.

⁸² *Id.* at 850.

Spelman Pipeline.⁸³ He is president of Great Plains Natural Gas Company⁸⁴, a producer and one of the companies' suppliers, and was formerly president of John D. Oil and Gas Exploration⁸⁵, another producer and supplier, where he remains a director. According to Ms. Howell, Mr. Smith was also president of John D. Oil and Gas *Marketing* during the audit period.⁸⁶ Mr. Smith is also president of the Gas Natural Service Company, which is supposed to be providing services to the very distribution companies of which he is also the president.⁸⁷

So Mr. Smith was president of a marketer that contracted for supplies with local producing companies, for some of which he served as president, for a services company, of which he was president, for the benefit of local distribution companies, for which he

⁸³ Tr. IV at 854. This assertion is somewhat troubling to Staff. On July 22, 2011, Spelman filed for authority to become a regulated pipeline company. *In the Matter of the Application of Spelman Pipeline Holdings, LLC for Commission Authorization to Become a Pipeline Company and for Approval of Tariffs*, Case No. 11-4444-PL-ATA. In its application, Spelman stated that it had “the requisite technical, financial and managerial capability needed to operate this type of transmission system.” In support of that statement, Spelman attached a document specifying the “Technical and Managerial Experience of Key Personnel,” identifying Martin K. Whelan as its president, with no mention of Mr. Smith. The Commission approved the application, specifically relying on “the affidavit of Martin K. Whelan, president of Spelman.” *Id.* (Finding and Order at 2) (Oct. 12, 2011).

⁸⁴ Tr. IV 849.

⁸⁵ *Id.* at 860.

⁸⁶ *Id.* at 946.

⁸⁷ *Id.* at 855.

was the president. In all of these presidential capacities, Mr. Smith made it very clear that he reported to Richard Osborne.⁸⁸

The evidence clearly points to the authority and control that Richard Osborne exerts (or is capable of exerting) over these companies and their related entities. The extent of his involvement is pervasive. Reporting lines not leading directly to Mr. Osborne are not, however, entirely clear, and this is particularly true with respect to accounting issues. Staff respectfully submits that these are the kinds of matters that a comprehensive audit could address.

According to Mr. Smith, it was his responsibility to hire adequate staff, including adequate and qualified accounting personnel.⁸⁹ Each distribution company would have a key accountant, or key financial officer.⁹⁰ These accountants would report, not to the president, but to the controller of the Ohio utilities, an Energy West employee.⁹¹ The Ohio controller would direct report to the controller for the holding company⁹², who would then report to the Chief Financial Officer (CFO). Of course, Mr. Smith is the vice president and CFO of Energy West.⁹³ It just so happened that the president of these Ohio

⁸⁸ Tr. IV at 870.

⁸⁹ *Id.* at 846.

⁹⁰ *Id.* at 902.

⁹¹ *Id.*

⁹² While this was Mr. Smith's testimony, Staff witness Lipnis testified that Ohio Controller didn't report to the corporate controller while she was corporate controller. Tr. III at 606.

⁹³ Tr. IV at 852.

local distribution companies (LDCs) was then, ultimately, accountable only to himself and to Mr. Osborne.

This lack of accountability poses a fundamental problem. As noted above, Mr. Smith is also president of the Gas Natural Service Company. This is a classic situation of the “rooster watching the henhouse.” Companies’ witness Patton was asked about the service company’s role, and explained:

- Q. And what is the function that Gas Natural Service Company does for Northeast based upon your understanding?
- A. They have all of our gas purchase contracts and our transportation contracts, and I believe they get the bills from JDOG for gas purchases and verify that we were billed for the contract terms.
- Q. So their function is to look at the contract and determine if they were billed for an amount that was consistent with what the contract calls for, correct?
- A. Correct.⁹⁴

Companies’ witness Whelan concurred that the function of Gas Natural Services is to match invoices to contracts and ensure that the LDC is billed correctly, both for volume and dollars.⁹⁵ But it is clear that the Service Company failed to do this. Mr. Whelan acknowledged that at least some of the bills approved by the Services Company were incorrect, and that Services did not catch billing errors from Cobra.⁹⁶

⁹⁴ Tr. II at 252-253.

⁹⁵ Tr. I at 154.

⁹⁶ *Id.* at 67.

The billing error occurred because Cobra charged a processing fee to Northeast for gas that did not undergo processing. Companies' witness Whelan admitted that none of the gas on the Cobra system that goes to Northeast customers goes through a processing plant.⁹⁷

Mr. Whelan was aware of the processing fee.⁹⁸ Companies' witness Patton was aware of the processing fee, but admitted that the companies did nothing to verify that the gas for which they were being charged a processing fee was actually processed.⁹⁹ Mr. Smith, the former Cobra president, was ultimately responsible, as president of the Services Company, for authorizing recovery of this improper charge from the customers of the distribution company of which he was also president. He obviously failed in that responsibility.

Shortly before the hearing in this case began, Mr. Whelan replaced Mr. Smith as president of NEO.¹⁰⁰ This was a sudden change, at least to Mr. Whelan.¹⁰¹ Although he had extensive operational knowledge about the company, he was made president with neither a college degree nor any kind of business management education or training.¹⁰² He was not aware of what his new duties as president would entail, or whether that would

⁹⁷ Tr. I at 102-103.

⁹⁸ *Id.* at 50.

⁹⁹ Tr. II at 243.

¹⁰⁰ Tr. I at 32.

¹⁰¹ *Id.* at 34.

¹⁰² *Id.* at 46.

include supervision of accounting functions.¹⁰³ When was asked to review the table of organizational for NEO provided by the company, he acknowledged that it made no sense.¹⁰⁴ The NEO chart, for example, listed Becky Howell, the Energy West Controller, at the top, making no mention of the company president.¹⁰⁵

This lack of clear definition, as to employer, job title or duties, was not limited to company presidents. Staff witness Rolf testified that she was hired as a staff accountant for Orwell, but did not perform any accounting functions for Orwell.¹⁰⁶ Ms. Rolf testified:

- Q. To your recollection did -- you said you were employed by Orwell, but you performed work for Northeast.
- A. Correct.
- Q. Were there other individuals who had similar types of employment --
- A. Yes.
- Q. -- who were also employed by Orwell?
- A. Usually they would be on different companies' payrolls. I know the person who did the accounting for Orwell company was actually on NEO's payroll.

¹⁰³ Tr. I at 33, 35.

¹⁰⁴ *Id.* at 139-142.

¹⁰⁵ *Id.* at 140.

¹⁰⁶ Tr. II at 333.

Q. Were you ever given any explanation why you were being paid by Orwell but you were performing duties for Northeast?

A. No.¹⁰⁷

Even companies' witness Howell testified that she was initially on Orwell's payroll, but performed duties for other companies.¹⁰⁸

Even where the lines of responsibility and accountability were supposedly more transparent, the companies continually blurred them to benefit Mr. Osborne's financial interests. The staff accountant, for example, is responsible for preparing and making the quarterly GCR filings here at the Commission. Of the witnesses who testified, both Staff witness Rolf and companies' witness Noce made GCR filings for the companies during the audit period. Concerns were raised in this case about the review and modification of those filings.

Companies' witness Smith testified that he was the only person who reviewed GCR estimations.¹⁰⁹ Ms. Howell agreed:

Q. And as controller, what was your interaction with the GCR process?

A. I did not check those at the time; Mr. Smith did. He approved them.

Q. As the controller of Northeast and Orwell, did you consider yourself the senior accountant for the company?

A. Yes.

¹⁰⁷ Tr. II at 337.

¹⁰⁸ *Id.* at 280.

¹⁰⁹ Tr. IV at 911.

Q. And is it your understanding that GCR filing is an accounting calculation?

A. Yes.

Q. Yet you never reviewed the accounting calculation as controller?

A. Because I knew Mr. Smith was doing it.¹¹⁰

Testimony of other companies' witnesses contradicted this assertion. Even though she had never prepared a GCR filing, and was never responsible for providing information that went into the GCR calculations, companies' witness Howell acknowledged that she was, from time to time, asked to review those filings.¹¹¹ She even did this in her capacity as president of Cobra Pipeline Company.¹¹² And Ms. Noce testified that the Ohio controller, and even Richard Osborne himself, would also review GCR filings from time to time.¹¹³

Mr. Smith testified that he would make adjustments to expected gas cost (EGC) estimates if he felt they were necessary, even though he did not know what information his employees relied on to make their estimates,¹¹⁴ whether anyone associated with the companies provided any information to those employees to assist them with their

¹¹⁰ Tr. IV at 932.

¹¹¹ *Id.* at 963.

¹¹² *Id.* at 925.

¹¹³ *Id.* at 1000.

¹¹⁴ *Id.* at 906.

estimations,¹¹⁵ whether there was any prescribed method for calculating these estimates,¹¹⁶ or even how to perform the GCR calculation.¹¹⁷ He relied on no information to check the accuracy of the estimates¹¹⁸, or perform or cause any analysis to be performed to evaluate the estimation process. Indeed, he acknowledged that he didn't even know how he arrived at his adjustments.¹¹⁹

Staff witness Rolf testified that she was told on one occasion to decrease sales numbers so that the GCR rate would be higher.¹²⁰ Staff witness Lipnis testified that Becky Howell intentionally increased the GCR.¹²¹ The companies dispute that this happened. Rather, Mr. Smith asserts that he believed that Ms. Rolf consistently underestimated or under-collected, and that the companies were thereby not charging customers enough.¹²² He was unable, however, to say how often (if at all) the companies were under-collecting during the audit period. Indeed, when shown Staff Ex. 3, he

¹¹⁵ Tr. IV at 907.

¹¹⁶ *Id.* at 908.

¹¹⁷ *Id.* at 878.

¹¹⁸ *Id.* at 911.

¹¹⁹ *Id.* at 916.

¹²⁰ Tr. II at 346.

¹²¹ Tr. III at 611.

¹²² Tr. IV at 908.

acknowledged that the company had been over-collecting, even on the magnitude of \$2.65 per Mcf.¹²³

Staff surmises that Ms. Rolf was asked to make a change to generate more immediate cash flow. While estimating gas costs is imprecise, Staff is concerned that this is another example of poor judgment, one exercised by managers ill-equipped to make such judgments. Mr. Smith did not know how to do a GCR calculation.¹²⁴ He did not know the component parts of the calculation, or how they related to each other.¹²⁵ He tried to distinguish between gas cost estimates (which he said he would adjust from time to time) and sales volumes (which he said that he never adjusted), but acknowledged that he did not know whether there are any sales volumes in the GCR calculation.¹²⁶

Ms. Howell fared no better:

- Q. Okay. When you see EGC, expected gas cost, do you know how the expected gas cost component of the GCR is calculated?
- A. It's based off your sales and a NYMEX price, NYMEX plus price.
- Q. NYMEX and sales. And what period of sales?
- A. For the -- I think the historical past year.
- Q. The historical past year? Is there any component of gas volume that's included as part of that calculation?

¹²³ Tr. IV at 915.

¹²⁴ *Id.* at 878.

¹²⁵ *Id.* at 910.

¹²⁶ *Id.* at 885.

- A. It's based on your sales times your NYMEX prices for your expected gas costs.
- Q. That's the entirety of the EGC calculation as you understand it?
- A. Yes, as I understand it.¹²⁷

Ms. Noce got it right. When asked to explain the EGC mechanism she recognized that price, historic sales, and purchased volumes are all essential components of the EGC calculation.¹²⁸

The curious situation of Ms. Rolf's termination demonstrates the problem with chains of command, authority, and accountability presented by this case. Ms. Rolf's supervisor was Larry Brainard, the Ohio Controller. Ms. Howell, as corporate controller, was Mr. Brainard's supervisor. Although she acknowledged that "he was pretty adamant he wanted to have supervision of his employees,"¹²⁹ it was Ms. Howell, and not Mr. Brainard, who terminated Ms. Rolf.¹³⁰

Counsel for the companies conducted lengthy cross-examination of Ms. Rolf on her refusal to sign a company Code of Conduct. The record demonstrates that Ms. Rolf had good cause to be concerned about what she was being asked to commit to. None of

¹²⁷ Tr. IV at 964-965.

¹²⁸ *Id.* at 999-1000.

¹²⁹ Tr. II at 298.

¹³⁰ *Id.* at 334.

the companies' witnesses were able to say who was responsible for enforcing the Code of Conduct¹³¹, or whether anyone had any such responsibility at all.¹³²

C. Lack of Adequate Internal Controls

Whether intentionally done, or simply a result of poor corporate structure, the companies lacked adequate control over their internal accounting practices.

The Sarbanes–Oxley (SOX) Act of 2002¹³³ set standards for all U.S. public company boards, management and public accounting firms. As a result of SOX, top management must now individually certify the accuracy of financial information. SOX requires that the management of public companies assess the effectiveness of the internal control of issuers for financial reporting, and that a publicly-held company's auditor to attest to, and report on, management's assessment of its internal controls.

Companies' witness Howell acknowledged her responsibility as corporate controller. She defined her responsibility as reviewing financial statements and presenting financial statements accurately.¹³⁴ But she had no idea who was responsible for SOX compliance for the local distribution companies:

¹³¹ Tr. IV at 945, 994.

¹³² *Id.* at 877.

¹³³ Pub.L. 107–204.

¹³⁴ Tr. IV at 933.

Q. Who on behalf of the local distribution companies is responsible for compliance with Sarbanes-Oxley?

A. That I do not know.

Q. Okay. Who with respect to Gas Natural is responsible for Sarbanes Oxley compliance?

A. I don't know who is ultimately responsible.¹³⁵

Companies' witness Noce, who just days prior to testifying was the assistant controller¹³⁶, gave a similar response:

Q. As an accountant, are you familiar with Sarbanes Oxley?

A. Yes.

Q. Do you know who the compliance officer for Sarbanes Oxley is at Northeast?

A. No.

Q. Do you know who it is for Gas Natural?

A. No.

Q. Or for Orwell?

A. No.¹³⁷

Companies' witness Smith testified that the individual utilities did not have controllers, but that they relied on an overall "Ohio controller," instead.¹³⁸

¹³⁵ Tr. IV at 966.

¹³⁶ Tr. II at 300

¹³⁷ Tr. IV at 994.

¹³⁸ *Id.* at 873.

While company witnesses testified frequently about independent external audits, the companies were unable to produce any audit report showing that their internal controls had either been assessed by management, or were effective, even though Mr. Smith would presumably have been responsible for those audits.¹³⁹ While companies' witness Whelan, for example, was aware that the companies go through an annual audit process, he was unaware of the results of any of those audits.¹⁴⁰

As demonstrated by Staff Ex. 4 and as acknowledged by Ms. Howell, Gas Natural's 2012 10-K filing with the Securities and Exchange Commission clearly states that it "does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting." There is simply no evidence in this record that any meaningful audit was ever made of the companies' internal controls.

But the record does demonstrate that the controls that were in place were not effective. Both Ms. Rolf and Ms. Lipnis testified to numerous examples where controls were either not in place or not followed.

Mr. Osborne unilaterally determined which payables should be paid in any given week, and routinely favored related parties. Checks would be cut and held because there were no funds available to pay them.¹⁴¹ Receivables given a similar treatment, with

¹³⁹ Tr. II at 292.

¹⁴⁰ Tr. I at 115.

¹⁴¹ Tr. III at 543-545.

invoices to related parties left unpaid for sometimes more than a year.¹⁴² The companies regularly “flushed accounts,” inappropriately offsetting payables and receivables.¹⁴³ The same was done for Mr. Osborne’s personal loans.¹⁴⁴ The companies purchased and were paying for a Cadillac Escalade for one of Mr. Osborne’s sons, who was not even an employee.¹⁴⁵ None of these poor business practices were disputed by the companies.

Becky Howell testified that, since the beginning of this audit period, no one from the marketing side had any access to the accounts, books, or records of the LDCs.¹⁴⁶ But she, as president of Cobra, had access to the LDC financial system, including the ability to make changes.¹⁴⁷ Ms. Lipnis testified that this was inappropriate as a SOX control.¹⁴⁸

Plainly stated, there should have been controls in place to prevent some of the incidents described in the record.¹⁴⁹ But even had there been, there is no assurance that any of those controls would have been followed. As Ms. Rolf testified:

¹⁴² Tr. III at 548.

¹⁴³ *Id.* at 579, 642-643.

¹⁴⁴ *Id.* at 654.

¹⁴⁵ *Id.* at 597.

¹⁴⁶ Tr. II at 303.

¹⁴⁷ Although she denied that she could change anything, Ms. Howell did admit that she had access to the financial accounting software of the LDCs. Tr. IV at 958.

¹⁴⁸ Tr. III at 534.

¹⁴⁹ Tr. II at 358.

Q. You have some experience on internal accounting controls based on your experience with your two previous jobs, correct?

A. Correct.

Q. When you were employed by Orwell, Northeast, did either one of the companies have similar types of internal controls to make sure that the type of compliance that you did when you were employed by the other companies was also occurring with Northeast and Orwell?

A. They had controls laid out. However, they were not followed.¹⁵⁰

Staff is very concerned that none of the companies' witnesses were able to identify anyone who was responsible for ensuring that internal controls were followed or effective. There are a number of factors that may have contributed to this confusion.

One factor, certainly, is the high rate of turnover among controllers. Staff witness Lipnis observed that there seemed to be a high turnover rate for controllers over the Ohio companies.¹⁵¹ Indeed, the most recent Ohio controller resigned his position during the course of the hearing.¹⁵² Mr. Smith, to whom the corporate controller apparently ultimately reported, testified that:

Q. So counting the new controller who you can't recall, that means that there were at least four controllers for the Ohio companies during the period from 2005 to 2013?

¹⁵⁰ Tr. II at 354-355.

¹⁵¹ Tr. III at 566.

¹⁵² Tr. IV at 873.

A. That's correct.

Q. And how many controllers has Gas Natural had during your time employed by Gas Natural?

A. Three, I believe.

Q. And what time would that cover?

A. That would cover -- oh, I couldn't tell you, probably 2006 -- no, it's after. It's 2009, 2010, sometime in that time period to the current.

Q. So in roughly a four- or five-year period they have had at least three different controllers?

A. Yes.¹⁵³

It is also possible that the controllers hired by the companies were either not qualified, or did not understand their job responsibilities. Although Staff witness Rolf had a Masters degree in accounting and experience with SOX and internal auditing¹⁵⁴, and Staff witness Lipnis was a CPA¹⁵⁵, Gas Natural instead hired Becky Howell, who is

¹⁵³ Tr. IV at 874.

¹⁵⁴ Tr. II at 331-332.

¹⁵⁵ Tr. III at 517.

not a CPA¹⁵⁶ and Anita Noce, who does not even hold a Bachelor's degree¹⁵⁷, as controllers.¹⁵⁸ And it was Ms. Noce who testified that:

Q. What was your understanding of your responsibility as an assistant controller?

A. I did various projects. I did various different things. I didn't have a set day-to-day procedure and job.¹⁵⁹

Even Mr. Smith found Ms. Howell's promotions puzzling. He was replaced at Orwell-Trumbull Pipeline by Ms. Howell because, as he explained, Mr. Osborne wanted "someone stronger" in accounting.¹⁶⁰ Mr. Osborne made this move even though Mr. Smith was a CPA and Howell was not, and even though Mr. Smith had the stronger accounting background.¹⁶¹

¹⁵⁶ Tr. II at 278.

¹⁵⁷ Tr. IV at 981.

¹⁵⁸ Indeed, even Ms. Howell was replaced as corporate controller during the course of the hearing. In its Form 8-K filed with the Securities and Exchange Commission on July 19, 2013, Gas Natural reported that "on July 15, 2013, the Company appointed Donald R. Whiteman, age 72, as the corporate controller. Mr. Whiteman started his career as the controller of Magnetics International, Inc., a publicly-held manufacturer of industrial products. After Magnetics International was sold in 1985, Mr. Whiteman served as corporate controller for various privately-held companies. From 2004 to 2009, Mr. Whiteman served as corporate controller of 2020 Train Avenue, a wholly-owned subsidiary of OsAir, Inc. ("OsAir"), which operates as a property developer and manufacturer of industrial gases for pipeline delivery. In 2009, he was appointed corporate controller of OsAir when 2020 Train Avenue was sold. Richard M. Osborne, the Company's chief executive officer, is the president and chief executive officer of OsAir."

¹⁵⁹ Tr. IV at 1002.

¹⁶⁰ *Id.* at 847.

¹⁶¹ *Id.* at 848.

D. The Companies fostered an environment that favors affiliated / related transactions.

Since their inception, these companies have functioned with little regard to corporate separation. Initially, the LDCs and the marketing operations all worked out of the same building, and all employees had access to all other company operations.¹⁶²

While some of the related entities were eventually moved to a separate physical location, relatively unfettered access remained a problem during the audit period:

Q. Were there others in your physical working area who were not employed by the local distribution companies?

A. There would have been Gas Natural Company employees in the same offices in the same suite. They had their own separate offices within the suite.

Q. But did they have access to your office?

A. Yes.

Q. Did they have access to your books and records?

A. Yes.

Q. There were Gas Natural personnel that had access to LDC records?

A. Yes.

Q. Were there specific individuals who had such access?

A. Well, anyone who had a key to the office would be able to pick up the books and look at them. They were pretty out in the open.

¹⁶²

Tr. II at 287.

Q. They were not limited or restricted in any way?

A. No.¹⁶³

Ms. Howell also testified that some JDOG Marketing personnel had access to LDC facilities, and that some LDC personnel had access to Marketing facilities.¹⁶⁴

The companies do all of their purchasing through a single individual, Mike Zapitello, for whose services they paid nearly \$640,000.¹⁶⁵ Companies' witness Patton acknowledged that Mr. Zapitello, as JDOG Marketing, purchased gas for the LDCs even when it was not needed.¹⁶⁶ Sometimes that gas would be put into storage, while at other times it would create an imbalance. Mr. Zapitello would inexplicably purchase more local gas even when there were positive imbalances. Ms. Patton testified that she knew of no limits on the amount of local gas Mr. Zapitello could purchase.¹⁶⁷

When asked about the safeguards in place to ensure arms' length transactions between affiliated or related parties, Mr. Smith indicated that the companies "occasionally" solicit outside bids for price comparison purposes.¹⁶⁸

¹⁶³ Tr. II at 338-339.

¹⁶⁴ *Id.* at 302.

¹⁶⁵ In addition to providing those services to the LDCs, Mr. Zapitello also provided services to at least three other affiliated or related companies, including OSAir, Cobra Pipeline, and Great Plains Exploration. Tr. I at 134-136.

¹⁶⁶ Tr. II at 250.

¹⁶⁷ *Id.* at 252.

¹⁶⁸ Tr. IV at 864.

The closeness of these relationships resulted in other abuses. Staff witness Rolf testified that she was asked by Ohio controller Larry Brainard to find instances where the companies had sold more gas than they had purchased, so that the pipeline could charge the LDC for additional gas.¹⁶⁹ Staff witness Lipnis testified that JDOG Marketing had stored gas in NEO contract storage facilities without payment.¹⁷⁰

CONCLUSION

The companies, of course, bear the burden of proving that their gas cost recovery rates were fair, just, and reasonable and that its gas purchasing practices and policies promote minimum prices consistent with an adequate supply of gas.¹⁷¹ The companies have failed to meet this burden.

The companies purchased supplies through a related marketing company supposedly created to centralize functions, but which resulted in added layers of bureaucracy, additional fees and charges, and, ultimately, higher prices for consumers. The interposition of a service company, yet an additional layer of self-dealing, did nothing to stem the practices the parties sought to correct in the last case. Instead, the selection of the related marketer by the service company was based on a flawed process intended, Staff submits, to maintain the status quo. The service company simply verified rates and quantities billed by the related marketer and passed the bills on to the

¹⁶⁹ Tr. II at 347.

¹⁷⁰ Tr. III at 564.

¹⁷¹ Ohio Adm. Code 4901:1-14-08(B).

companies. Bills that the companies' management acknowledged were improper, but never investigated.

Staff witness Sarver testified that these companies' management philosophy is driven by upper management, and that management's decisions were sometimes contrary to regulatory compliance.¹⁷² This philosophy was enabled by structural issues that blurred lines of authority and responsibility and promoted a general lack of accountability. Company management, who know little about how the GCR mechanism works, manipulated components to increase cash flow in the absence of meaningful internal controls. A revolving door of ill-equipped controllers, none of whom seemed to know who was ultimately responsible for the controls at the companies, further shielded these management practices.

Staff has done its best to try to identify problem areas and recommend way of rectifying those issues. But Mr. Sarver ultimately concluded that Staff simply doesn't have the expertise to determine what is actually taking place at a management level in these companies, or how to effectively remedy these ongoing problems.¹⁷³ Staff's recommended adjustments should be adopted. In addition, the Commission should, at a minimum, open an investigation into these companies, and their affiliated regulated pipeline and distribution companies, and order full management and forensic audits.

¹⁷² Tr. III at 685.

¹⁷³ *Id.* at 824.

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PROOF OF SERVICE

I hereby certify that a true copy of the foregoing **Post Hearing Brief**, submitted on behalf of the Staff of the Public Utilities Commission of Ohio, was served by via electronic mail upon the following parties of record, this 19th day of August, 2013.

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