BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained Within the Rate Schedules of Northeast Ohio Natural Gas Corporation.	))))	Case No. 12-209-GA-GCR
In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained Within the Rate Schedules of Orwell Natural Gas Company.	))))	Case No. 12-212-GA-GCR

REPLY BRIEF BY THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

BRUCE J. WESTON
OHIO CONSUMERS' COUNSEL

Joseph P. Serio, Counsel of Record
Assistant Consumers' Counsel

Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
Serio Phone: (614) 466-9565
serio@occ.state.oh.us

August 30, 2013

TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. BURDEN OF PROOF 3

III. LAW AND ARGUMENT 9

A. The Utilities are Permitted to Collect From Customers the Prudent and Reasonable Cost of Gas that Result in Gas Cost Recovery Rates That are Fair, Just and Reasonable and Promote Minimum Prices Consistent With an Adequate Supply of Gas. 9

B. OCC's Re-Pricing of Local Production is Reasonable and Should be Adopted by the PUCO. 12

C. Customers Should Not Pay $145,363 for Gas Processing Paid to Cobra Because the Gas Was Not Processed by Cobra. 16

D. Customers Should Not Have to Pay the $645,906.06 in JDOG Fees for Interstate Services That Were Not Provided. 18

E. The Request For Proposal Process Was Flawed and Did Not Produce a Competitive Result. 20

1. There is No Evidence to Support the Utilities' Claim That the PUCO Cannot Determine Whether the RFP Process Had a Competitive Result in These Proceedings. 20

2. The Vectren GCR Case Supports a PUCO Decision to Re-Price the Utilities' Local Gas Purchases and to Reject the RFP. 21

F. Regardless of the Time Period, the Utilities' Actions Were Imprudent 23

G. The Utilities' Analysis that Their Gas Procurement Policy for Local Production was Reasonable and Prudent Should be Rejected by the PUCO Because it is Flawed. 23

IV. CONCLUSION 24

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained Within the Rate Schedules of Northeast Ohio Natural Gas Corporation.	))))	Case No. 12-209-GA-GCR
In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained Within the Rate Schedules of Orwell Natural Gas Company.	))))	Case No. 12-212-GA-GCR

REPLY BRIEF
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

I. INTRODUCTION

The evidence from the Audit Report of the Staff of the Public Utilities Commission of Ohio ("Commission" or "the PUCO") ("PUCO Staff"), combined with the testimony of the PUCO Staff witnesses, OCC witness and the public witnesses demonstrates that Northeast Natural Gas Corporation ("Northeast") and Orwell Natural Gas Company ("Orwell") (together "the Utilities") incurred imprudent and unreasonable costs for gas. Additionally, the evidence shows that the Gas Cost Recovery ("GCR") rates paid by customers were not fair, just and reasonable. Those unreasonable rates resulted from the gas purchasing practices and policies of the Utilities that did not promote minimum prices consistent with an adequate supply of gas. Instead, their imprudent actions resulted in GCR customers paying higher rates.

As was the situation in the Utilities' 2010 GCR Cases,[1] there is evidence of affiliate contracts that had a detrimental impact on the GCR, mismanaged contracts, incomplete contracts and a general lack of attention to contract details. In addition, the Utilities relied on a flawed Request for Proposal ("RFP") process to award an asset management contract to its affiliate, which also had a negative impact on the GCR.

Despite an extensive recitation of the history and background of the GCR rules and the standards by which Local Gas Distribution Companies ("LDCs") have their GCR rates judged in their Initial Brief, the Utilities demonstrated a basic lack of understanding of how to adhere to those rules in a GCR case.[2] The Utilities also identified the key rules and PUCO precedent for GCR cases.[3] However, the Utilities also misapplied those rules and precedent in these cases. As a result of the Utilities' imprudent actions, the OCC has argued for the disallowance of three categories of costs: (1) the over-priced local gas purchases of $561,719, (2) the Cobra Processing Fee for services not provided of $145,363 and (3) the JDOG Fees for interstate services that were not provided of $647,906.06.[4] The OCC also recommends a number of penalties in response to the Utilities' imprudent actions.[5]

---

[1] *In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained Within the Rate Schedules of Northeast Ohio Natural Gas Corporation*, Case No. 10-209-GA-GCR and *In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained Within the Rate Schedules of Orwell Natural Gas Company*, Case No. 10-212-GA-GCR ("2010 GCR Cases"), Opinion and Order (November 26, 2010).

[2] Utilities Initial Brief at 8-12.

[3] Utilities Initial Brief at 8-12.

[4] OCC Initial Brief at 12-27.

[5] OCC Initial Brief at 30-39.

The Utilities failed to meet their burden of proving that the cost of gas was prudent and reasonable and that the GCR rates paid by customers were fair, just and reasonable. To the contrary, the evidence shows that the Utilities' management decisions were imprudent and unreasonable. Accordingly, the PUCO should grant the relief that OCC seeks because GCR customers should not have to pay for imprudent and unreasonable costs.

II. BURDEN OF PROOF

The Utilities bear the burden of demonstrating that the GCR rates paid by customers were fair, just and reasonable and that their gas purchasing practices and policies promoted minimum prices consistent with an adequate supply of gas.[6] The Utilities acknowledge this requirement.[7] But then the Utilities claim that the other parties must overcome a presumption that utility decisions are prudent.[8] But neither the language of Ohio Adm. Code 4901:1-14-08(B) or R.C. 4905.302 or Supreme Court of Ohio precedent support the Utilities' argument about a presumption in its favor.

The Utilities' claim to a presumption of prudence is based on the Commission's ruling in a 1986 purchased gas adjustment clause case involving Syracuse Home Utilities Company, Inc.[9] In that case ("*Syracuse*"), the PUCO adopted the guidelines reported in the National Regulatory Research Institute ("NRRI") paper, "The Prudent Investment

---

[6] Ohio Adm. Code 4901:1-14-08(B); s*ee also In Re Duke Energy Ohio, Inc.*, 131 Ohio St.3d 487, 2012-Ohio-1509, 967 N.E.2d 201, at ¶9.

[7] Utilities Initial Brief at 8.

[8] Utilities Initial Brief at 11.

[9] [9] *In the Matter of the Regulation of Purchased Gas Adjustment Clause Contained within the Rate Schedules of Syracuse Home Utilities Company, Inc. and Related Matters*, Case No. 86-12-GA-GCR, 1986 Ohio PUC LEXIS 1, at 21-23 (Dec. 30, 1986) ("Syracuse").

Test of the 1980s".[10] The first of these guidelines called for utility decisions to be viewed with a presumption of prudence.[11]

In the *Syracuse* case the Commission distinguished the burden of proof from the burden of producing evidence.[12] However, the burden of proof requires that the utility produce evidence to support its position and regardless of how the Commission determined to word the burden, it remains with the utility. The PUCO's rule states that the utility "shall demonstrate."[13] By requiring the PUCO Staff or another party to produce evidence rebutting any alleged presumption of prudence, the Commission is asking the challenger to prove a negative. This approach was rejected by the Supreme Court of Ohio.[14]

In the Supreme Court's decision in *Duke Energy*, Duke sought reimbursement for approximately $30.7 million in costs associated with damages caused by Hurricane Ike.[15] Duke argued that "other parties did not conclusively prove that the claimed expenses were unreasonable or imprudent."[16] But, as the Supreme Court held, "that [argument] is irrelevant because those parties did not bear the burden of proof."[17] The Court explained that it is the Utility that has to "prove a positive point: that its expenses had been prudently incurred * * * [t]he commission did not have to find the negative: that the expenses were imprudent."[18] As a result, the Supreme Court upheld the Commission's

[10] Id. [Citing to "The Prudent Investment Test in the 1980s," NRRI-85-16, (April, 1985)].

[11] Id. at *22.

[12] *Syracuse* at *22.

[13] O.A.C. 4901:1-14-08 (B).

[14] *In Re Duke Energy Ohio, Inc.*, 131 Ohio St.3d 487, 2012 Ohio LEXIS 849, 967 N.E.2d 201, ¶8.

[15] *In Re Duke Energy Ohio, Inc.*, 131 Ohio St.3d 487, 2012-Ohio-1509, 967 N.E.2d 201, at ¶2.

[16] *In Re Duke Energy Ohio, Inc.*, 131 Ohio St.3d 487, 2012-Ohio-1509, 967 N.E.2d 201, at ¶9.

[17] *In Re Duke Energy Ohio, Inc.*, 131 Ohio St.3d 487, 2012-Ohio-1509, 967 N.E.2d 201, at ¶9.

[18] *In Re Duke Energy Ohio, Inc.*, 131 Ohio St.3d 487, 2012-Ohio-1509, 967 N.E.2d 201, at ¶8.

decision to disallow much of the $30 million that Duke sought to recover from customers for storm damage, flatly rejecting any presumption of prudence. The Supreme Court also noted, "Duke has not been given a blank check, but an opportunity to prove to the commission that it had reasonably and prudently incurred the costs it sought to recover."[19]

Likewise, in this case, according to the PUCO's rule, the Utilities must prove that their expenses were reasonable and prudent and it is not up to the other parties to first prove otherwise. Any shifting of the "burden of producing evidence" does just that and is contrary to the Supreme Court precedent and Ohio law and PUCO rule. Because the Utilities bear the burden of proof, it is axiomatic that there can be no presumption of prudence.

Furthermore, there is no a presumption of prudence when analyzing transactions between affiliated companies. This principle is recognized by the National Association of Regulatory Utility Commissioners ("NARUC").[20] NARUC states that there are "four widely accepted guidelines to determine whether an investment or expenditure is prudent."[21] It then lists the guidelines, which are the exact same guidelines the Commission used in the *Syracuse* case from the NRRI paper, "The Prudent Investment Test of the 1980s."[22] But there is one addition. NARUC added, "**There is no presumption of prudence for affiliate transactions, whether they are for expenditures or investments**" to the end of the first guideline which is the presumption of prudence.[23] Additionally, there

---

[19] *In Re Duke Energy Ohio, Inc.*, 131 Ohio St.3d 487, 2012-Ohio-1509, 967 N.E.2d 201, at ¶9.

[20] Model State Protocols for Critical Infrastructure Protection Cost Recovery, NARUC, July 2004- Version 1, at pg. 21.

[21] Id.

[22] Id. fn.17.

[23] Id. (Emphasis in the original.)

is significant precedent (from other jurisdictions) which illustrates the principle of no presumption of prudence in affiliate transactions.

In a Supreme Court of Missouri case, the Missouri Public Service Commission ("PSC") decision to review affiliate transactions with the presumption of prudence was challenged.[24] The Supreme Court of Missouri found that while the burden of proof fell to the utility, the PSC had a practice, though not codified, of applying a presumption of prudence to utility expenditures.[25] The Court, however, held that any presumption of prudence was improper to apply to transactions between affiliates because of the greater risk of self-dealing.[26] The Court cited to a report of a Congressional Staff Investigation into Enron which it characterized as particularly egregious.[27] The report stated:

> [W]henever a company conducts transactions among its own affiliates there are inherent issues about the fairness and motivations of such transactions. ... One concern is that where one affiliate in a transaction has captive customers, a one-sided deal between affiliates can saddle those customers with additional financial burdens. Another concern is that one affiliate will treat another with favoritism at the expense of other companies or in ways detrimental to the market as a whole.[28]

The Supreme Court of Missouri noted that affiliate transactions are not arm's length transactions and there is simply no place for a presumption of prudence.[29] The Court also noted that since the presumption was not codified the PSC had no authority to change the

---

[24] *Office of the Public Counsel v. Missouri Public Service Commission*, 2013 Mo. LEXIS 45, at *1 (Missouri 2013).

[25] Id. at *12.

[26] Id. at *14.

[27] Id.

[28] Id. [Citing Staff of Senate Comm. on Gov't Affairs, 107th Cong. *Committee Staff Investigation of the Federal Energy Regulatory Commission's Oversight of Enron 26*, n.75 (Nov. 12, 2002)].

[29] Id. at *15-16.

burden of proof set out in the relevant statutes.[30] The Supreme Court of Missouri also held that a presumption of prudence is inconsistent with the PSC's obligation to prevent regulated utilities from subsidizing their non-regulated operations.[31] Finally, the Court held that by changing the burden of proof, the PSC required Staff to prove a negative, but that was wrong as the burden of proof is on the company and it would have the records that would allow it to meet its burden.[32]

The Supreme Court of Missouri's decision is in line with many other courts which have held that affiliate transactions should be scrutinized. One court is the Supreme Court of Idaho which stated, "The reason for this distinction between affiliate and non-affiliate expenditures appears to be that the probability of unwarranted expenditures corresponds to the probability of collusion."[33] In addition, the Superior Court of Pennsylvania stated:

> Charges arising out of intercompany relationships between affiliated companies should be scrutinized with care [citations omitted] and if there is an absence of data and information from which the reasonableness and propriety of the services rendered and the reasonable cost of rendering such services can be ascertained by the commission allowances is properly refused. * * *
>
> It therefore follows that the commission should scrutinize carefully charges by affiliates, as inflated charges to [an] operating company may be a means to improperly increase the allowable revenue and raise the cost to consumers of utility service as well as the unwarranted source of profit to the ultimate holding company.[34]

---

[30] Id. at *20.

[31] Id. at *19.

[32] Id. at *25.

[33] *Boise Water Corp. v. Idaho Pub. Util. Comm.*, 97 Idaho 832, 838, 1976 Ida. LEXIS 368, 555 P.2d 163 (Idaho 1976).

[34] *Solar Electric Co. v. Pennsylvania Public Utility Com.*, 137 Pa. Super. 325, 374, 1939 Pa. Super. LEXIS 47, 9 A.2d 447 (November 15, 1939).

The Court of Appeals of Michigan stated, "the utility has the burden of demonstrating that transactions with its affiliate are reasonable."[35] The Supreme Court of Oklahoma has stated, "It is generally held that, while the regulatory agency bears the burden of proving that expenses incurred in transactions with non-affiliates are unreasonable, the utility bears the burden of proving that expenses incurred in transactions with affiliates are reasonable."[36] The Supreme Court of Utah also rejected a presumption of prudence in affiliate transactions and stated, "While the pressures of the competitive market might allow us to assume, in the absence of a showing to the contrary, that non-affiliated expenses are reasonable, the same cannot be said of affiliate expenses not incurred in an arm's length transaction."[37] Finally, Justice Scalia of the Supreme Court of the United States, in a concurrence, stated, "it is entirely reasonable to think that the fairness of rates and contracts relating to joint ventures among affiliated companies cannot be separated from an inquiry into the prudence of each affiliate's participation."[38]

The precedent is clear that transactions between affiliates should never be subject to a presumption of prudence. Affiliate transactions present too many opportunities for self-dealing and potentially fraudulent or inflated contracts. Consistent with the opinion of the Supreme Court of Missouri, presumptions of prudence in affiliated transactions are inconsistent with the PUCO's duty to prevent regulated entities from subsidizing their unregulated affiliates. Another relevant point from the decision of the Supreme Court of

---

[35] *Mich. Gas Utilities v. Mich. Pub. Serv. Comm.*, No. 206234, 199 Mich. App. LEXIS 1954, *6 (February 8, 1999).

[36] *Turpen v. Ok. Corp. Comm.*, 1988 OK 126, 769 P.2d 1309, 1320-21 (Okla. 1988).

[37] *US West Communications, Inc. v. Pub. Srv. Comm.*, 901 P.2d 270, 274, 1995 Utah LEXIS 46, 268 Utah Adv. Rep. 27 (Utah 1995).

Missouri was that the Commission cannot just shift the burden of proof when the rules explicitly state who must carry it, as is the situation in the case at bar. Even Justice Scalia would view affiliate transactions more carefully to ensure prudence. Finally, even the test which the PUCO adopted as its prudence standard is not applicable to affiliate transaction according to the very organization that oversees the research institute that published the test—NARUC. And the test which the PUCO relied upon in finding a presumption of prudence for utility decisions was created for a completely different situation. The paper is entitled "The Prudent Investment Test of the 1980's" and was designed to be applied to utility investment decisions, namely, investments in large power plants.[39] Accordingly, the Utilities have the burden of proving the reasonableness of their gas purchases and their gas purchasing policies and practices. The Utilities have failed to meet this burden and the PUCO should disallow certain gas costs as detailed below.

III. LAW AND ARGUMENT

A. The Utilities are Permitted to Collect From Customers the Prudent and Reasonable Cost of Gas that Result in Gas Cost Recovery Rates That are Fair, Just and Reasonable and Promote Minimum Prices Consistent With an Adequate Supply of Gas.

The Utilities argue that the PUCO Staff and the OCC are attempting to hold them to a higher standard -- a least cost standard, rather than the appropriate reasonable cost standard.[40] However, in making this allegation, the Utilities failed to cite the direct testimony of any PUCO Staff or OCC witness where this "least cost" standard was applied. In addition there is no citation to any transcript page where a PUCO Staff or

---

[38] *Miss. Power & Light Co. v. Miss.*, 487 U.S. 354, 382, 108 S. Ct. 2428, 101 L. Ed. 2d 322 (1988) (Scalia, J., concurring).

[39] "The Prudent Investment Test in the 1980s," NRRI-85-16, at 62 (April, 1985).

[40] Utilities Initial Brief at 16-17.

OCC witness made such a claim. The reason the Utilities did not make any record citation to support their claim is because they could not, because neither the PUCO Staff nor the OCC based their recommendations on a least cost standard.

A review of OCC witness Slone's testimony elicits exactly what Mr. Slone recommended:

> I recommend the Commission find that the gas costs for Northeast and Orwell during the 2012 Audit period were **not prudent and reasonable**. And I recommend that the PUCO order Northeast to refund $2,629,289 to GCR customers and Orwell to refund $117,382 to GCR customers for **excessive charges** for local production gas during the audit periods. In addition, I recommend that the PUCO order the Northeast and Orwell to terminate their gas purchase, agent and asset management contracts with affiliated companies, because these contracts had a **detrimental impact** on Northeast's and Orwell's residential customers' GCR. I also recommend that the Commission require Northeast and Orwell to discontinue the use of JDOG, or any affiliated company, to act as the gas purchase agent and asset manager. Specifically, I recommend the work currently outsourced to JDOG be done in-house by employees of Northeast and Orwell.
>
> With regard to the specific issue of re-pricing **the imprudent and unreasonable** gas purchases for the Utilities, I recommend that the intrastate gas supply from local gas producers provided by JDOG during the audit periods be re-priced. It should be re-priced based on the historic difference between the cost of interstate gas and the cost of local production gas prior to the insertion of JDOG in 2008 as the asset manager for both Northeast and Orwell, as discussed in greater detail below.[41]

As can be seen from Mr. Slone's testimony, there is no reference to a least cost standard, but instead he based his recommendation on the imprudence and unreasonableness of the Utilities' gas purchasing practices -- which is the standard as set forth in R.C 4905.302(E) and Ohio Admin. Code Rule 4901:1-14-08(B).

---

[41] OCC Ex. No. 12 at 6-7 (Direct Testimony of Greg Slone) (July 1, 2013). (Emphasis added).

The Utilities also allege that "the OCC and the Staff essentially conclude that the Companies' gas cost recovery rate was unreasonable **because** the Companies purchased from JDOG."[42] However, after making this accusation, the Utilities again failed to cite to any OCC or PUCO Staff testimony that supports this claim. The Utilities' allegation also falls flat in light of Mr. Slone's direct testimony which demonstrates the negative impact from the insertion of a Marketer -- JDOG -- into the Utilities' gas purchasing process for local production.[43] Mr. Slone did not testify that the price differential of $1.88 per Mcf occurred because JDOG was an affiliate. Rather he merely pointed out that the cost of local production when purchased by in-house personnel was significantly cheaper than when JDOG did the purchasing:

> As can be seen in Attachment 7, for the eight-year period from 2000 through 2007, Northeast purchased local production gas at an average rate that was $1.03 per Mcf less than the average cost of interstate gas supplies. However, after JDOG began purchasing local gas production for Northeast, for the five-year period from 2008 through 2012, the average cost of local gas averaged $0.85 per Mcf more than the average cost of interstate gas. This represents a total shift of $1.88 per Mcf after JDOG began purchasing local gas for Northeast and Orwell.[44]

Not only did the Utilities purchase local production gas using in-house personnel prior to 2008, but they did so at a considerable savings compared to JDOG's results.[45] Even more troubling is that the Utilities' management manipulated personnel so that many of the same individuals who previously did the purchasing for the Utilities went on

---

[42] Utilities Initial Brief at 17.

[43] OCC Ex. No. 12 at 18 (Direct Testimony of Greg Slone) (July 1, 2013).

[44] OCC Ex. No. 12 at 18 (Direct Testimony of Greg Slone) (July 1, 2013).

[45] OCC Ex. No. 12 at 18 (Direct Testimony of Greg Slone) (July 1, 2013).

to work for the affiliate Marketer -- JDOG -- that ultimately sold gas to the Utilities at a higher price than the Utilities were able to purchase when using in-house personnel.[46] Moreover, there can be no pretense that the affiliate personnel have greater experience or expertise than the in-house personnel, because they are one and the same.[47] The only difference is that they now work for the affiliate instead of the Utilities, and their services are now more costly.

When the fact that the Utilities paid more for local production after JDOG was inserted into the purchasing process is combined with the PUCO Staff conclusion that JDOG was charging the Utilities more for local production gas despite not paying more to local producers for local production,[48] and the manipulation of moving employees from one company to another -- the reasonable fact-based retrospective conclusion is that the Utilities paid too much for local production gas. The fact that the Utilities paid too much is the imprudence. The fact that the Utilities paid their own affiliate too much exacerbates the imprudence. The PUCO should adopt the disallowance recommendations made by the OCC because the Utilities' GCR during the Audit Periods was inflated, and thus not fair, just or reasonable.

B. OCC's Re-Pricing of Local Production is Reasonable and Should be Adopted by the PUCO.

The PUCO should re-price the Utilities' local production using the prices recommended by Mr. Slone in order for the GCR rates to be fair, just and reasonable. As demonstrated by the PUCO Staff in the Audit Report, and by Mr. Slone, the Utilities paid

---

[46] PUCO Staff Initial Brief at 4.

[47] PUCO Staff Initial Brief at 4.

[48] PUCO Staff Initial Brief at 6.

too much for their local production gas supply. Re-pricing is necessary to ensure that GCR customers are not over-charged for their natural gas purchases. The Utilities argue that the re-pricing methodology set forth by OCC witness Slone is unreasonable because it included information outside the Audit Periods and because the methodology he used relied on an arithmetic average instead of a weighted average.[49] The Utilities also argue that Mr. Slone essentially compared the Utilities' GCR rates to those of three small LDCs.[50] The Utilities are wrong on all three counts.

First, Mr. Slone demonstrated that during the eight year period of 2000-2007, the Utilities were able to purchase local production gas using in-house personnel at an average cost of $1.03 per Mcf **less** than the cost of interstate gas.[51] Yet after the Utilities' affiliate Marketer -- John D. Oil and Gas Marketing ("JDOG")[52] -- was inserted into the gas procurement process as a middleman, for the period of 2008-2012, the average cost of local production was $0.85 per Mcf **more** than intestate gas.[53] Although the Utilities disputed the use of the period 2008-2012[54] as part of Mr. Slone's analysis, the Utilities did not dispute any other aspect of the analysis. It is the $1.88 shift in cost that constitutes imprudent and unreasonable gas purchasing by the Utilities.

---

[49] Utilities Initial Brief at 28-29.

[50] Utilities Initial Brief at 28.

[51] OCC Ex. No. 12 at 18 (Direct Testimony of Greg Slone) (July 1, 2013).

[52] Throughout the 2010 GCR Cases (Case Nos. 10-209-GA-GCR and 10-212-GA-GCR) and these proceedings John D. Oil and Gas marketing, LLC was referred to as JDOG. However, in these cases it was noted that there is a John D. Oil and Gas marketing, LLC and also a john D. Oil and Gas [Tr. Vol. II at 307-309 (Howell) (July 9, 20132)]. It is OCC's understanding that all references to JDOG refer to John D. Oil and Gas Marketing, LLC. Also, the PUCO Staff has identified JDOG as JDOGM.

[53] OCC Ex. No. 12 at 18 (Direct Testimony of Greg Slone) (July 1, 2013).

[54] Utilities Initial Brief at 28-29.

Regarding the argument that Mr. Slone's methodology used a time frame outside the Audit Periods, the Utilities' argument is myopic. Using the longer time period of 2000-2007 provides an eight-year period during which the Utilities purchased local production gas using in-house personnel. Using the entire five-year period (2008-2012) that JDOG has been purchasing local production gas for the Utilities provides the most complete record of gas purchasing activities since the Utilities stopped using in-house personnel to make their local production gas purchases. The Utilities argue that to analyze the impact of JDOG's purchase of local production gas, Mr. Slone should have used a different time period (2009-2011) which would result in a $0.59 per Mcf difference instead of $0.85 per Mcf.[55] However, limiting the analysis to the shorter time period would reduce the number of data points in the analysis which would have the effect of increasing the impact of any individual data point from the shorter time period. The eight-year period is a reasonable reflection of the cost of gas during the time period that in-house personnel did the purchasing, before JDOG was inserted into the process. The longer period also provides a more accurate reflection of gas costs during that time period because it lessens the impact of any one-year anomaly.

In addition, while the Utilities criticize the use of the longer time period, the use of shorter time period (by the Utilities) still results in a concession of the fact that in-house personnel were able to purchase local production at a lower cost than JDOG. The question then becomes one of not whether the Utilities in-house personnel were able to do a better job purchasing local production gas -- but rather -- how much better.

[55] Utilities Initial Brief at 28-29.

Second, the Utilities' criticism that Mr. Slone used an arithmetic average rather than a weighted average is equally specious. In regard to this criticism, the Utilities do not offer any analysis of what the impact using the weighted average would be compared to use of the arithmetic average. And the Utilities do not offer any explanation as to how a weighted average might be calculated, or why a weighted average is superior to the arithmetic average. Thus, this criticism is nothing more than a red herring offered to confuse the issue, not to refute it.

Third, the Utilities are wrong in their claim that Mr. Slone's comparison was "essentially a comparison to the local gas purchases of three local distribution companies ("LDCs"): Piedmont Gas Co. ("Piedmont"), Ohio Cumberland, and Eastern Natural Gas ("Eastern").[56] Rather, Mr. Slone's comparison was one of the impact of local production gas on each of the LDC's GCR rates.[57] Based on his review of the other three LDCs, Mr. Slone concluded that local production gas was priced lower than interstate gas, a fact that both Utilities witnesses Whelan[58] and Patton[59] acknowledged. OCC witness Slone's analysis then compared the price the Utilities paid for local production gas during 2000-2007 (when in-house personnel were doing the purchasing) to the period 2008-2012 (when JDOG was doing the purchasing).[60]

A factual retrospective analysis indicates that the Utilities personnel were able to purchase local production gas at a lesser cost than through their affiliate JDOG. The

---

[56] Utilities Initial Brief at 28.

[57] OCC Ex. No. 12 at 15-17 (Direct Testimony of Greg Slone) (July 1, 2013).

[58] Tr. Vol. I at 42-43 (Whelan) (July 8, 2013).

[59] Tr. Vol. II at 259-269 (Patton) (July 9, 2013).

[60] OCC Ex. No. 12 at 15-17 (Direct Testimony of Greg Slone) (July 1, 2013).

record also shows that during 2008-2012 the Utilities paid JDOG Fees for interstate services that were not provided, because the Utilities did the function in-house.[61] Thus re-pricing the local production gas (in accordance with the recommendation of OCC witness Slone) is a reasonable step to protect customers from the unfair, unjust and unreasonable results of the Utilities' imprudent behavior.

C. Customers Should Not Pay $145,363 for Gas Processing Paid to Cobra Because the Gas Was Not Processed by Cobra.

OCC also identified other imprudent actions by the Utilities regarding charges paid to affiliates for services that were not provided. There is no set of circumstances under which paying for a service that was not provided is reasonable -- whether the payment is made to an affiliate or a non-affiliate. The fact that an affiliate is involved in the transaction only exacerbates the imprudence.

There is nothing in any of the direct testimony filed by the Utilities that supports the $145,363 in Processing Fees paid to Cobra, because there is no proof that any of the gas was actually processed at the plant. Rather, the testimony of numerous Utilities witnesses confirms that the Utilities simply do not know if the gas was processed. Northeast's past Vice President, and now President, Mr. Whalen, testified that he did not know if all of the local production gas used by Northeast's customers on the Churchtown system actually flowed to the Processing Plant and were actually processed:[62]

> Q. **Is it possible that you pay the fee to Cobra for gas that is not processed?**
>
> A. **I don't know?**[63]

[61] See Section III D below.

[62] Tr. Vol. I at 51 (Whalen) (July 8, 2013).

[63] Tr. Vol. I at 51 (Whalen) (July 8, 2013) (Emphasis added).

If the Utilities do not know if the gas was actually processed, then they cannot prove that it was processed.

While he did not know if the gas was processed, Utilities witness Whalen acknowledged that all of the gas volumes on the Churchtown system were charged the $0.25/Dth processing fee.[64] Northeast's Chief Administrative Officer, Stephanie Patton, acknowledged receiving bills from Cobra for processing.[65] Ms. Patton, similarly did not know if any of the gas actually went to the Processing Plant or was actually processed.[66]

Later in the hearing, when asked by the Attorney Examiner if any gas that was sold to Northeast's customers was actually processed at the Cobra Processing Plant, Mr. Whalen stated that none of the gas went to the Processing Plant and thus was not processed:

> Q. Do you know how much of the gas on the Cobra system goes through the processing plant before it goes to customers?
>
> A. Whose customers?
>
> Q. Northeast customers?
>
> A. **None of it**.[67]

Thus, while it is undisputed that the Processing Fee was paid, Northeast has not proven that any of the gas was actually processed. The Utilities made no claim that any gas was actually processed at the Cobra Processing Plant, thus the Cobra Processing Fee of $145,363 should be disallowed.

---

[64] Tr. Vol. I at 54 (Whalen) (July 8, 2013).

[65] Tr. Vol. II at 243 (Patton) (July 9, 2013), see also OCC Ex. No. 2 (Cobra Monthly Invoices).

[66] Tr. Vol. II at 243 (Patton) (July 9, 2013).

[67] Tr. Vol. I at 102-103 (Whalen) (July 8, 2013) (Emphasis added).

D. Customers Should Not Have to Pay the $645,906.06 in JDOG Fees for Interstate Services That Were Not Provided.

Customers should not have to pay the $645,906.06 in JDOG Fees for interstate services that were not provided. One of the key work requirements of the contract[68] is that JDOG is to do the nominating, scheduling and confirmations on Columbia Gas Transmission Corporation ("TCO").[69] Yet the record indicates that JDOG was not performing the services outlined in its contract with the Utilities. Instead, the Utilities witness Patton testified that she does the nominating, scheduling and confirmations on TCO.[70]

> Q. **Who does the nominating, scheduling, and confirming of gas volumes on TCO? Is that you or Mr. Zappitello?**
>
> A. **That's me**.
>
> Q. And how do you do that? Is that done electronically? Over the phone?
>
> A. Yeah. Columbia Gas Transmission is electronically.
>
> Q. **And you do that on a daily basis?**
>
> A. **Maybe every other day.**[71]

---

[68] OCC Ex. No. 6 (Utilities Responses to OCC Discovery, Attachment 6 "Duties Performed by John D. Oil and Gas Marketing).

[69] Tr. Vol. II at 246 (Patton) (July 9, 2013).

[70] Tr. Vol. II at 246 (Patton) (July 9, 2013).

[71] Tr. Vol. II at 246 (Patton) (July 9, 2013).

The Utilities witness, Gas Natural Controller, Rebecca Howell, also acknowledged that JDOG was not providing the service for which the Utilities paid:

> Q. **But you signed -- when you signed this contract, it was your intent that J.D. Oil and Gas Marketing would do all of the scheduling, nominating, and performing other services on TCO so that Northeast Oil would not have to do it themselves?**
>
> A. **Yes.**
>
> Q. **So to the extent that Northeast is actually doing it themselves, you're not enforcing this contract with your affiliate to do their job, are you?**
>
> A. **I did not know that he wasn't doing that.**[72]

There is nothing in the record that contradicts this testimony. The Utilities had an opportunity to present rebuttal testimony refuting this claim, but they filed no rebuttal testimony on this issue. In fact, although Ms. Howell filed rebuttal testimony, she did not address this issue.[73]

The PUCO Staff also determined that a portion of JDOG Fees for local production services paid by Northeast ($368,000) were unreasonable in part because PUCO Staff believed that the Utilities' in-house employees were performing most of the functions necessary to obtain gas from non-Cobra and Gatherco sources.[74] Thus, there seems to be a pattern of the Utilities paying various fees or charges to their affiliates for services they did themselves or for services that were not provided.

---

[72] Tr. Vol. II at 321-322 (Howell) (July 9, 2013) (Emphasis added).

[73] Utilities Ex. No. 8 (Rebuttal Testimony of Rebecca Howell) (July 22, 2013).

[74] PUCO Staff Initial Brief at 8.

In addition to paying JDOG Fees for interstate services not provided, the $645,906.06 should be disallowed because there is no evidence on the record to suggest that the Utilities received any value for those JDOG interstate Fees. Thus again, based on a retrospective factual inquiry, it is clear that JDOG did not provide the service contracted for, thus the JDOG interstate Fees are imprudent and should not be collected from the Utilities' customers.

E. The Request For Proposal Process Was Flawed and Did Not Produce a Competitive Result.

1. There is No Evidence to Support the Utilities' Claim That the PUCO Cannot Determine Whether the RFP Process Had a Competitive Result in These Proceedings.

The PUCO has acknowledged that it "has an obligation to rely on the evidence admitted into the record, not any party's brief, to justify its conclusions." The Utilities argue in their Initial Brief that "it is impossible to determine whether the result of the (Request for Proposal) RFP was fair and competitive at this time because the audit period of the gas purchases of the RFP's successful bidder is currently on-going."[75] But there is no evidence in the record to support this claim.

In fact, this statement (that it is impossible to determine whether the result of the RFP was fair and competitive now because the audit period of the gas purchases of the RFP's successful bidder is currently on-going) completely contradicts the testimony of the Utilities' past Vice President and now President. Specifically, Mr. Whalen testified that the RFP produced a competitive bid because the RFP process was fair.[76] But during cross-examination, Mr. Whalen acknowledged that not only had the Utilities not done any

---

[75] Utilities Initial Brief at 3.

[76] Tr. Vol. I at 120 (Whalen) (July 8, 2013).

actual analysis to determine if the RFP result was competitive, but that he did not even know why no analysis was done.[77]

> Q. Did you do any analysis to determine if the end price from that single bid was truly a market-based competitive price?
>
> A. No.
>
> Q. And why not?
>
> A. I don't know.[78]

Any notion that the PUCO cannot now determine whether the RFP process had a competitive result has only now been raised for the first time through the Utilities' Initial Brief and is not supported by any evidence in the record. Because the Utilities are only raising this issue in their Initial Brief, the argument is not supported by evidence and should be rejected by the PUCO.

2. The Vectren GCR Case Supports a PUCO Decision to Re-Price the Utilities' Local Gas Purchases and to Reject the RFP.

The Utilities reliance on the Vectren GCR Case is misplaced because the Vectren GCR Case is an example of why the PUCO should find that the Utilities' actions in these cases were imprudent. In the Vectren GCR Case, the PUCO concluded that the contract between Vectren, the utility, and its affiliate ProLiance, was not an arm's length agreement.[79] However, the conclusion of imprudence was not based on the affiliate relationship.[80] Rather, the conclusion of imprudence was based on evidence produced at

[77] Tr. Vol. I at 121 (Whalen) (July 8, 2013).

[78] Tr. Vol. I at 121 (Whalen) (July 8, 2013).

[79] Vectren GCR Case, Opinion and Order at 17 (June 14, 2005).

[80] Vectren GCR Case, Opinion and Order at 17 (June 14, 2005).

the hearing.[81] To that end, the PUCO concluded that Vectren awarded the asset management contract to ProLiance without any consideration given to any other party.[82] In these current cases there is evidence that the Utilities structured the RFP bid so that their affiliate would have an advantage in the bidding process.[83] To the extent that there was already history from the prior Audit Periods that the affiliate relationship with JDOG was not a benefit for customers, the decision to include the affiliate in the bidding was prejudicial. In both the Vectren GCR Case and in these cases, the end result was that the affiliate was awarded a contract to the detriment of the GCR, thus, warranting a disallowance.

In the Vectren GCR Case, the PUCO concluded that in evaluating the current ProLiance agreement in comparison to the prior agreement with Columbia Energy Services, there was evidence that Vectren's evaluation did not include a complete market value consideration.[84] In these cases, the Utilities, through Mr. Whalen, have acknowledged a lack of any market evaluation.[85] Thus, again, in both cases, a lack of analysis of the competitive market for services to be purchased led to an inflated GCR.

In both instances the affiliate relationship is not the basis for the imprudence. Rather, the imprudence is based on actions that caused the GCR rate to be greater than it should have been. In both cases, the participation of the affiliate in the transaction serves to exacerbate the imprudent action. In the case of Northeast and Orwell, the imprudent

[81] Vectren GCR Case, Opinion and Order at 18 (June 14, 2005).

[82] Vectren GCR Case, Opinion and Order at 18 (June 14, 2005).

[83] OCC Ex. No. 12 at 13 (Direct Testimony of Greg Slone) (July 1, 2013); Staff Ex. No. 1 at 4-5, 11 (Direct Testimony of Patrick Donlon) (July 1, 2013).

[84] Vectren GCR Case, Opinion and Order at 18 (June 14, 2005).

[85] Tr. Vol. I at 120 (Whelan) (July 8, 2013).

affiliate actions justify the disallowances recommended by the OCC as well as the penalties recommended.[86]

F. Regardless of the Time Period, the Utilities' Actions Were Imprudent

The Utilities argue that they were prejudiced because the PUCO Staff improperly changed the Audit Periods.[87] The Utilities argue that they were prejudiced because the Audit Period for Northeast had already ended when the PUCO issued its Opinion and Order in the 2010 GCR Cases on October 23, 2011.[88] The prejudice claimed by the Utilities is that they were somehow held to a higher standard because of the actual time frame of the Audit Periods.[89] The Utilities make this broad general statement, but then fail to demonstrate the specifics of any actual harm or prejudice from this action.

In fact, a review of the record demonstrates that the Utilities' imprudent behavior was pervasive from the 2010 GCR time period through the current Audit Periods from March 1, 2008 through June 30, 2012.[90]

G. The Utilities' Analysis that Their Gas Procurement Policy for Local Production was Reasonable and Prudent Should be Rejected by the PUCO Because it is Flawed.

The Utilities argue that the analysis and testimony of their expert, Dr. Overcast, demonstrates that, based on market conditions during the Audit Periods, the Utilities'

---

[86] OCC Initial Brief at 30-39.

[87] Utilities Brief at 12-16.

[88] Utilities Brief at 15.

[89] Utilities Brief at 15.

[90] For Northeast the 2010 GCR Audit Period was from March 1, 2008 through February 28, 2010, and the current Audit Period is March 1, 2010 through February 29, 2012. For Orwell the 2010 GCR Audit Period was July 1, 2008 through June 30, 2010, and the current Audit Period is July 1, 2010 through June 30, 2012.

purchases were reasonable and prudent.[91] This claim is not supported by the record. In making his analysis, Utilities witness Dr. Overcast assigned interstate demand charges for transportation and storage only to Interstate gas.[92] However, this was wrong, because testimony from the Utilities' own witnesses (Mr. Whalen) indicated that local production gas was also injected into storage.[93] Thus, Dr. Overcast's analysis understated the cost of local production gas, because the local gas injected into storage required the use of the interstate transportation and storage services that Dr. Overcast's analysis only charged to interstate gas.

In addition, the PUCO Staff Initial Brief noted that Staff witness Roger Sarver explained the inaccuracies in Dr. Overcast's Schedule 1, which had the impact of inflating the cost of Interstate gas.[94] The Utilities failed to rebut Mr. Sarver's testimony and his correction of Dr. Overcast's analysis.[95] Therefore, the Utilities' analysis is incorrect and should not be relied upon by the PUCO in rendering its decision.

IV. CONCLUSION

Throughout the current Audit Periods and the prior Audit Periods, the Utilities have engaged in behavior that has inflated the GCR resulting in unfair, unjust and unreasonable rates for customers. Exacerbating the Utilities' imprudence has been the fact that the actions also involved the Utilities' affiliates. Accordingly, the PUCO should order disallowances of $561,719 for the re-pricing of over-priced local gas, $145,363 for

---

[91] Utilities Initial Brief at 17.

[92] Utilities Ex. No. 5 at 4 (Direct Testimony of Dr. Overcast) (June 21, 2013). ; Tr. Vol. II at 436-437(Overcast) (July 9, 2013).

[93] Tr. Vol. II at 443 (Overcast) (July 9, 2013).

[94] Staff Initial Brief at 13, citing Staff Ex. No. 2 at 23-24 (Direct Testimony of Roger Sarver) (July 1, 2013).

[95] Staff Initial Brief at 13, citing Staff Ex. No. 2 at 23-24 (Direct Testimony of Roger Sarver) (July 1, 2013).

the Cobra Processing Fee for services not provided and $647,906.06 for the JDOG Fees for interstate services not provided. In addition, as detailed in OCC Initial Brief, the PUCO should order the Utilities to terminate the asset management agreement and to adopt the PUCO Staff recommendations for a new RFP, and impose no less than $220,000 in penalties as a result of the numerous statutes that the Utilities' actions violated.

Respectfully submitted,

BRUCE J. WESTON
OHIO CONSUMERS' COUNSEL

/s/ Joseph P. Serio
Joseph P. Serio, Counsel of Record
Assistant Consumers' Counsel

Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
Serio Phone: (614) 466-9565
serio@occ.state.oh.us

CERTIFICATE OF SERVICE

I hereby certify that a copy of the *Reply Brief by the Office of the Ohio Consumers' Counsel* was provided to the persons listed below, electronically, this 30th day of August, 2013.

/s/ Joseph P. Serio
Joseph P. Serio
Assistant Consumers' Counsel

PARTIES OF RECORD

Werner L. Margard III
Devin Parram
Assistant Attorneys General
Public Utilities Section
180 East Broad Street, 6th Floor
Columbus, Ohio 43215
Werner.margard@puc.state.oh.us
Devin.parram@puc.state.oh.us

AE: scott.farkas@puc.state.oh.us

Mark S. Yurick
Zachary D. Kravitz
Taft, Stettinius & Hollister LLP
65 East State Street, Suite 1000
Columbus, Ohio 43215
myurick@cwslaw.com
zkravitz@cwslaw.com

Erik L. Walter
Dworken & Bernstein Co., LPA
60 South Park Place
Painesville, Ohio 44077
ewalter@dworkenlaw.com

This foregoing document was electronically filed with the Public Utilities

Commission of Ohio Docketing Information System on

8/30/2013 3:53:15 PM

in

Case No(s). 12-0209-GA-GCR, 12-0212-GA-GCR

Summary: Brief Reply Brief by the Office of the Ohio Consumers' Counsel electronically filed by Patti Mallarnee on behalf of Serio, Joseph P.