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 and Orwell Natural Gas Company.	)))))	Case No. 12-209-GA-GCR Case No. 12-212-GA-GCR
In the Matter of the Regulation of the Uncollectible Expense Riders of Northeast Ohio Natural Gas Corporation and Orwell Natural Gas Company.	)))))	Case No. 12-309-GA-UEX Case No. 12-312-GA-UEX

OPINION AND ORDER

The Commission, having considered the evidence of record, and being otherwise fully advised, hereby issues its Opinion and Order.

APPEARANCES:

Taft, Stettinius & Hollister, LLP, by Mark S. Yurick and Zachary D. Kravitz, 65 East State Street, Suite 1000, Columbus, Ohio 43215, and Dworken & Bernstein Co., L.P.A., by Erik L. Walter, 60 South Park Place, Painesville, Ohio 44077, on behalf of Northeast Ohio Natural Gas Corporation and Orwell Natural Gas Company.

Mike DeWine, Ohio Attorney General, by Werner L. Margard III and Devin Parram, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of Staff of the Public Utilities Commission of Ohio.

Bruce E. Weston, Ohio Consumers' Counsel, by Joseph P. Serio and Larry S. Sauer, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215-3485, on behalf of the residential customers of Northeast Ohio Natural Gas Corporation and Orwell Natural Gas Company.

BACKGROUND AND DISCUSSION:

I. Overview of this Opinion and Order

In this Opinion and Order, we first review the statutory requirements and the burden of proof in the purchased gas adjustment or gas cost recovery (GCR) proceedings, Northeast Ohio Natural Gas Corporation (Northeast), Case No. 12-209-

GA-GCR (12-209), and Orwell Natural Gas Company (Orwell), Case No. 12-212-GA-GCR (12-212) (*2012 GCR Audit Cases*) (Northeast and Orwell are jointly referred to as the Companies). Next we provide the history of the GCR proceedings, a brief overview of the origin and relationship of the Companies, their affiliates, and related entities. Next, in order to provide a perspective on the parties and issues in the GCR proceedings, we review the issues from the Companies' GCR audits in Case Nos. 10-209-GA-GCR and 10-212-GA-GCR (*2010 GCR Audit Cases*), the stipulation intended to address those issues, as well as the directives of the Commission from those cases. Then, we turn to the *2012 GCR Audit Cases* , as well as the proceedings associated with the Companies' uncollectible expense (UEX) rider audits in Case Nos. 12-309-GA-UEX and 12-212-GA-UEX (*2012 UEX Audit Cases*).[1]

Because all of the findings and recommendations of the 2012 *UEX Audit Cases* and the findings and recommendations of the sections of the *2012 GCR Audit Cases* for the refund and reconciliation adjustment (RA), balance adjustment (BA), customer billing, unaccounted for gas (UFG), and certain portions of the actual adjustment (AA), were noncontested, we present those findings and recommendations next. Finally, the Opinion and Order sets forth the principal issues in dispute including the development and implementation of the request for proposal (RFP) undertaken by the Companies, and the portion of the calculation of the AA for the purchases of local production, as well as issues raised by the Ohio Consumers' Counsel (OCC) and Staff related to the fees charged by John D Oil and Gas Marketing (JDOG) for gas purchases, the charges for processing gas on the Cobra Pipeline Co., LTD (Cobra) system, the organizational structure and management of the Companies, and, finally, certain allegations related to the propriety of GCR filings of the Companies.

In this Opinion and Order, we find that, during the GCR audit period, the Companies failed to demonstrate that their purchasing policies and procedures were fair, just, and reasonable or that they resulted in minimum gas prices. We find that Staff's recommendation as to the adjustments for this audit period were reasonable and appropriate and should be applied to the Companies for this audit. We find that the Companies' RFP for the purchase of gas was flawed in design and implementation. Further, we find that the Companies paid a processing fee to an affiliate for gas that was not processed, that insufficient evidence was presented to warrant fees paid to the Companies' affiliate JDOG, and that Orwell provided transportation service to residential customers without proper tariff authority. Lastly, we review evidence, related to the management structure, personnel responsibilities

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1 *In re Northeast Ohio Natural Gas Corp.* and *Orwell Natural Gas Company*, Case Nos. 10-209-GA-GCR and 10-212-GA-GCR (*2010 GCR Audit Cases* and 10-309-GA-UEX and 10-213-GA-UEX (*2010 UEX Audit Cases*, Opinion and Order (January 23, 2012).

and decisions and practices of and between the Companies and their affiliates, and the Companies' management structure, all of which raise sufficient legitimate concerns warranting an investigative audit be undertaken of the Companies, as well as all affiliates and related companies.

II. Background of GCR Proceedings

A. GCR Requirements and Burden of Proof

Pursuant to R.C. 4905.302(C), the Commission promulgated rules for a uniform purchased gas adjustment clause to be included in the schedules of gas or natural gas companies subject to the Commission's jurisdiction. Northeast and Orwell are natural gas companies, as defined in R.C. 4905.03, and public utilities under R.C.4905.02. These rules, which are contained in Ohio Adm.Code 4901:1-14, separate the jurisdictional cost of gas from all other costs incurred by a gas or natural gas company and provide for each company's recovery of these costs.

R.C. 4905.302 also directs the Commission to establish investigative procedures, including periodic reports, audits, and hearings, to examine the arithmetic and accounting accuracy of the gas costs reflected in each company's GCR rates, and to review each company's production and purchasing policies and their effect upon these rates. Pursuant to such authority, Ohio Adm.Code 4901:1-14-07 requires that periodic financial audits of each gas or natural gas company be conducted. Ohio Adm.Code 4901:1-14-08(A) requires the Commission to hold a public hearing at least 60 days after the filing of each required audit report, and Ohio Adm.Code 4901:1-14-08(C) specifies that notice of the hearing be provided in one of three ways at least 15 days, but not more than 30 days, prior to the date of the scheduled hearing.

Ohio Adm.Code 4901:1-14-07(C) provides that the purpose of the audit is to determine the following:

(1) The costs reflected in the gas or natural gas company's gas cost recovery rates were properly incurred by the company;

(2) The gas cost recovery rates were accurately computed by the gas or natural gas company;

(3) The gas cost recovery rates were accurately applied to customer bills; and

(4) If the company utilized weather-normalized historic and/or forecasted volumes, the auditor shall verify that the company has reasonably applied such approach throughout the audit period.

At the hearing, the natural gas company has the burden to demonstrate that its gas purchasing policies and procedures are fair, just, and reasonable, and result in minimum gas prices. Ohio Adm.Code 4901:1-14-08(B) provides that:

> The gas or natural gas company shall demonstrate at its purchased gas adjustment hearing that its gas cost recovery rates were fair, just, and reasonable and that its gas purchasing practices and policies promote minimum prices consistent with an adequate supply of gas.

The Supreme Court of Ohio has held that a prudent decision by an electric distribution utility is a decision "which reflects what a reasonable person would have done in light of conditions and circumstances which were known or reasonably should have been known at the time the decision was made." *Cincinnati Gas & Elec. Co. v. Pub. Util. Comm.*, 86 Ohio St.3d 53, 58, 711 N.E.2d 670 (1999), *citing Cincinnati v. Pub. Util. Comm.*, 67 Ohio St.3d 523, 530, 620 N.E.2d 826 (1993). Additionally, the Commission has previously found that "[p]rudence should be determined in a retrospective, factual inquiry." *In re Syracuse Home Utils. Co.*, Case No. 86-12-GA-GCR, Opinion and Order (Dec. 30, 1986), at 10. Our determination that the Companies bear the burden of proof in these proceedings is also consistent with the Supreme Court of Ohio's recent holding in *In re Duke*, 131 Ohio St.3d 487, 967 N.E.2d 201, at ¶ 8, where Duke Energy Ohio, Inc. (Duke) sought reimbursement for roughly $30.7 million in costs associated with damages caused by Hurricane Ike and the Commission had limited Duke's recovery to only $14.1 million. In its appeal to the Court, Duke argued that "other parties did not conclusively prove that the claimed expenses were unreasonable or imprudent." In upholding the Commission's decision, the Court established that it is the utility that has to "prove a positive point: that its expenses had been prudently incurred and that the Commission did not have to find the negative: that the expenses were imprudent" and it rejected any presumption of prudence on the part of the utility.

Thus, in these cases, it is the Companies' burden to demonstrate that their gas purchasing policies and procedures were prudent. Notwithstanding that burden, we emphasize that, although the Companies ultimately bear the burden of proof in these proceedings, the Commission should presume that the Companies' management

decisions were prudent. Nevertheless, we emphasize that, as discussed in *Syracuse*, the presumption that a utility's decisions were prudent is rebuttable, and evidence produced by Staff or interveners may overcome that presumption.

B. History of *2012 GCR Audit Cases*

By entry issued January 23, 2012, the Commission initiated the *2012 GCR Audit Cases* for Northeast and Orwell, established the GCR audit periods, directed Staff to conduct financial audits, and established the date upon which the GCR audit reports must be filed. The GCR audit period for Northeast was March 1, 2010, through February 29, 2012, and the audit period for Orwell was July 1, 2010, through June 30, 2012. In the same entry, the Commission scheduled the hearing for February 19, 2013. By entry issued January 23, 2013, the attorney examiner granted Staff's motion for a continuance of the hearing until April 30, 2013, granted Staff's motion for an extension of time to file the staff report, granted the motion to intervene in 12-209 and 12-212 filed by OCC, and granted the Companies' motion for an extension of time to publish legal notice of the hearing. The UEX audit reports of Northeast (Comm. Ord. Ex. 2) and Orwell (Comm. Ord. Ex. 3) were filed on December 7, 2012, and February 14, 2013, respectively. The GCR audit report of the Companies (Comm. Ord. Ex. 1) was filed on February 28, 3013.

By entry issued April 29, 2013, the attorney examiner continued the hearing until July 8, 2013. By entry issued June 13, 2013, the attorney examiner denied the motion filed by the Companies to continue the hearing and extend the procedural schedule. On July 3, 2013, the Companies filed proof of publication of the legal notice of the hearing required by Ohio Adm.Code 4901:1-14-08. The hearing was held on July 8, 9, 10, and 22, 2013. The parties filed initial briefs on August 19, 2013, and reply briefs on August 30, 2013.

C. Background of Northeast and Orwell

Northeast and Orwell are local distribution companies (LDCs) serving portions of Ohio, as well as related companies sharing common corporate status. As of June 2012, Northeast served approximately 14,100 residential and 1,060 commercial customers on its noncontiguous systems through interconnects with two interstate pipelines, two intrastate pipelines, one LDC, and local production. At the same time period, Orwell served approximately 7,230 residential and 860 commercial customers on four noncontiguous systems through interconnects with two intrastate pipelines, one LDC, and local production. Northeast also provides transportation service to 42 customers and Orwell provides transportation service to 93 customers. (Comm. Ord. Ex. 1 at 7-8.)

Northeast was founded in 1986. Portions of Northeast's operations were obtained from the former Ellis T. Myers Company pursuant to the Commission's December 16, 1986 finding and order in Case No. 86-2198-GA-ATR. Historically, Northeast and its predecessor operations relied upon the availability of local production to serve its customers' requirements. Since 1986, Northeast has increasingly relied upon interstate natural gas transmission pipelines to meet the needs of its growing customer base. (Comm. Ord. Ex. 1 at 7.)

In 1996, Northeast was acquired by Marbel Energy Corporation (Marbel). In 1998, Marbel was acquired by FE Holding, LLC, in a joint venture between FirstEnergy Corporation (FirstEnergy) and Belden & Blake Corporation (B&B), of which both FirstEnergy and B&B were equal owners. In June 2003, Northeast was purchased by Great Plains Natural Gas Company (Great Plains) based in Mentor, Ohio. Great Plains was owned by Mr. Richard Osborne, the former Chairman and Chief Executive Officer (CEO) of Orwell. This sale was approved by the Commission in Case No. 03-1229-GA-UNC. (Comm. Ord. Ex. 1 at 7.)

Orwell is a small LDC serving customers in Ashtabula, Geauga, Lake, and Trumbull counties. Orwell was formed by Willard Scott in 1986 to serve the village of Orwell. In 1987, Orwell filed an application for approval of rules and regulation governing the distribution and sale of gas, which was approved by the Commission on February 29, 1988. In March 2002, Mr. Scott agreed to transfer all of Orwell's stock to Lightning Pipeline Company, Inc. (Lightning). The transfer of stock was approved by the Commission in Case No. 02-915-GA-UNC on May 21, 2002. Lightning stock was held primarily by Richard M. Osborne Trust (Osborne Trust). Mr. Osborne is the sole trustee of this Trust. (Comm. Ord. Ex. 1 at 7.)

On February 16, 2007, in Case No. 07-163-GA-ATA, Orwell filed an application to establish rates and tariffs in its unincorporated areas, along with the GCR filing with the Commission. Prior to this filing, Orwell did not file its GCR with the Commission but, instead, filed its rates with the municipalities that it served. On June 27, 2007, the Commission approved Orwell's application and established its initial GCR rate and case number for the filing of its GCRs. In Case No. 08-204-GA-GCR, Staff completed its initial GCR audit of Orwell. (Comm. Ord. Ex. 1 at 8.)

On October 28, 2008, Energy West Incorporated (Energy West), along with Orwell, Northeast, and Brainard Gas Corporation (Brainard), jointly filed an application with the Commission for approval to transfer stock. With approval of the application, all of the stock of the three Ohio gas utilities would be purchased by Energy West. On December 3, 2008, the Commission approved the transfer of stock.

In August 2009, Energy, Inc. completed reorganization into a holding company as the successor to Energy West, Inc., now a direct, wholly-owned subsidiary of Gas Natural, Inc. (Gas Natural). Gas Natural is a publicly traded company. Mr. Osborne is a major shareholder, CEO, and chairman of the board of Gas Natural. The Osborne Trust is the majority shareholder for the following companies: JDOG, Great Plains Exploration, LLC (GP Exploration), Cobra, and Orwell-Trumbull Pipeline Co., LLC (OTP). (Comm. Ord. Ex. 1 at 8.)

D. *2010 GCR Audit Cases*

During the *2010 GCR Audit Cases*, issues were raised about the Companies' gas purchases and dealings with related and affiliated companies. There were questions raised by Staff about whether the Companies were properly enforcing contract terms, the appropriateness of purchase price provisions, and overlapping contracts between Orwell, ONG Marketing, and JDOG. There were concerns that the Companies entered into service contracts with related parties that were unsigned, unexecuted, and/or executed in a fashion that exceeded the terms of the contracts, and this resulted in the Companies paying higher than normal prices for gas. There was evidence that some of Orwell's related companies were using Orwell's name, credit, and pipeline capacity to purchase supplies for Great Plains at discounted rates. There were also issues with the appropriateness of the Companies' corporate structure including individuals serving as gas executives for the regulated utility, while also functioning in the same capacity for the unregulated related party marketing company. Ultimately, Staff concluded that the Companies' decisions were driven by their affiliate/related parties' interests and, this, in part, resulted in higher purchased gas costs for their sales customers with minimal benefit to those customers. Staff also believed that the Companies had the personnel capable of performing the gas procurement functions and should procure interstate and local supplies on their own, and that an RFP should be developed by the Companies to solicit bids for an asset manager. (2010 Audit Report at 9-13.)

As part of the *2010 GCR Audit Cases*, Staff, OCC, and the Companies reached a stipulation that purported to resolve all of the outstanding issues, including concerns over related-party transactions. The stipulation, in relevant part, provided that: the Companies would terminate their effective contracts for purchases of local production and the arrangement of natural gas purchases; Gas Natural would act as a gas procurement manager; the contracts with JDOG would be terminated; the Companies would not permit the available lines of credit to be employed to acquire natural gas for nonutility affiliate companies or related parties; Gas Natural would coordinate with Staff and OCC in designing and implementing an RFP, and the selection criteria process that would be established through which gas purchases would be made by the

Companies; and that the intended date for the first competitive bidding process would be November 1, 2011.

In the Opinion and Order in the *2010 GCR Audit Cases*, the Commission approved the stipulation submitted by the parties intended to resolve the issues in the cases; however, we also expressed our concern about the Companies' failure to provide the appropriate consumer protections for the regulated ratepayers, as evidenced through Staff's GCR audit findings and the testimony presented at the hearing. We directed Staff to monitor closely the actions of the Companies to ensure their compliance with the rules and regulations, as well as the stipulation. In our Opinion and Order approving the stipulation in the *2010 GCR Audit Cases*, we stated:

> ...while the stipulation provides that Gas Natural will coordinate with Staff in designing and implementing the RFPs, and the selection criteria, Northeast and Orwell shall bear the ultimate responsibility for the RFPs and the selection process. These regulated companies, Northeast and Orwell, must ensure that the RFP process and selection criteria provide for an arms-length relationship with their affiliated companies, and result in the selection of a successful bidder that is in the best interest of the utility ratepayers. (Opinion and Order at 24.)

As noted in the 2012 GCR audit report, the drafting of the RFP for the competitive bidding process was not completed by the Companies until one year later, following which, the Companies' affiliate JDOG was selected by the Companies and continued to purchase gas for the Companies.

E. *2012 GCR Audit Cases*

The 2012 GCR audit report was filed on February 28, 2013. In conducting the 2012 audit of the Companies, Staff reviewed the GCR mechanisms for the effective GCR periods March 1, 2010, through February 29, 2012, for Northeast and July 1, 2010, through June 30, 2012, for Orwell. Based, in part, on information provided by the Companies, Staff recalculated the Companies' purchased gas costs, purchased volumes, customer billings, sales volumes, and informational items, such as number of customers and transportation through-put (Comm. Ord. Ex. 1 at 4). In the audit report, Staff first calculated the expected gas cost (EGC), which matches future gas revenue of the upcoming quarter with the anticipated cost to procure gas supplies. Next, Staff calculated the AA, which reconciles the monthly cost of purchased gas with

the EGC billing rate. Staff then calculated the RA which is used to pass-through the jurisdictional portion of refunds received from gas suppliers and adjustments ordered by the Commission. Staff then calculated the BA, which corrects for under- or over-recoveries of previously calculated AAs and RAs. Lastly, Staff reviewed the Companies' customer billing, UFG, and the RFP. In the GCR audit report, Staff made several findings, including:

(1) The unsolicited insertion of JDOG into the gas procurement function resulted in increased costs and little benefit;

(2) Little evidence was discovered that the Companies reviewed the pricing determinant in their bills, which resulted in substantial cost being borne by their customers. Staff only identified instances in which the service company, Gas Natural, compared billed prices to confirmation sheets, but no comparison to pricing in the market;

(3) The insertion of Gas Natural into the process for contractual adherence and review did not alleviate any of Staff's concerns;

(4) JDOG billed its agency/broker fees to the Companies for the entire audit and the Companies ceased seeking recovery of these fees through their GCRs as of September 2011.

Staff made the following recommendations:

(1) The Companies should examine on a monthly basis its least costs options for meeting its sales customers' requirements through its different supply sources;

(2) The Commission should adopt Staff's alternative pricing of local production; only Commission approved tariff provisions be offered to the Companies' customers;

(3) All costs for which the Companies seek to recover through their rates and or riders be closely examined;

(4) The Companies should use in their GCR filings their monthly sales volumes less free gas, as Staff had in its AA and BA calculations;

(5) Northeast's sales volumes of the months of March 2010 through May 2010 should be increased by 181,172 Mcf;

(6) The Commission should adopt Staff's calculations of the AA and BA for the Companies that include: an AA for Northeast of ($2,457,141) and ($234,801) for Orwell, both in the customers' favor, and a BA for Northeast of $2,201,2323 in the company's favor and a BA for Orwell of ($16,280) in the customers' favor.[2]

(7) Orwell should monitor its UFG levels as it changes out meter devices and adds new metering devices for system growth;

(8) The Commission find that the RFP process did not lead to competitive bids as required by the stipulation and as ordered by the Commission; the Commission should reject the results of the RFP process and order the Companies to start a new RFP process that includes the input of Staff, OCC, and the Companies' technical and operational staff;

(9) The bidder that was selected by the Companies be rejected and the Commission reject any RFP and bid selection that the Companies may initiate prior to the incorporation of Staff and OCC input.

(Comm. Ord. Ex. 1 at 4-6.)

III. OPINION AND CONCLUSION ON NONCONTESTED ISSUES

There are several issues not in dispute in these proceedings. First, there was no dispute with the findings and recommendations of the Staff related to the *UEX Audit Cases*. Also, the Companies did not dispute the portions of the financial audits involving the EGC, RA, BA, customer billing, UFG, and portions of the AA, related to interstate purchases, storage volumes, and sales volumes. The chief area of dispute in the GCR audits of the Companies involved the portion of the AA related to local

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[2] Throughout this Opinion and Order, amounts shown in parenthesis indicate negative numbers.

production and Staff's calculation of a proposed alternative premium for JDOG. First, we discuss the UEX proceedings.

A. *2012 UEX Audit Cases*

Consistent with R.C. 4929.11, the Commission authorized Northeast and Orwell to recover uncollectible expenses through UEX riders.[3] In approving the UEX riders for the Companies, the Commission required that these riders be audited in the course of each company's GCR audit. Therefore, by entry issued January 23, 2012, the Commission initiated both the GCR audits summarized above and the UEX rider audits in the *2012 UEX Audit Cases*. On December 7, 2012, Staff filed its audit for the UEX rider for Northeast, for the period January 2010 through December 2011, and on February 14, 2013, Staff filed its audit for the UEX rider for Orwell, for the period January 2010 through December 2011. The Companies did not dispute either the findings or recommendations of the UEX audit reports.

1. Northeast's UEX Audit

In the UEX audit for Northeast, Staff first reviewed and analyzed Northeast's collection practices and procedures. Residential, commercial, and industrial accounts are due 14 days after the billing date, and are subject to finance charges, if the payment is not made within that time frame. An examination of randomly sampled accounts confirmed Northeast's policy of providing ample time to allow payments to be made before finance charges were applied. Staff determined that sufficient attempts were made to collect on past due accounts. Staff also examined randomly selected accounts to verify Northeast's write-off policy which revealed that, during the audit period, Northeast's average number of days to write off an account is 352 days from the date of the last payment. In some cases, Northeast did not write off an account for a period of over two years, based on promises by the account holder or the owner to pay on the account. (Comm. Ord. Ex. 2 at 3.)

Staff also verified Northeast's monthly bad debt write-offs as contained in the annual balance reconciliation (ABR) filed with the Commission. In Northeast's 2010 UEX audit, Case No. 10-309-GA-UEX, (*2010 Northeast UEX Audit Case*) Staff recommended that Northeast have a January 2010 beginning balance of ($3,754.03).

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3 By Finding and Order issued on December 17, 2003, in *In the Matter of the Joint Application of The East Ohio Gas Company dba Dominion East Ohio, et al., for Approval of an Adjustment Mechanism to Recover Uncollectible Expenses*, Case No. 03-1127-GA-UNC, the Commission approved, in concept, an application brought jointly by five natural gas companies, including NEO, that proposed to alter the method by which the five recover uncollectible accounts expenses.

Staff concluded that Northeast complied with Staff's recommendation for the ABR. Staff also compared the write-offs with a bad debt report provided by Northeast which individually lists each account written off. No discrepancies were identified. In addition, Staff randomly selected several accounts from the bad debt report and requested billing histories for each account. Staff verified that, for each account selected, all but one account had the proper amount included in the bad debt report and that, for each account written off, no payment had been made for at least six months prior to writing off the account according to company policy. (Comm. Ord. Ex. 2 at 3.)

Staff examined recoveries resulting from the billing of the UEX rider. According to Staff, from January 1, 2010 through August 25, 2011, the approved UEX rider rate was $0.081 per thousand cubic feet (Mcf). In Northeast's 2011 UEX audit, *Northeast*, Case No. 11-3505-GA-UEX, Northeast applied for and was approved by the Commission to charge its UEX rider rate of $0.00 per Mcf. Northeast's tariff filing states that the current rate took effect on August 25, 2011. Staff also determined that Northeast did not accurately apply the amount of sales volumes with the previously Commission-approved UEX rider rate of $0.081 per Mcf for August 2011. Instead of applying the $0.00 per Mcf on August 25, 2011, Northeast began to apply the new rate on or about August 10, 2011. Additionally, Northeast periodically charged the former rate to accounts throughout the month. Further, Northeast reported recoveries of $1,845.98. Staff determined that, had Northeast applied the UEX rider properly, the correct amount of recoveries would have been $3,282.61, a difference of $1,436.63. (Comm. Ord. Ex. 2 at 3-4.)

In the *2010 Northeast UEX Audit Case*, Staff's investigation determined Northeast did not use accurate sales volumes which resulted in an over-reporting of recoveries though the UEX rider. During this audit period, Staff confirmed that, for other than the month of August 2011, as discussed above, Northeast used actual sales volumes less free gas to calculate recoveries. (Comm. Ord. Ex. 2 at 4.)

Staff pointed out that, pursuant to *The East Ohio Gas Company d.b.a. Dominion East Ohio, et al.*, Case No. 03-1127-GA-UNC, Finding and Order (Dec. 13, 2003) (*LDC UEX Case*), LDCs must "annually file with the Commission a report that identifies amounts recovered, deferred, and, as applicable, amortized pursuant to the (UEX) mechanism." In the instant audit, Staff found that Northeast complied with the Order in the *LDC UEX Case* during the audit period. Staff noted that Northeast's collection policies and practices require accounts to be written off after 180 days for nonpayment of billed charges; however, Northeast did not act in accordance with this policy. In addition, in its examination of bad debt write-offs, Staff explained that, with the exception of one account, the amounts included on the ABRs matched those detailed

in Northeast's bad debt reports. Further, when calculating recovery through the UEX rider, Staff found that Northeast did not properly calculate recoveries for August 2011, resulting in an under-reporting of revenue. Finally, Staff reported that Northeast filed Commission-ordered annual 2010 and 2011 UEX rider balance reports. (Comm. Ord. Ex. 2 at 4.)

Staff made two recommendations for Northeast's UEX. Staff recommended that Northeast follow company procedures in writing off accounts after 180 days of nonpayment to individual accounts. Staff also recommended that Northeast adjust its January 2012 starting balance to ($75,655.82) to correct an error made in the calculation of a bad debt account. (Comm. Ord. Ex. 2 at 5.)

2. Orwell's UEX Audit

In its audit of Orwell's UEX, Staff reviewed Orwell's collection practices and procedures and indicated that sufficient attempts were made to collect on past due accounts. As it did with Northeast, Staff randomly selected several accounts from Orwell's bad debt report and requested complete billing histories for each account. Staff explained that the number of days from a customer's last payment to writing off the account averaged 350 days during the audit period. Staff also discovered that Orwell immediately writes-off accounts when notified that an account has been included in a bankruptcy proceeding or upon death of a customer, regardless of the minimum 180-day policy. Immediately writing off accounts in this manner is contrary to Orwell's written policy. Additionally, some accounts were written off prematurely. (Comm. Ord. Ex. 3 at 2.)

Staff then conducted a random sample of write-off accounts contained in the annual balance reconciliation to determine accuracy of final amounts written off. Staff did not find any errors to customer's account balances to the reported write-off amounts. Staff also discovered that Orwell continued to bill monthly service and finance charges to customer accounts when no payment activity had taken place on the account 180 days after the last payment. Staff discovered that Orwell billed monthly service and finance charges after service disconnection. Staff submitted that these amounts are disallowed and not used in the calculation of the company's write-off amounts. (Comm. Ord. Ex. 3 at 2-4.)

In addition, Staff examined recoveries resulting from the billing of the UEX rider. Staff determined that, from January 1, 2010, through July 31, 2011, the approved UEX rider rate was $0.05331 per Mcf. In Case No. 11-312-GA-UEX, Orwell applied for and was approved by the Commission to charge a UEX rider rate of $0.17081 per Mcf. Orwell's UEX rider rate became effective in August 2011. Staff reviewed the amount

of recoveries for July and August 2011, and determined Orwell correctly applied the $0.05331 per Mcf rate to customer's July bills, yet reported on the ABR as charging customers the current effective rate, thereby reporting an over-collection of recoveries for that month. (Comm. Ord. Ex. 3 at 4.)

According to Staff, Orwell reported recoveries of $2,064.41 on the ABR for July 2011. Staff determined that, had Orwell reported the correct UEX rider rate, the proper amount of recoveries would have been $597.78, a difference of $1,466.63. Staff reported that Orwell correctly applied the current UEX rider rate to customer's bills beginning in August 2011. Staff found that Orwell included free gas in the sales volume calculation for the periods of January through March 2010 and October through December 2011. Staff ascertained that the amount of gas volumes Orwell reported for the two accounts in its calculations were incorrect during the following time frames: January 2010, October 2010, December 2010, and July through December 2011. In addition, Staff made adjustments to these accounts and used the AA sales volume calculation in Orwell's 2012 GCR audit. The result of the new calculation indicated Orwell over-collected revenue through the UEX rider by $5,343.36. (Comm. Ord. Ex. 3 at 4-5.)

Staff concluded that Orwell complied with the order in the *LDC UEX Case* by filing the appropriate reports during the audit period. Staff also reported that Orwell's collection policies and practices require accounts to be written off after 180 days for nonpayment of billed charges, but Orwell does not act in accordance with this policy. Staff also indicated that: there were no errors in write-off amounts compared to customer's ending account balances; Orwell continued to bill monthly service and finance charges to customer accounts when no payment activity had taken place on the account following the 180-day time frame; Orwell continued to bill monthly service and finance charges to customer accounts after disconnection of service; and Orwell correctly applied the $0.05331 per Mcf rate to customer's bills in July 2011, but reported on the ABR as charging customers the current effective rate of $0.17081 per Mcf, thereby reporting an over-collection of recoveries for that month. In addition, Staff observed that Orwell correctly applied the current UEX rider rate to customer's bills beginning in August 2011. According to Staff, Orwell made errors in the calculation used to determine the sales volumes applied to the UEX rider rate for two quarters of the audit period. Finally, Staff explained that Orwell complied with the Commission order in the *LDC UEX Case*. (Comm. Ord. Ex. 3 at 5.)

Staff made six recommendations regarding Orwell's UEX rider. First, Staff recommended that Orwell follow company procedures in writing off accounts after 180 days of nonpayment to individual accounts. Second, Staff recommended that, upon notification of bankruptcy or death on accounts, Orwell place those accounts

into a contra account until the 180-day time frame has been attained. Third, Staff recommended that Orwell discontinue the practice of applying monthly service and finance charges to customer accounts beyond the 180-day time period or after disconnection. Fourth, Staff recommended that Orwell review its 2012 write-off accounts for monthly service and finance charges that were applied to accounts beyond the 180-day time limit. Orwell should remove those charges to accurately reflect proper write-off amounts. In addition, Staff recommended that Orwell double check its accuracy reflecting the amount of gas volumes for the purpose of calculating recoveries through the UEX rider. Finally, Staff recommended Orwell adjust its December 2011 ending balance to $41,880.39 to correct an error made in the ABR. (Comm. Ord. Ex. 3 at 6.)

B. *2012 GCR Audit Cases* Noncontested Findings and Recommendations

The financial audit of Northeast and Orwell was conducted by Staff, pursuant to which Staff examined the EGC, RA, BA, customer billing, and UFG. Staff's findings and recommendations related to these areas, as well as the portions of the Staff's calculations of the AA related to interstate volumes, storage volumes, and sales volumes were not in dispute.

1. Expected Gas Cost

The purpose of the EGC is to match future gas revenue for the upcoming quarter with the anticipated cost to procure gas supplies. It is calculated by extending 12-month historical purchase volumes from each supplier by the rate that is expected to be in effect during the upcoming GCR quarter. The cost for each supplier is summed and the total is divided by 12-month historical sales to develop an EGC rate to be applied to customer bills.

In reviewing the EGC, Staff reviewed the supply sources and agreements of the Companies, sales volumes, purchase volumes, and transportation service. Because the pricing of local production had been a concern in the *2010 GCR Audit Cases*, and that pricing was still in place through a portion of this audit, Staff also reviewed the Companies' purchases of local production. Staff found that, beginning in 2008 with the acquisition of Cobra, JDOG began purchasing local production on behalf of the Companies. Staff indicated that the pricing structure contained in agreements between JDOG was problematic and recommended an alternative pricing calculation for local production. This calculation and the rationale for it were disputed by the Companies and are discussed later in this Opinion and Order. (Comm. Ord. Ex. 1 at 25.)

In its review of supply sources, Staff noted that Northeast's gas supplies are delivered through a combination of interstate and intrastate pipelines including Cobra, an affiliated pipeline company, Dominion East Ohio Gas (DEO), an LDC, and local production. Orwell's gas supplies are delivered from a combination of local production and interstate supplies, even though Orwell does not have any direct connections to an interstate pipeline (Comm. Ord. Ex. 1 at 10). Cobra's pipeline system connects portions of the Companies' system to Columbia Gas Transmission (TCO). Cobra initiated service to the Companies in February 2008 and serves Northeast off its Churchtown, Holmesville, and North Trumbull systems. Orwell is served off Cobra's North Trumbull system. Staff reported no change in the transportation services that Northeast received and little change in the transportation services Orwell received from its interstate, intrastate and LDC sources. Staff indicated that the sales volumes used to calculate the Companies' AA should not include free gas volumes or volumes substantially less than those contained in the Companies' daily invoicing report. In addition, Staff found that the difference between Northeast's purchase and sale volumes was less than one percent, which it noted was common for smaller gas companies. Staff determined that Orwell's purchase and sale volumes consistently show that year after year the gas entering its system is less than the gas leaving its system which is also common for smaller gas companies. Further, Staff determined that Orwell continued to provide, without a tariff, residential transportation service from July 2010 through April 2011, even though Staff had been assured by the Company that this service would end by November 1, 2010. (Comm. Ord. Ex. 1 at 22-24.)

2. Refund and Reconciliation Adjustment

The RA is used to pass through the jurisdictional portion of refunds received from gas suppliers and adjustments ordered by the Commission. Ten percent annual interest is applied to the net jurisdictional amount of the RA. That amount is divided by 12 months of historic sales volumes. The end result is a unit rate that is included in the GCR calculation for four quarters. (Comm. Ord. Ex. 1 at 39.)

In its review of the Northeast's RA, Staff ascertained that Northeast started collecting and refunding its RAs from the Commission's October 26, 2011 Opinion and Order. Staff also found that the RAs as filed were consistent with the Commission Order. Staff had no recommendations for Northeast's RA, but noted that it would examine the RAs to determine if they were properly included for the required number of consecutive months. (Comm. Ord. Ex. 1 at 39.)

Staff similarly discovered in its review of Orwell's RA, that Orwell started collecting and refunding its RAs from the 2010 GCR audit. Staff concluded the RAs, as

filed, were consistent with the Commission order in the *2010 – GCR Audit Cases*. In addition, Staff had no recommendations for Orwell's RA, but noted that it would examine the RAs to determine if they were properly included for the required number of consecutive months. (Comm. Ord. Ex. 1 at 39.)

3. Balance Adjustment

The BA mechanism corrects for under- or over-recoveries of previously calculated AAs and RAs. The BA is calculated by subtracting the product of each respective AA and RA and the sales to which those rates were applied from the dollar amounts of the respective AA or RA previously included in the GCR and used to generate those adjustment rates. Since those adjustment rates were derived by dividing the dollar amounts by historic sales, the BA calculation depicts the differences in revenues generated for each of these adjustment mechanisms using actual versus historical sales. The sum of the differences for the previously calculated AA and RA is the total BA for the current audits, which is then incorporated into the AA calculation for the current audit. (Comm. Ord. Ex. 1 at 40.)

In its audit, Staff found that Northeast's monthly sales volumes for the first year of the audit period contained free gas, which Staff excluded in its AA and BA calculations. Staff also determined that, for the first BA calculation, Northeast had started to collect from its customers an under-recovered prior AA balance of $1,222,992 at a rate of $0.7395 per Mcf, but changed that AA amount to $(0.3079) by the third month. The negative rate remained in effect for the next nine months. The result of this error was a difference of $1,701,338. Staff also established that there was one additional error by Northeast in which it did not carry through the proper rate for 12 consecutive months. This resulted in an adjustment of $492,823. The difference calculated by Staff was a difference of $2,201,232 in the company's favor. The differences between Staff and the Companies' calculations of the BA are not self-correcting through the GCR mechanism. Staff recommended an adjustment for Northeast of $2,201,232 in its favor and that this adjustment should be applied in the first GCR filing following the Opinion and Order in these cases. (Comm. Ord. Ex. 1 at 40-41.)

Staff established that Orwell's monthly sales volumes for one quarter (October through December 2011) contained free gas, which Staff excluded in its AA and BA calculations. In its review, Staff concluded that, in three separate instances, the company included the same rate for 15 consecutive months and, in another instance, a rate was included for only three months. The difference calculated by Staff was $16,280 in the customers' favor. As with Northeast, the differences between the calculations by Staff and Orwell of the BA are not self-correcting through the GCR

mechanism. Staff recommended an adjustment for Orwell of $16,280 in the customers' favor and that this adjustment should be applied in the first GCR filing following the Opinion and Order in these cases. (Comm. Ord. Ex. 1 at 41.)

4. Customer Billing

According to the staff report, an important component in the GCR process is the proper application of GCR rates to customer bills. Staff reviewed and verified the GCR and customer service base rate charges applied to customer bills during the audit period. Although not every bill was examined, several customer bills were verified in each monthly billing period in order to ensure billing accuracy. Staff ascertained no errors and made no recommendations related to the customer billings of Northeast or Orwell. (Comm. Ord. Ex. 1 at 51.)

5. Unaccounted for Gas

UFG is the difference between gas purchases and gas sales. It is calculated on a 12-month basis, ending in one of the low-usage summer months. The purpose of identifying UFG is to minimize the effects of unbilled volumes on the calculation. The GCR rules allow the Commission to adjust a company's future GCR rates, if the UFG is above a reasonable level, presumed to be no more than five percent for the audit period. (Staff Ex. 3 at 28.)

In the *2010 GCR Audit Cases*, Staff found Northeast's UFG levels were between one and two percent positive. Staff concluded in this audit that the slightly positive UFG from the prior audit changed to slightly negative UFG levels and that the change was likely the result of metering differences. Staff had no recommendations with regard to Northeast's UFG. (Comm. Ord. Ex. 1 at 53.)

In the *2010 GCR Audit Cases*, Staff established that Orwell's UFG rates were slightly negative. Staff's calculation of UFG from the prior audit was based on ONG Marketing invoicing and did not include all of the volumes flowing into and out of Orwell's system. In this audit, Staff determined that, for the 12 months ending July 2011, the UFG was (3.95) and for the 12-month period ending July 2012, the UFG was (2.83). Staff recommended that Orwell monitor its UFG levels as it changes out meter devices and adds new metering devices for system growth. (Comm. Ord. Ex. 1 at 53.)

6. Actual Adjustment

The AA reconciles the monthly cost of purchased gas with the EGC billing rate. The purpose of the EGC is to match future gas revenue of the upcoming quarter with the anticipated cost to procure gas supplies. Staff's calculations and findings related to interstate gas purchases and sales and storage volumes were not contested by the Companies. In addition, two of Staff's recommendations from the audit involving the proposed AA were not contested by the Companies. First, Staff recommended increasing Northeast's sales volumes for the months of March 2010 through May 2010 by 181,172 Mcf and that free gas be removed from the AA calculation for the Companies. Staff also recommended the Commission disallow all agency/broker fees paid to JDOG for the purchase of interstate gas that the Companies are seeking to recover from GCR customers. (Comm. Ord. Ex. 1 at 24.)

C. Conclusion for Noncontested UEX and GCR Issues

As there was no dispute by any of the parties to the findings and recommendations from Staff's UEX audit of Northeast and Orwell, the Commission adopts and approves the findings and recommendations of the Staff's UEX audits of Northeast and Orwell. Similarly, because there was no dispute by any of the parties to the portions of Staff's GCR audits of Northeast and Orwell related to the EGC, RA, BA, customer billing, UFG, and those portions of the AA related to interstate purchases, storage volumes, and sales volumes, the Commission adopts and approves those findings and recommendations.

IV. OPINION AND CONCLUSIONS ON CONTESTED ISSUES

In these proceedings, there are two principal issues in dispute. The first issue is the development and implementation of the RFP required by the stipulation in the *2010 GCR Audit Cases*. The second is the portion of the AA that involves the recovery of costs by the Companies for purchases of local gas production. Following a review of these issues, we address concerns raised by Staff and OCC related to Cobra's processing charges, premiums paid to JDOG, and Orwell's residential transportation service, as well as issues concerning the structure and management of the Companies, the adequacy of internal controls, and allegations related to GCR filings. We begin with a review of the RFP undertaken by the Companies.

A. Request for Proposal

In accordance with the stipulation approved in the *2010 GCR Audit Cases*, the Companies issued an RFP on October 1, 2012, soliciting bids for supply of all or part of

the natural gas requirements of the Companies. The RFP was sent to 15 marketers. Of those 15 marketers only five submitted prequalification agreements. Only one of those five marketers that submitted prequalification agreements submitted a bid in response to the RFP. That sole bidder, JDOG, was ultimately chosen by Gas Natural as the winning bidder. (Staff Ex. 1 at 8.)

1. Should the RFP be Considered in the *2012 GCR Audit Cases*

In order to fully understand the concerns of Staff and OCC related to the Companies' RFP, a more extensive review of the stipulation in the *2010 GCR Audit Cases* is helpful. One of the principal agreements contained in the stipulation in the *2010 GCR Audit Cases* was to have been the Companies' development and implementation of an RFP, which would lead to a competitive bidding process to procure the natural gas commodity requirements for GCR customers. Staff and OCC both expressed concerns regarding what Staff verified during its audit of the Companies related to JDOG. The stipulation was intended, in part, to address those concerns. In the stipulation in the *2010 GCR Audit Cases*, the parties agreed that Gas Natural would coordinate with Staff and OCC in designing and implementing the RFP and the selection criteria to manage the interstate transportation and storage capacity assets of the Companies and procure the gas requirements of the Companies' GCR customers in the local and interstate markets. Gas Natural was an affiliated company formed by the Companies and JDOG to purchase interstate and intrastate supplies from JDOG and then resell those supplies to the Companies. The stipulating parties agreed that bids received from competitive gas marketers would be provided to Gas Natural, the Companies, Staff, and OCC, contemporaneously, and Gas Natural would select the successful bidder in consultation with Northeast and Orwell. The stipulating parties also agreed that marketers who were affiliated with or related to the Companies, such as JDOG, would have the opportunity to participate in the competitive bidding process on the identical terms and access to information as nonaffiliated marketers. Further, the stipulating parties agreed that the RFP process would be completed by November 1, 2011; however, it was not completed until 13 months later. In the end, JDOG submitted the sole bid and was selected by Gas Natural. (*2010 GCR Audit Cases*, Order at 13-18; *2010 GCR Audit Cases* Jt. Ex. 1 at 5-8.)

Initially, we address the arguments of the Companies first raised in their reply brief, that: the RFP is not ripe for review because the RFP was not issued in the audit period; the results of the RFP have no bearing on the GCR rate analyzed in the current audit; and a review of the RFP in these proceedings is barred by the doctrine of res judicata (Co. Br. at 33-35). In response, Staff countered that the RFP could have been issued within the biannual audit period adopted by the Commission and it was the Companies alone that delayed issuing the RFP for nearly 14 months. Staff also

asserted that just because the contract awarded as a result of the RFP did not impact the rates effective during the audit period does not make it inappropriate to review either the process or the results of the RFP. (Staff Reply Br. at 16.)

As to the Companies' argument that the RFP should not be the subject of review by the Commission in these proceedings, we find no merit. In our Opinion and Order in the *2010 GCR Audit Cases*, we stated:

> "These regulated companies, Northeast and Orwell, must ensure that the RFP process and selection criteria provide for an arms-length relationship with their affiliated companies, and result in the selection of a successful bidder that is in the best interest of the utility ratepayers. Accordingly, the Commission directs Staff, in the next audit of these companies, to review the RFP and selection processes implemented by Northeast and Orwell as a result of this order to ensure that the Companies are responding to our concerns herein appropriately."

Thus, it was clear in our Opinion and Order in the *2010 GCR Audit Cases* that Staff was directed, as part of its audit, to review the design, implementation, and results of the RFP and that the RFP would be included in the 2012 audit.

As to the Companies' position that the issues raised by Staff and OCC about the RFP are barred by the doctrine of res judicata, we similarly find no merit. The Supreme Court of Ohio has held that "[t]he doctrine of res judicata precludes relitigation of a point of law or fact that was at issue in a former action between the same parties and was passed upon by a court of competent jurisdiction. *See Consumers' Counsel v. Pub. Util. Comm.*, 16 Ohio St. 3d 9, 10, 475 N.E.2d 782 (1985), *citing Trautwein v. Sorgenfrei*, 58 Ohio St.2d 493, 391 N.E.2d 326, syllabus (1979). For the doctrine of res judicata to apply here, the issues and claims raised by Staff and OCC related to the RFP would have to have been the subject of a prior proceeding. That is not the case here. The *2010 GCR Audit Cases* were resolved, in part, under the terms of a stipulation whereby the Companies would develop and implement an RFP in cooperation with Staff and OCC. Since the RFP did not exist until the stipulation in the *2010 GCR Audit Cases* was approved by the Commission, and the Companies had not yet completed the tasks of developing and implementing an RFP until after the Commission issued its Opinion and Order, the instant proceedings are essentially the first time Staff and OCC have raised any issues related to the development and

implementation of the Companies' RFP. As such, there is no relitigation here and the doctrine of res judicata is inapplicable. We now turn to the issue of the RFP.

2. Consideration of the RFP

a. Companies' Position on the RFP

The Companies assert they established an RFP that met the terms of the stipulation. They claim they coordinated with Staff and OCC on the design and implementation of the RFP as well as the selection criteria for the successful bidder (Co. Ex. 1 at 3.) According to the Companies, the RFP process was fair and competitive for a number of reasons. They contend they sent the invitation to bid to 15 marketers which had the opportunity to review the RFP and ask as many questions as needed to determine whether to submit a bid. Further, the Companies stress the entire RFP process was anonymous and a total of six marketers submitted pre-qualification agreements. (Co. Ex. 1 at 5-7.) Although the RFP resulted in only one bid, the Companies maintain there was no prohibition in the stipulation in the *2010 GCR Audit Cases* regarding affiliated companies participating in the RFP process. Moreover, each potential bidder, as well as Staff and OCC, had complete access to the Companies' information in the data room, and bidders could ask questions and answers were published in a secure online data room for all bidders to review. (Co. Ex. 1 at 4-6.) According to the Companies' witness Whelan, bids were initially due on October 23, 2012; however, the bidders asked for more time to evaluate the RFP and Gas Natural extended the bid date to November 9, 2012. Mr. Whelan indicated that the Companies received one bid, and the Companies did not know the identity of the bidder. (Co. Ex. 1 at 5.) He further testified that the bid was reviewed to ensure that it conformed to the requirements of the RFP and that the single bid was a competitive and responsive bid. According to the Companies, the bid met the requirements, therefore, it was accepted. Mr. Whalen acknowledged that, of the 15 marketers the RFP was sent to, he did not know if any had the financial ability to do the purchasing that was requested in the RFP. He also admitted there was no follow up with the nine marketers that did not submit a prequalification agreement. (Tr. I at 116-118.) The Companies reject Staff witness Donlon's criticisms of the RFP because they claim Mr. Donlon was never involved in the issuance of an RFP and had never been responsible for the final determination of evaluating an RFP. (Co. Brief at 39.)

b. Staff's Position on the RFP

Staff recommended the Commission reject the results of the RFP process and find the RFP process did not lead to competitive bids, as required by the stipulation and as ordered by the Commission in the *2010 GCR Audit Cases.* Staff also

recommended that the bidder selected by the Companies and the results of the RFP process both be rejected and the Commission order the Companies to start a new RFP process that includes input of Staff, OCC, and the Companies' technical and operational staff. In addition, Staff recommended the Commission reject any RFP and bid selection that the Companies may initiate prior to the incorporation of Staff and OCC input. (Staff Ex. 2 at 9.)

Staff witness Donlon maintained that, based on his research, an effective RFP should have several basic characteristics and he asserted the Companies' RFP had none. The RFP was neither clear nor concise, which would have ensured that vendors understood what they were bidding on and that responsive bids accurately reflected the needs of the Companies. The RFP lacked an executive summary which would have allowed for a quick review of the solicitation to determine if the vendors would like to do an in-depth analysis of the RFP. The RFP did not provide sufficient background information regarding the Companies' operations current and in the past. For example, Mr. Donlon explained that, because gas usage is heavily dependent on weather patterns for residential usage and the Companies have been in operation for decades, providing at least three years of historical usage should not have been a problem and would have allowed vendors to examine this data in order to assess the Companies' gas purchasing needs more accurately. For this RFP, the Companies only provided information on the combined purchases for the last 12 months. Mr. Donlon also stressed that the selection process was unclear and contained ambiguous statements and was not intuitive to the readers of what was requested. Mr. Donlon noted the RFP should have had a timeline and instructions for submitting the bids to provide vendors with adequate time to review and respond to the solicitation, but the RFP initially only provided a three-day time period. Mr. Donlon also pointed out that there was an additional timeline that was provided, but it also created issues for potential vendors. (Staff Ex. 1 at 5-8.) Lastly, Mr. Donlon was concerned by the RFP process that included anonymous responses, which he believed did not reduce bias toward affiliates (Tr. II at 481).

Staff witness Sarver testified that the Companies took it upon themselves to develop the RFP and never requested a template from Staff (Tr. III at 681). Staff argued that it recommended the Companies make changes to the draft RFP. Staff points to language in the RFP that it viewed as ambiguous and not intuitive to the readers of what the solicitor was requesting. According to Staff, such language would discourage marketers from participating. However, Staff claimed that the suggested changes to that language and other changes recommended by Staff were not made by the Companies. (Staff Ex. 1 at 10, 13.) Staff maintained that, by limiting the procurement strategies to include local production contracts by JDOG, the Companies created an advantageous market for their own related party JDOG and discouraged

potential bidders. Staff pointed out that it warned the Companies, in June 2012, that the RFP was heavily favored toward their own affiliate and would result in limited interest from vendors. According to Staff, the Companies ignored Staff's recommendations (Staff Ex. 1 at 13-14). In contrast to the Companies' development of its RFP, Staff witness Sarver pointed to cases involving Dayton Power and Light Company (DP&L) in 2000 and 2002, in which DP&L had first used an affiliate for its asset manager, which was disallowed, and then DP&L fully cooperated with Staff to ensure that the process was improved (Tr. III at 759-760).

c. OCC's Position on the RFP

OCC argued the Companies' RFP was deficient. OCC contended the RFP was unreasonably delayed because it was not issued until nearly a year after it was scheduled to be completed. In addition, OCC emphasized that, even though the RFP was sent to 15 marketers, only six marketers submitted the prequalification agreements and only one supplier, JDOG, ultimately submitted a proposal. OCC maintained that, since only one proposal was received and was available for evaluation and selection, the RFP process did not provide Northeast and Orwell with a competitive offer and Northeast and Orwell should have revised and reissued their RFP. (OCC Ex. 12 at 13; Tr. I at 187-188.) OCC stressed that another shortcoming with the RFP process was that Northeast and Orwell allowed JDOG to participate in the process, noting that JDOG is an affiliate and had an on-going relationship with Orwell and Northeast to perform the same duties being solicited in the RFP. OCC emphasized that allowing JDOG to participate in the RFP was likely a deterrent to other suppliers that considered submitting a proposal, because of the potential bias of Northeast and Orwell towards their affiliate (OCC Ex. 12 at 13). In addition, JDOG had a tainted relationship with Northeast and Orwell due to highly suspect affiliate transactions, which were a significant issue in the *2010 GCR Audit Cases*. OCC witness Sloan attested that the use of anonymous bidding also created problems and did not alleviate the concerns about bias and it was impossible to know whether the bidder that was selected was capable of completing the tasks required by the RFP (Tr. I at 194-195.) According to OCC, while it is difficult to determine why there are a certain number of responders to an RFP process, it is important to follow up; however, the Companies made little effort to find out why only six of the 15 bidders submitted prequalification agreements (Tr. I at 197-198).

According to OCC, Northeast and Orwell indicated in responses to discovery that some of the potential suppliers who did not bid on the RFP were contacted, although the results of those discussions were not revealed to OCC or at the hearing. Rather than contacting the entities who did not submit prequalification agreements, OCC argued the Companies should have contacted the entities that did submit

prequalification agreements because those marketers already put time and effort into the process. Input as to why they did not follow through with a bid would have been valuable in assessing the success or lack of success of the RFP. OCC asserted that, having only one bid, made the RFP noncompetitive and the Companies should have made efforts to modify the RFP (OCC Ex. 12 at 14-15; Tr. I at 199).

d. Commission Conclusion on the RFP

The burden of proof to show that the RFP preparation, design, implementation, solicitation, and the ultimate selection of the winning bidder was prudent is on the Companies. Upon review of the record in these cases, it is clear that the Companies have not sustained their burden of proof in that the Companies failed to undertake a reasonable RFP process and acted imprudently in designing and implementing a reasonable RFP.

As to the design, implementation, and results of the RFP, the Commission believes that the evidence demonstrates that the Companies have failed to show that their decisions with respect to all aspects of the RFP were appropriate and prudent. While there are no specific templates, rules, or statutory requirements for RFPs, there have been hundreds of RFPs ordered through a myriad of Commission proceedings from which the Companies could have solicited examples, had they elected to do so. They did not. In addition, Staff witness Donlon presented general criteria that he believes all RFPs should meet and we believe these criteria serve as reasonable benchmarks for RFPs. However, the Companies' RFP failed to satisfy any of these requirements. The RFP lacked an executive summary, it provided insufficient background information on the Companies, and provided an inadequate amount of historical information of the Companies' purchases. The evidence shows that there were flaws associated with the RFP process, as well as the outcome. In light of the fact that this RFP process was the result of a stipulation among several parties, it would be reasonable to presume that, when the Companies were fashioning their RFP, they would not only solicit cooperation from the parties to the stipulation, but welcome suggestions to improve the process. There is no evidence that the Companies made such efforts. The evidence shows that Staff made suggestions and raised concerns with parts of the draft RFP, but the Companies were unwilling to incorporate any of Staff's suggested changes or modifications. Staff and OCC both pointed to ambiguous language in the RFP that they specifically requested be deleted, however, the Companies elected to retain the language. The evidence also shows that the Companies failed to provide any evidence of what, if any, participant feedback was solicited by, or reported to, the Companies. The evidence shows that, nine of the 15 prospective bidders declined to submit prequalification agreements and there was insufficient evidence the Companies contacted those entities to discern the reasons

why they declined to further respond or whether the entities that did not submit prequalification agreements had concerns with the RFP. While the Companies claim to have solicited input from some of the six marketers that submitted prequalification agreements, no evidence was presented as to their suggestions.

We are also concerned that the bidding process was anonymous, as the Companies acknowledged that, of the 15 marketers the RFP was sent to, it was unknown whether any had the financial ability to do the purchasing that was requested in the RFP. The Companies put on no evidence to demonstrate they ever attempted to find out anything about the sole bidder, which when chosen was allegedly anonymous, such as whether the bidder had the capability, both managerially and financially, to provide the service requested in the RFP. In addition, the evidence shows that the RFP included a requirement that limited the procurement strategies to include local production contracts by JDOG and, as evidenced by the result of only one bidder, which appears to have created an RFP that favored the Companies' own affiliate. Finally, even though there was no prohibition against the participation of JDOG, ultimately, when the only entity providing a bid was identified as JDOG, which was the same affiliate of the Companies that in the *2010 GCR Audit Cases* was revealed to have committed questionable and imprudent gas purchases at the expense of GCR customers, the Companies should have sought assistance from Staff prior to proceeding. However, the Companies failed to take the actions necessary to ensure that the RFP was appropriately managed.

Having concluded that the Companies failed to sustain their burden of proving that the RFP was reasonable and appropriate, the Commission directs the Companies to immediately commence a new RFP process with assistance from Staff and OCC. Within 60 days of the date of this Opinion and Order, the Companies must submit a draft RFP to Staff and OCC, and file a letter in these dockets evidencing that the draft RFP has been submitted. Staff shall have final approval of any changes or modifications proposed by the Companies or OCC. The Companies, Staff, and OCC will all have input on the selection of the winning bidder; however, Staff will have final approval. The RFP process will not be undertaken using anonymous bidding. Most importantly, in order to ensure that the proper costs are passed through to customers, the Commission finds that the RFP must require that, if the ultimate winning bidder is an affiliate of the Companies, the contract with such affiliate must require that the Companies and the Commission have the right to request, and will be provided, copies of all purchase invoices. Any affiliate that refuses to agree to such terms may not be awarded the ultimate contract.

In addition, until the completion of the new RFP process, as ordered by the Commission herein, beginning 70 days from the date of this Opinion and Order, the

Companies shall purchase any and all local production using in-house employees and strictly limit the purchases made by JDOG to non-local production. Furthermore, in the short term and until a new successful bidder is chosen, the Companies shall not purchase gas from any affiliate, including JDOG, unless such affiliate provides the Companies and Staff with copies of the invoices that identify the actual invoiced cost of gas purchased and any other charges. Absent invoices, the Companies are directed to no longer use the services of JDOG.

B. Local Production Issue

We next turn to the issue of the appropriate calculation of the cost of local production. The Companies asserted that the actual gas costs incurred, including the premiums paid to JDOG, were reasonable and the Commission should allow the Companies full recovery of these costs (Co. Ex. 5 at 14). Staff recommended that there be an AA for Northeast of $2,457,141 in the customers' favor and an AA of $234,801 for Orwell in the customers' favor. Staff also asserted there was no reasonable basis for the premiums the Companies paid JDOG for local production and it proposed the Commission adopt an alternative pricing mechanism to calculate an appropriate substitute. (2012 GCR audit report at 6; Staff Reply Br. at 6.) OCC maintained the Companies' gas purchasing practices were imprudent and led to unjust and unreasonable rates paid by GCR customers. OCC recommended the Commission order Northeast to refund $2,629,289 to GCR customers and Orwell to refund $117,382 to GCR customers and that the Companies terminate their gas purchase, and agent and asset management contracts, with all affiliated companies. (OCC Ex. 12 at 6.)

1. Companies' Position on Local Production

The Companies asserted that they should be allowed full recovery of their gas costs. The Companies claim that Staff and OCC have attempted to impose a standard of "least cost" and that this not the standard approved by the Commission. According to the Companies, Staff and OCC ignored the Companies' business decisions that were forward looking. The Companies pointed to the testimony of Dr. Overcast, their sole expert witness, who claimed that the Companies' purchases were prudent and reasonable because the Companies paid the amounts charged for gas and that the Companies did not pay more for intrastate gas than interstate gas. (Co. Ex. 5 at 4; Co. Br. at 18.) The Companies noted that neither the OCC nor Staff made any recommendations with respect to disallowing the Companies' interstate gas costs. They claimed these costs represent the best sample of market prices for interstate gas because they are the actual prices that the Companies paid. Thus, the Companies asked the Commission to find that their interstate gas costs were reasonable. (Co. Br. at 18.)

According to the Companies' witness Overcast, if the actual volumes and prices are examined, it is clear that the Companies' intrastate gas purchases were less expensive than the market cost of interstate gas delivered. The Companies asserted that Dr. Overcast's methodology is based on a month-by-month comparison using the Companies' actual gas purchases during the audit period (Co. Br. at 18-19). Dr. Overcast's prefiled testimony shows the average monthly city gas cost per Mcf for each month for both interstate and intrastate gas purchases. Dr. Overcast then compared the prices paid for intrastate gas for each month during the audit period with the prices paid for interstate gas for the corresponding month during the audit period. The monthly average cost difference between intrastate and interstate purchase was then multiplied by the actual volume of intrastate gas purchased that month to determine the net benefit or cost of the intrastate gas purchases. Those values were summed to calculate the net benefit or cost of intrastate gas purchases. The Companies submitted that, during the audit period, for Orwell, the savings from purchasing local gas, rather than interstate gas delivered, was $39,000 and, for Northeast, the savings achieved by purchasing local gas, rather than interstate gas, was approximately $747,000 in favor of the customers. The Companies claimed these values do not take into account the higher British thermal unit (BTU) content of locally produced gas, which would increase the savings for customers (Co. Ex. 5 at 11-12.)

2. Staff's Position and the Companies' Response on Local Production

Staff contended that the Companies' principal argument to justify their recovery of gas purchases is based on Dr. Overcast's theory that the Companies paid no more for intrastate gas than interstate gas. Staff maintained that the Companies' reliance on Dr. Overcast's exhibit (Co. Ex. 5 at Sch. 1-2) is misplaced because Dr. Overcast miscalculated the city-gate cost of gas and inflated the underlying costs of interstate gas because it includes the costs of transporting gas across DEO's system for both Northeast and Orwell. According to Staff witness Sarver, Dr. Overcast calculated the city-gate cost of gas by taking city-gate deliveries to DEO and then increasing them by the costs to move this gas across the DEO system to the Orwell and Northeast systems. Mr. Sarver asserted the true city gate price for customers behind DEO is the city-gate price to DEO, because there was no local production during the audit that was delivered directly into the systems of Orwell and Northeast, thus, bypassing DEO's distribution system and the associated charges. According to Mr. Sarver, absent the ability to bypass DEO's system in its entirety, interstate and local production would have paid the DEO transportation charges. Mr. Sarver maintained that, to make these comparisons realistic in regards to the physical requirements of moving gas to customers behind DEO's system, Dr. Overcast should have excluded the DEO charges which would have reduced the costs for transportation without local

production by approximately $1.75 million for Northeast and almost $400,000 for Orwell. (Staff Ex. 2 at 23.)

Mr. Sarver submitted that Dr. Overcast also included the demand charges paid by Northeast to TCO in his calculations, thus, inflating the costs of interstate supplies. According to Mr. Sarver, these demand charges were approximately $31,100 per month for the six summer months and $39,500 per month for the six winter months. These TCO demand charges for the audit period were approximately $1.178 million. On the Orwell system, his calculations include the fixed monthly lease charge of $1,100 per month or $26,400 for the audit period. Mr. Sarver explained that these TCO demand charges were applicable to interstate and local production volumes and these services were utilized to move local production from Cobra onto TCO to Northeast's customers. These TCO services provided firm transportation and storage services that increased the ability of JDOG to sell local production to Northeast. For Orwell, the monthly lease charges were for distribution pipe, and indistinguishable as to supply source. Mr. Sarver offered that, with the elimination of these charges, the interstate purchases were less expensive than local production purchases. (Staff Ex. 2 at 23-24; Staff Br. at 13.) Mr. Sarver also concluded that Dr. Overcast's analysis was incorrect because he made the determination that the intrastate gas contracts between JDOG and the Companies were full requirements contracts which increased their value to the Companies; whereas, these contracts were, by their terms, best efforts agreements, which are interruptible contracts, which make them less valuable. Staff asserted that Dr. Overcast's full requirements theory is, therefore, without merit and does not help explain the inflated premiums the Companies paid JDOG (Comm. Ord. Ex. 1 at 21; Staff Exs. 9 and 10; Staff Reply Br. at 5).

Staff noted that, prior to 2008, Orwell and Northeast negotiated their own contracts with local producers and purchased their gas supplies directly from those producers. Under these contracts, Orwell and Northeast paid the contractual rate without a premium. Beginning in 2008, the Companies stopped using in-house employees to purchase local production and JDOG became the purchaser for all local production on behalf of both Orwell and Northeast (Comm. Ord. Ex. 1 at 11). According to Staff, in order to determine the amounts JDOG was paying local producers, it reviewed the pricing provisions of contracts between JDOG and local producers provided in the *2010 GCR Audit Cases* because the pricing of many of these contracts were still in effect for a portion of the 2012 audit. (Tr. III at 734-735; Comm. Ord. Ex. 1 at 11.)

Staff witness Sarver indicated the process under which Staff conducted its audit. He stated that Staff first examined the prices paid by Orwell and Northeast to JDOG for local production. Staff then calculated the premiums earned by JDOG as the

difference between the costs charged to Northeast and Orwell, less the amounts paid to local producers, delivery charges, and shrink. According to Mr. Sarver, this allowed Staff to determine the amount of the premiums that JDOG was earning on local production. Mr. Sarver also emphasized that Staff ascertained the prices JDOG charged to the Companies distorted the cost of purchasing local production to where, in most months, these purchases exceeded the cost of purchasing interstate supplies, which should not have been the case. Because of this circumstance, Staff sought to create pricing consistent with the underlying prices paid to producers. (Staff Ex. 2 at 14-15.)

Mr. Sarver testified that Staff utilized the local production purchase agreements and pricing sheets that were provided in the *2010 GCR Audit Cases*. These agreements/sheets represented the value a buyer was willing to pay for local production at various locations. These agreements were all priced using the New York Mercantile Exchange (NYMEX). He further pointed out that Staff organized the purchase agreements based on how JDOG billed local production to the Companies. Staff rejects the Companies' claim that Staff inappropriately relied upon local purchase agreements provided in the *2010 GCR Audit Cases* has no merit. Mr. Sarver testified that Staff repeatedly requested the Companies provide copies of all the contracts JDOG had with local producers relevant to the 2012 audit period; however, the Companies did not provide this information even though this information was provided in the *2010 GCR Audit Cases* (Staff Ex. 2 at 16-18; Tr. III at 731; Comm. Ord. Ex. 1 at 12). Staff maintained that it was inappropriate for the Companies to criticize Staff for not using updated local production prices when the Companies refused to give this information to Staff (Staff Reply Br. at 14).

The audit report indicated the differences, for the period of September 2009 through May 2012, between what JDOG paid to producers on the Cobra system and the charges billed to Northeast, the transportation and processing charges, and total paid by JDOG, as follows:

System	Billed to Northeast	Paid to Producer	Transport and Processing Fees	Total Paid by JDOG	Billed to Northeast Less Paid by JDOG
	a	b	c	d = b + c	e = a - d
Churchtown	$2,990,408	$1,997,939	$436,093	$2,434,032	$556,376
Holmesville	$1,412,048	$1,039,805	$150,563	$1,190,368	$221,681
North Trumbull	$364,164	$294,171	$35,445	$329,616	$34,548
Total					$812,605

(Comm. Ord. Ex. 1 at 12).

Staff stated that, during that same time period, Northeast paid JDOG premiums in the amount of $335,000 for non-Cobra local production volumes on approximately 376,000 Mcf. Additionally, Northeast paid $0.15 on each unit purchased from Gatherco, which generated another $33,000 (Comm. Ord. Ex. 1 at 13). According to Staff, it calculated the price JDOG was paying local producers by reviewing the pricing provisions of contracts between JDOG and local producers provided in the *2010 GCR Audit Cases,* since these contracts were still in effect for a portion of the 2012 audit. (Comm. Ord. Ex. 1 at 25; Staff Br. at 6.) Staff offered that JDOG paid the producers on the Cobra Churchtown, Holmesville, and North Trumbull systems NYMEX less $0.45, $0.25, and $0.10, respectively; but, charged Northeast a price that was increased by $1.00 over the NYMEX charge on each of the Cobra systems. Staff also submitted that Orwell paid JDOG approximately $86,400 in premiums for the purchase of 63,700 Mcf of local production gas (Comm. Ord. Ex. 1 at 11, 21). Because Staff finds no reasonable basis for the premiums Northeast and Orwell paid JDOG and Staff maintains that in-house employees were performing most of the functions necessary to obtain gas from non-Cobra and Gatherco sources, Staff proposed an alternative pricing mechanism to compensate JDOG, which is described later in this Opinion and Order (Comm. Ord. Ex. 1 at 23).

Staff pointed out that, at some point, the Companies should have questioned why JDOG was charging them more for local production than the cost of interstate gas (Staff Br. at 9). According to Mr. Sarver, the Companies' witness Whelan was very familiar with purchasing local production, having been a part of that between 2004 and 2008 and because he stayed in contact with the producers through maintenance of the system; therefore, Mr. Whelan should have been cognizant of the changes in pricing for local production. (Tr. III at 728-729.) Staff also noted that the Companies never attempted to independently verify that the premiums they were being billed by JDOG were justified. Although the Companies hired Gas Natural to act as a gas procurement manager, Staff contended the evidence demonstrates that Gas Natural only verified the rates and quantities billed by JDOG and then passed the bills along to the Companies. Staff submitted that the Companies never questioned why local production began to cost more than interstate gas and did not question JDOG about the prices for local production, nor had any process for determining the effectiveness of JDOG's purchasing. (Staff Ex. 2 at 5-6; Staff Br. at 9.)

Staff recommended the Commission adopt its AA calculations for Northeast and Orwell. Staff's calculation recognizes, on a weighted average basis, the prices paid to producers, plus a premium to compensate JDOG for its services. Staff

recommended an AA adjustment for Orwell of $234,801, in the customers' favor, and an AA for Northeast of $2,457,141, also in the customers' favor. Staff notes that these AAs are not self-correcting through the GCR mechanism and, therefore, recommended they be applied in the first GCR filing following the Opinion and Order in these cases (Comm. Ord. Ex. 1 at 28).

The Companies challenged Staff's use of NYMEX as an appropriate market indicator of local gas supply in Ohio and they counter that the local production at the DEO delivery point would be a more accurate indicator of local gas prices. The Companies asserted that, by repricing intrastate gas based on NYMEX, Staff neglected to consider the basis differential in Staff's recommended price of gas; even though Staff acknowledged that producers who sell at NYMEX negotiate shorter contracts to capture the changing basis differential. (Co. Ex. 3 at 7.) The Companies also insisted that, in Staff's alternative premium NYMEX plus proposal, Staff repriced the premium to be paid to JDOG during the current audit period based on contracts in the prior audit period. In addition, the Companies contended Staff's estimation for JDOG's premium is unsupported and unrelated to the weighted difference calculation. The Companies professed there is no stated or apparent correlation between their $0.45 weighted difference and Staff's $0.50 alternative premium NYMEX plus and that it is a totally arbitrary figure unrelated to any actual calculation of weighted difference or any other objective criteria. The Companies suggested the basis for the repricing appears should be an evaluation of a "fair" premium for the seller, rather than any objective evaluation as to a prudent purchase cost. According to the Companies, by repricing gas purchased from a marketer, Staff is inserting itself into the market to question the prudence of decisions made by the Companies in the market. (Co. Ex. 5 at 8; Co. Br. at 23-25).

The Companies claimed that Staff and OCC both based their review of the prudency of the Companies' intrastate purchases by using interstate gas prices as a comparison. The Companies challenged Staff's recommendation to use NYMEX as its base price for intrastate gas, because this price does not take into account basis differential transportation fees, agency fees, or shrinkage. According to the Companies, Staff's analysis of the Companies' purchase price for gas did not recognize that the gas sold to the Companies was not based on NYMEX contracts, but on local production contracts, which were full requirement contracts, and there was a premium associated with these types of contracts (Co. Ex. 5 at 10; Co. Br. at 20; Tr. II at 450.) In addition, the Companies alleged that, because their interstate gas purchases had not been repriced, they were a reasonably far better basis for comparison. Further, the Companies advance that their use of actual intrastate purchases during the audit period is more reliable than Staff's use of historical prices paid to marketers in a prior audit period (Co. Br. at 27).

3. OCC's Position and the Companies' Response on Local Production

OCC agreed with Staff's conclusion that the price paid by the Companies during the audit periods for local production was too high and that it should be adjusted; however, OCC recommended a different methodology for the repricing of local production, which results in: an AA of $2,629,289 for Northeast and of $117,382 for Orwell (OCC Ex. 12 at 6, 11-12); a BA of $2,201,232 for Northeast and $16,280 for Orwell; resulting in a total credit to Northeast customers in the amount of $428,057 and a total credit of $133,662 to Orwell customers (OCC Ex. 12 at 13). OCC argued the Companies failed to prove that their use of JDOG to purchase local production and its ensuing price increase of $1.88 per Mcf was just and reasonable (OCC Br. at 16).

OCC witness Sloan stated that, 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. OCC notes that this price difference was acknowledged by the Companies' witness Ms. Patton. (Tr. II at 259-269.) Accordingly to OCC witness Sloan, after JDOG began purchasing local gas production for Northeast between 2008 and 2012, the average cost of local gas was $0.85 per Mcf more than the average cost of interstate gas (OCC Ex. 12 at 18). OCC also stressed the only explanation offered by the Companies was Mr. Whelan's claim that the Companies' gas purchasing became more complex in 2008 as a result of the growth of Northeast, due to the addition of 5,000 customers and another layer of pipeline (Tr. I at 79).

In order to conduct an analysis of local production costs, OCC witness Slone compared the price the Companies paid for local production to the prices paid by three Ohio LDCs that are of similar size and have similar potential access to local gas production including Ohio Cumberland Gas Company (Cumberland), Piedmont Gas Company (Piedmont) and Eastern Natural Gas Company (Eastern). He confirmed that, in general, the greater the percentage of local production that made up each LDCs total gas purchases, the lower the respective GCR rates. (OCC Ex. 12 at 15-16.) As examples, Mr. Sloan pointed out that local gas makes up almost 50 percent of Ohio Cumberland's supply mix and it has historically had the lowest GCR rate; whereas, Eastern had no local gas supply and had the highest GCR rate. In contrast, Northeast has approximately 27 percent of its supply portfolio sourced from local production, but had a GCR rate near or even higher than Orwell, even though Orwell's local gas production purchases made up only eight percent of its supply portfolio. (OCC Ex. 12 at 16.)

OCC witness Sloan compared the price Piedmont paid for local production to the prices paid by Northeast and Orwell. Mr. Sloan explained that, because Eastern did not purchase any local production and Ohio Cumberland's annual report did not break down gas purchases between local and interstate, it was only possible to use Piedmont for a comparison. Mr. Sloan observed that, in 2010, Northeast paid an average price of $7.01 per Mcf for local production gas, compared to Piedmont's price of $5.48 per Mcf, a $1.53 per Mcf difference. In 2011, Northeast paid an average of $6.57 per Mcf for local production gas, compared to Piedmont's price of $5.04 per Mcf, again a difference of $1.53 per Mcf. Mr. Sloan calculated the 2012 prices paid by Northeast to be $4.33 per Mcf, which was $0.19 per Mcf more than Piedmont's average price for local production gas of $4.14 per Mcf. As an additional comparison, OCC notes that, in 2011 and 2012, the price Piedmont paid JDOG for local production gas was significantly lower than the per Mcf price Northeast and Orwell paid JDOG in the same years. OCC points out that, in 2011, Piedmont paid $4.62, while Orwell paid $5.57 and Northeast paid $6.57; in 2012, Piedmont paid $3.29 while Orwell paid $3.92 and Northeast paid $4.33. (OCC Ex. 12 at 18-20.)

OCC noted that Mr. Sloan also analyzed the pricing relationship between local gas and interstate gas that was established in the eight years prior to JDOG's involvement in the purchase of gas for Northeast, to determine an appropriate annual price for local production for the period 2008 through 2012). According to OCC, reducing the average annual price of local production for 2008 through 2012 by the average difference between local gas and interstate gas of $1.03 per Mcf from the previous eight-year period, 2000-2007, provided a more appropriate price for local gas during the audit period. By multiplying the average overpayment by the adjusted local production gas purchased during the audit period, the amount customers overpaid Northeast for local production gas during the audit period is $2,629,289 during the audit period for these cases. Mr. Sloan also noted that, for this audit period, he performed a similar calculation, but that the only change in the methodology was that Orwell did not report a breakdown of local gas purchases and interstate gas purchases on its annual report to the Commission for the years between 2000 and 2007. Because of the limited data points for Orwell prior to 2008, Mr. Sloan also used the $1.03 per Mcf differential calculated for Northeast and calculated a total overpayment for local production gas purchases by Orwell's GCR customers of $117,382 during the this audit period. (OCC Ex. 12 at 27-30.)

OCC claimed that, although the Companies dispute the use of the 2008 to 2012 time period portion of Mr. Sloan's analysis, they did not dispute that using in-house personnel to purchase gas was on average $1.03 per Mcf less that the cost of interstate gas and that, once JDOG was involved in the purchasing of gas, the average cost of local production was $0.85 per Mcf more than interstate gas. According to OCC, it is

this $1.88 shift in costs that constitutes imprudent and unreasonable gas purchasing by the Companies. OCC maintained that using an eight-year time period, 2000 to 2007, during which the Companies purchased local production and using a five-year time period, 2008 to 2012, during which JDOG has been purchasing local production, provides the most complete record of gas purchasing. OCC also noted that using a shorter time period would reduce the number of data points in the analysis and increase the impact of any individual data point from the shorter time period. OCC argues that the Companies' criticism that Mr. Sloan used an arithmetic average, rather then a weighted average, has no merit because the Companies failed to offer any analysis of what impact using a weighted average would be compared to use of the arithmetic average, and the Companies did not offer any explanation as to how a weighted average might be calculated or why a weighted average is superior to the arithmetic average. (OCC Reply Br. at 13-15.)

As to OCC's analysis, the Companies claimed OCC's comparison to the gas costs of three LDCs over a 10-year period is problematic. According to the Companies, this comparison is flawed because local gas prices paid by the LDCs over that 10-year period varied substantially by quarter and there was no consistency between which LDC paid the most or least for gas over the period. The Companies also concluded that OCC's methodology is not reasonable because it uses cost information from outside the audit period to determine current market conditions and many different factors affect the local production market prices. The Companies submitted that OCC's calculations are based on an arithmetic average and not a weighted average, which does not accurately represent the average cost of gas since it is not adjusted for volume. The Companies further argued that OCC bases the value of the repriced gas on Northeast's interstate gas purchases and that comparison penalizes Northeast for purchasing well-priced interstate gas. (Co. Br. at 28-30).

4. Commission Conclusion on Local Production

As noted previously, R.C. 4905.302(E) provides the standard for reviewing the gas purchasing practices of the Companies, and allows recovery of only prudent and reasonable costs of gas to a natural gas company. Further, Ohio Adm.Code 4901:1-14-08(B) provides that the Companies must demonstrate that their gas cost recovery rates were fair, just, and reasonable and that their gas purchasing practices and policies promote minimum prices consistent with an adequate supply of gas. Based on the evidence, the Commission finds that the Companies failed to sustain their burden of proof. The evidence shows that the gas costs were not fair, just, and reasonable and their gas purchasing practices and policies did not promote minimum prices consistent with an adequate supply of gas. Furthermore, Staff and OCC produced

sufficient evidence to demonstrate the prices paid by the Companies for local production were unreasonable and imprudent.

The Companies purchase of local production was the focus of this portion of the AA calculated by Staff in its audit report. The Companies provided records indicating their invoiced costs of local production that were paid to JDOG and essentially argued that these costs were prudently incurred because they paid such costs. We reject that postulate. We note that the Companies failed to provide to Staff or OCC, or produce at hearing, the underlying contracts that would definitively show the costs their affiliate JDOG paid for local production. In order to determine whether the gas costs incurred by the Companies were prudent and reasonable, the Companies should have produced a witness, an affidavit, or the contracts themselves demonstrating the actual gas costs that they passed along to customers. As a result, we considered the record evidence and find that Staff's calculation of the AA is the best evidence and that the Companies did not sustain their burden of proof on this issue.

The evidence shows that, prior to 2008, the Companies used in-house employees to purchase gas directly from local producers. The evidence shows that local production is priced less than interstate supplies because local producers are often located in isolated markets and have limited supply options and are interruptible supply sources, and, therefore, local production is priced less than firm interstate sources. Beginning in 2008, the Companies' affiliate, JDOG, took over the gas purchasing function and became the sole entity responsible for gas purchases, with the resulting effect that the Companies paid more for local production. Prior to that time, from 2000 through 2007, the Companies purchased local production gas at an average rate that was $1.03 per Mcf less than the average cost of interstate gas supplies. However, in 2008, when JDOG began purchasing local gas production, the average cost of local gas was $0.85 per Mcf more than the average cost of interstate gas. The Companies produced insufficient evidence to dispute these findings of fact.

As to whether the Companies responded prudently when faced with higher costs for local production, they produced no evidence to demonstrate that they took any affirmative steps to discern the causes. The evidence shows that the prices for local production increased after 2008 and that Gas Natural, which acted as the gas procurement and asset manager of the Companies, merely verified the rates and quantities billed by JDOG and passed those bills along to the Companies; thereafter, the Companies just paid what they were billed by JDOG, even though there is no evidence they had any information as to the actual cost of the gas. There is no evidence that either Gas Natural or the Companies ever questioned JDOG about the actual prices for local production or why those costs increased over prices paid prior

to 2008, when gas costs had not increased and were higher than interstate gas. In addition, there is nothing on the record that indicates the Companies ever attempted to solicit offers from other marketers. Moreover, there is no evidence that anyone at the Companies ever performed any analysis to determine the reasonableness of the price for local production before and after JDOG was performing the purchasing function. Nor is there any showing that the Companies or Gas Natural ever attempted to independently analyze the premiums they paid to JDOG with the services provided; especially when the evidence shows that those premium payments to JDOG amounted to approximately $1.2 million. Such inaction was imprudent especially when the evidence reveals that costs for local production increased upon JDOG's inclusion into the purchasing process.

The findings of the audit report were based, in part, on contracts between JDOG and local producers provided in the *2010 GCR Audit Cases*. The evidence shows that Staff organized the purchase agreements based on how JDOG billed local production to the Companies and utilized the NYMEX-based purchase agreement price paid to each producer, times the monthly volumes that producer supplied to Orwell or Northeast based on JDOG's invoices. While the Companies' witness Overcast disagreed with Staff's use of contracts from the *2010 GCR Audit Cases* and for use of the NYMEX in some of its calculations, we find that Staff's analysis was both reasonable and appropriate. The evidence shows that, prior to 2008, purchasing of local production was done based on a NYMEX price, the Companies acknowledged that they used NYMEX in determining its purchase agreements, and that most local producers in Ohio similarly use NYMEX as a pricing point in local production agreements. The Commission also notes that for the instant audit, the record reflects that Staff repeatedly requested the Companies provide the underlying contracts for gas purchases that would definitively reveal the underlying gas costs paid to local producers; however, the Companies refused to provide any of these documents. We believe Staff had a reasonable expectation that the Companies would provide this information because, as Staff witness Sarver testified, this information had been provided in the *2010 GCR Audit Cases*. Therefore, it was reasonable to expect the Companies to provide the same type of information to Staff for use in the instant audit and the Companies failed to provide any reasonable justification on the record as to why they treated these cases differently than the *2010 GCR Audit Cases*.

The Companies insist that JDOG is a separate entity and they had no ability to obtain this information; however, they provided no evidence they ever: attempted to obtain the contracts sought by Staff from JDOG; inquired as to the reasons why gas costs had increased; attempted to find other suppliers prior to the implementation of the RFP; attempted to contact the Commission or Staff to inquire what steps to take in order to obtain this information; or attempted to contact the Commission or Staff to

question how to revise or revamp the RFP to require JDOG provide the underlying contracts that would reveal the actual price of local production. Such actions would have demonstrated an attempt by the Companies to appropriately and prudently respond to the issues. As a result, all of the underlying contracts for local production executed by the Companies for purchases made during the instant audit are not a part of this record. Nevertheless, given the failure of the Companies to produce the underlying contracts evidencing the actual costs of local production paid by JDOG, coupled with the fact that many of the contracts used in the audit in the *2010 GCR Audit Cases* were still in effect for portions of the audit, and these contracts were based on NYMEX prices, we believe that Staff's reliance on such information provides not only a reasonable and appropriate basis on which to determine the underlying costs of local production, but the best evidence of record.

We also note that the findings of the audit report reflect consistency with the calculations of OCC witness Sloan who made similar findings of the AA through a different analysis. Mr. Sloan analyzed the prices paid for local production by three small Ohio LDCs. Mr. Sloan's findings and calculations of the AA were consistent with Staff's findings. Of note was the analysis provided by Mr. Sloan who compared the price Piedmont paid for local production to the prices paid by Northeast and Orwell from 2010 through 2012. One of the more telling of Mr. Sloan's findings was that Piedmont's purchases of local production from JDOG were significantly lower than the prices Northeast and Orwell paid JDOG for local production in those same years.

We find no merit to the observations of the Companies' witness Overcast who challenged Staff's findings that local production was more expensive than interstate production. The evidence shows that Dr. Overcast's calculations of intrastate gas costs were not the best evidence because, as pointed out by Staff witness Sarver, he incorrectly included the costs of transportation gas across DEO's system and these costs would have applied to intrastate and interstate gas and because Dr. Overcast incorrectly included TCO demand charges when these costs similarly would have applied to both interstate and interstate gas supplies. Mr. Sarver's critique of Dr. Overcast's analysis was not challenged by the Companies at hearing. Moreover, there were other inaccuracies in Dr. Overcast's assertions, including his claim that the intrastate gas contracts between JDOG and the Companies were of greater value because they were full requirements contracts. The evidence shows that the contracts were interruptible and best efforts contracts, not full requirements contracts (Staff Reply Br. at 5).

We note that, on pages 3 and 4 of the Companies' reply brief there are new assertions made challenging the findings and conclusions of Staff witness Sarver

related to intrastate and interstate gas costs and purchases. Such assertions include references to the physical or virtual backhaul capabilities, physical realities and possibilities of the delivery system, gas flow pressures, and pipeline schematics, without any citations to evidence in the record. It is noteworthy that references to these same assertions were never made by the Companies when Mr. Sarver testified or when he was cross-examined by the Companies, nor were such claims testified to by the Companies' witness Overcast or other witnesses for the Companies, nor was this same "information" introduced by the Companies at any time at the hearing. Staff witness Sarver's prefiled testimony was available to the Companies well in advance of the hearing and the Companies had every opportunity to cross-examine Mr. Sarver as to these exact points of inquiry. In addition, the Companies had every opportunity to introduce any and all evidence to support these post-hearing assertions at the hearing. Further, we would have expected the Companies to take every opportunity to challenge the findings of Staff witness Sarver and introduce evidence at the hearing on these subjects had they believed there was any merit to any of these assertions. They did not.

Based on the record evidence, we find that Staff's calculation is supported by the record and has not been sufficiently rebutted by the Companies; therefore, it is the most appropriate means of calculating the AA to be used for this audit period. However, as discussed below, this calculation must be adjusted by Staff to accurately reflect our findings with respect to the premiums the Companies paid to JDOG, charges paid by Northeast to process gas, and the determination of the audit period.

C. Consideration of Additional Evidence Resulting in Adjustments to the GCR

In this section, we review evidence related to fees paid to JDOG, fees paid to process gas, and the length of the audit periods in these cases. In conclusion, we find that adjustments should be made to the Companies' GCR filings in the customers' favor, and the financial adjustments should be recalculated to reflect the audit period from March 1, 2010, to February 29, 2012, for Northeast and from July 1, 2010, to June 30, 2012, for Orwell.

1. Fees Paid to JDOG

Both OCC and Staff questioned the legitimacy of the fees the Companies paid to JDOG. According to OCC, the Companies failed to provide evidence or even a reasonable explanation as to the value, if any, the Companies received in exchange for JDOG's fees. OCC questioned why any fees were paid to JDOG when there was evidence that employees of the Companies performed the same duties JDOG was paid

to perform. OCC cited to the evidence that the Companies' witness Patton performed nominating, scheduling, and confirmation of deliveries on TCO "maybe every other day," even though JDOG was charging a fee for such services. (OCC Br. at 24; Tr. II at 246.) In addition, OCC pointed out that, even though Ms. Patton testified that Mr. Zapitello (who represents JDOG, Mentor Energy Resource Company (Mentor), OsAir, Inc. (OsAir), John D. Resources, LLC (JD Resources), and Great Plains Exploration Limited (GP Exploration), all related parties of the Companies) regularly provided information, the Companies failed to demonstrate on the record that the information provided by Mr. Zapitello was information that Ms. Patton had not already obtained from other sources (OCC Br. at 24; Tr. II at 264-265). OCC contended that, because Mr. Zapitello was the signatory to the contracts for such services for not only JDOG, but also Mentor, OsAir, JD Resources, and GP Exploration, it was unreasonable that he could have performed sufficient valuable work for the Companies to support a payment to JDOG of fees equating to $647,906.06, while at the same time performing the work for the other companies. (OCC Br. at 26; OCC Ex. 7.)

Staff similarly argued that the premium payments to JDOG were unjustified because there was no evidence that JDOG provided any service justifying the premiums charged and this ultimately distorted the cost of local production (Staff Brief at 9-10). Staff noted that the Companies paid JDOG approximately $1.2 million in premiums to purchase local production, including $583,417.80 to Northeast and $224,991.60 to Orwell. (Tr. Vol. III at 671.) Staff notes the evidence shows that the Companies purchased all of their gas through a single individual, Mike Zapitello (Staff Br. at 41). Staff calculated that, for his services, Mr. Zapitello was paid approximately $640,000 during the audit period. (Tr. I at 134-136.) Staff contended the evidence demonstrates that Mr. Zapitello's purchasing decisions were questionable. Staff noted that the Companies' witness Patton acknowledged that Mr. Zapitello purchased gas for the Companies even when it was not needed. In addition, there were occasions when gas was purchased and would be put into storage, which at times, would create large imbalances; yet Mr. Zapitello would, inexplicably, purchase more local gas. According to Staff, Ms. Patton knew of no limits on the amount of local gas Mr. Zapitello could purchase. (Tr. II at 250-252.) Staff also pointed out that, at the same time Mr. Zapitello was purporting to provide service to the Companies, he was also purporting to provide services to at least three other affiliate or related companies (Tr. I at 134-136).

While Staff concluded that there was no reasonable basis for the extremely large premiums the Companies paid JDOG, Staff proposed an alternative premium that the Commission could use to calculate a reasonable level of compensation to JDOG. In calculating its alternative premiums, Staff requested the Companies provide all relevant local production agreements, but the Companies refused. As a result, Staff

calculated its alternative premiums based on the local production agreements provided in the *2010 GCR Audit Cases*. (Staff Ex. 2 at 7.) Staff believed its alternative premium amounts are reasonable and within the range of premiums being charged by JDOG and other marketers for non-local production; these include NYMEX plus $0.50 for Cobra, $0.70 for Northeast non-Cobra, and $0.25 for Orwell (Staff Br. at 12; Comm. Ord. Ex. 1 at 25). Staff rejected the Companies' assertions that Staff incorrectly used the NYMEX as the pricing index for developing Staff's alternative premium amounts. Staff emphasized that the reason it used NYMEX as a pricing index is because all of the Companies' local production purchases were actually based on NYMEX. (Staff Ex. 2 at 22.) Staff also submitted that most local producers in Ohio use NYMEX as a pricing point in their local production agreements. (Tr. III at 691, 790.)

The Companies claimed that OCC's recommendation to disallow all of JDOG's fees was misleading because OCC's calculation of fees paid to JDOG includes fees paid for services related to interstate and intrastate purchases and any other service JDOG provided for the Companies. The Companies also asserted that they did not know the operations of JDOG or the number of employees at that company and that OCC's position that JDOG's fees should be disallowed solely relied on discovery responses in which the Companies identified one individual, Mr. Zapitello, as the individual responsible for JDOG's procurement of natural gas during the audit periods. They claimed that JDOG is a separate entity and they have no knowledge as to how many employees JDOG has. However, Ms. Patton testified that she knew of two employees of JDOG, including Mr. Zapitello and Ms. Stevens, and she claimed that Mr. Zapitello was the only employee of JDOG that did work on behalf of Northeast and that he provided information that was "helpful" (Tr. Vol. II at 255, 264-265). The evidence of record shows that Mr. Zapitello was the only named individual at JDOG who signed the contracts for not only JDOG, but four other affiliated/related entities that also contracted with the Companies. The Companies further contended that OCC's analysis of JDOG lacked any objectivity and that JDOG provided services by assisting in the purchases of gas so that the purchase volumes were more accurate and it performed recommendations for the Companies. (Tr. I at 88; Co. Reply Br. at 14-15.)

The Commission emphasizes that the Companies have the burden of proof to demonstrate that their gas purchases, including any associated fees, were prudently incurred; therefore, because such purchases included payments to JDOG, it was incumbent on the Companies to establish record evidence to support their assertions that all such costs were prudent. Upon review of the record, however, we find that the Companies have not provided sufficient evidence to sustain their burden to prove that JDOG provided service warranting the excessive premiums paid to it by the Companies. Staff and OCC provided evidence clearly demonstrating that the

premiums paid to JDOG were excessive and not comparable to amounts charged by other marketers, and the Companies failed to rebut this evidence by presenting any evidence supporting their unsubstantiated assertion that the premium payments to JDOG for purchasing local production were warranted or that the gas procurement function provided by JDOG was not also provided by employees of the Companies. Ms. Patton, testified that she performed, on a regular basis, "every other day," the nominating, scheduling, and confirmation of deliveries on TCO, even though JDOG was responsible for and compensated for these same duties and responsibilities. The Companies, in their brief, contend that Mr. Whelan testified that JDOG provided estimates which the Companies reviewed and then directed JDOG to implement (Co. Br. at 14-15). However, the Companies failed to demonstrate that any specific information JDOG provided with respect to any specific transaction undertaken at any time during the audit period was not done by the Companies' own employees or that any suggestions or estimates provided by JDOG were of such value to warrant any premium. Therefore, the Commission finds that the premiums paid to JDOG, which the Companies have passed on through the GCR should be disallowed and an adjustment to the GCR should be made in the customers' favor for Northeast of $583,417.80 and for Orwell of $224,991.60, and that this adjustment should be applied in the first GCR filing following the Opinion and Order in these cases.

2. Fee for Processing Gas

As noted in the audit report, Northeast relies on Cobra for a portion of the local production. Cobra includes three separate and non integrated pipeline systems including the Churchtown, Holmesville, and North Trumbull systems, that are all interconnected to Northeast's distribution system. The Companies' witness Whelan testified that the Churchtown system, which only serves Northeast, includes a processing plant that processes higher BTU content "wet" gas. (Tr. I at 97; Comm. Ord. Ex. 1 at 10.) Cobra's Tariff provides that "Northeast is subject to a $0.25/[dekatherm] Dth processing and compression fee when gas received by the company at the Receipt Point has a heat content in excess 1,130 Btu per cubic foot and is processed through a processing plant on the Company's system." (OCC Ex. 1 at 7.) In addition, Cobra's tariff defines processing as "the extraction of moisture, helium, natural gasoline, butane, propane, and/or other hydrocarbons (except methane) from natural gas tendered by Customer at the Receipt Point(s)." (OCC Ex 1 at 3).

OCC contended that, during the audit period, Northeast paid the processing fee to Cobra on natural gas volumes that it cannot prove were ever sent to the processing plant or actually processed. OCC cited to Mr. Whalen who admitted he did not know if all of the local production used by Northeast's customers on the Churchtown system actually flowed to the processing plant and was processed, or whether any of the gas

charged a processing fee was actually processed; however, he acknowledged that all of the volumes on the Churchtown system were charged the $0.25 per Dth processing fee. (Tr. I at 51-52, 54.) OCC also pointed to the testimony of the Companies' witness Patton who testified that she was responsible for providing monthly interstate volume estimates for gas purchasing and system balancing; however, she did not verify that the gas charged a processing fee was actually processed and she did not know if any of the gas actually went to the processing plant or was actually processed. (Tr. II at 239, 242-243.) OCC also noted that Ms. Lipnis, a former employee of the Companies who voluntarily testified at the hearing, asserted that at the time she attempted to verify whether the volumes that were charged that $0.25 per Dth fee by Cobra were actually processed, she was fired (Tr. III at 572). OCC witness Sloan testified that he believes all of the gas that went into the Cobra Churchtown system from local production was charged a processing fee and, based on the deposition testimony of the Companies' witness Whelan, none of that gas would have gone through the processing plant (Tr. I at 227-228). OCC cites to Staff witness Sarver's testimony that 581,457 Dth of local gas was purchased by Northeast on the Churchtown system (Staff Ex. 2 at 7). According to OCC, when that volume of gas is multiplied by the $0.25 per Dth processing fee, the total processing fee for Northeast during the audit periods amounts to $145,363. OCC argues that, because Northeast cannot prove that any of the gas on the Churchtown system was actually processed at the processing plant and the volumes cited to by Mr. Sarver were not disputed by the Company, the Commission should disallow the Companies' recovery of $145,363. (OCC Br. at 21-23.)

In reply, the Companies asserted that it would be inappropriate and unreasonable to disallow all of Cobra's processing fees. The Companies admitted that Mr. Whelan was unaware whether the Companies were being charged processing fees by Cobra for volumes that were not actually processed and Mr. Whelan admitted that none of the gas that Northeast's customers receive has been treated by Cobra's processing facility. The Companies also acknowledged that Mr. Whelan stated that some Cobra bills were incorrect, but he could not confirm that all of Cobra's processing charges were incorrect. (Tr. I at 51, 102, 167.) The Companies submitted that the record is not clear with respect to volumes of Northeast gas on Cobra's pipeline that was processed. The Companies also claimed that the GCR hearing is not the appropriate proceeding to determine whether a separate regulated entity overcharged Northeast for processing fees and that such fees are unrelated to any of the Companies' procurement policies. Further, the Companies suggested that Cobra must be involved in a proceeding to determine whether Cobra overcharged Northeast. (Co. Reply Br. at 11-12.)

Initially, the Commission finds no merit to the Companies' argument that the consideration of the propriety of processing charges is not the proper subject of these

GCR proceedings and should be the subject of another hearing. Clearly, the subject of any GCR audit is whether charges that GCR customers paid related to the procurement of gas, including the processing fees at issue here, were prudently incurred. In this situation, the Companies included the charges for processing in their calculation of charges for gas passed along to its customers. Therefore, it is unquestionably appropriate for the Commission to consider whether such charges are appropriately included in the GCR passed on to customers, especially when the prudency of such charges is called into question. Further, these charges were the subject of inquiry at the hearing and, if the Companies wished to challenge assertions by Staff or OCC on this subject, they had every opportunity to present evidence on rebuttal with respect to this subject. They simply elected not to do so.

Upon consideration, the Commission finds that the evidence of record warrants the disallowance of the Cobra processing fees charged Northeast's GCR customers during the audit period. The Companies bear the burden to demonstrate that *all* gas costs were just and reasonable and prudently incurred. First and foremost, the evidence shows the Companies failed to ensure that any of the gas flowing through the Churchtown system was processed, even though Northeast was charged and paid the processing fee to Cobra, and GCR customers were charged that processing fee for gas. The Companies contend that the evidence is unclear on this subject and that the GCR hearing is not the appropriate proceeding to determine whether a separate unregulated entity overcharged Northeast processing fees. It appears from the evidence that the Companies demonstrated an indifference to their fiduciary duties. The evidence shows that this indifference started at the top with Mr. Smith, who testified that, as president of Northeast, he did not know whether all of the gas on the Churchtown system goes through the Cobra processing plant before it goes to customers or whether customers were charged for processing gas; yet, he acknowledged he had a fiduciary duty to ensure that customers were not charged for fees that were not rendered (Tr. IV at 890-891). Mr. Whelan confirmed that all of the gas volumes on the Churchtown system were charged the $0.25 per Dth processing fee and he admits none of the gas on the Cobra system that goes to Northeast customers goes through a processing plant (Tr. I at 50, 54, 102-103). In addition, the Companies' witness Patton affirmed she reviewed bills from the Cobra pipeline that included charges for processing gas and she testified she did not know if any of the gas was actually processed; further, she was unaware if anyone actually verified that the gas charged for processing was processed (Tr. II at 243-244). The evidence further shows that the Companies did not dispute or rebut Ms. Lipnis' testimony that, she was fired as a result of her attempt to verify whether the volumes that were charged the $0.25 per Dth by Cobra were actually processed. The fact that the Companies cannot definitively state or provide evidence that all gas volumes, or any gas volumes, charged the processing fee were actually processed, demonstrates the Companies

failure to ensure that these costs were prudently incurred and is sufficient basis on which to disallow such charges, as the Companies bear the burden of proof.

Therefore, we conclude that, having failed to provide any evidence that these charges were prudently incurred, such charges should be disallowed. Further, there was no dispute raised by the Companies as to the calculation of gas flowing through the processing plant calculated by Mr. Sarver or with the processing charge of the $0.25 per Dth. Accordingly, the amount of $145,363 should be disallowed and an adjustment to Northeast's GCR in this amount should be made in the customers' favor, and that this adjustment should be applied in the first GCR filing following the Opinion and Order in these cases.

3. Length of the Audit Period in These Cases

The Companies suggested Staff altered the audit periods of these proceedings to the detriment of the Companies and they request the Commission limit its review of the audit period to the timeframe set forth in the January 23, 2011 entry. The Companies stated that by entry issued January 23, 2013, the audit period for Northeast was stated as from March 1, 2010, through February 29, 2012. However, the Companies assert that Staff extended the audit period until December 31, 2012, in its audit report. The Companies argued that Staff witness Sarver indicated that Staff added one quarter to the audit period, but the Companies claim that Staff extended the audit period by three quarters without Commission approval. The Companies asserted that the public is harmed when the Commission publishes an order stating one audit period and the Staff selects an alternative audit period, because the public will not know for what period of time the audit is being conducted and will not have a fair opportunity to raise issues with the Commission regarding GCR rates. (Co. Br. at 12-15.)

Staff contended that its review of matters outside of the audit period was reasonable, appropriate, and consistent with the Commission's orders. Staff noted that, even though the audit periods for the *2010 GCR Audit Cases* ended on February 28, 2010, and June 30, 2010, the Commission's Opinion and Order was not issued in those cases until October 26, 2011, and a final decision was not issued until January 23, 2011, almost two years after the end of the audit period for Northeast in the *2010 GCR Audit Cases*. Staff claimed that there were difficulties in obtaining information from the Companies that compelled Staff to request a delay of the audit report filing deadline, and that the Companies requested and were granted continuances due to the Companies' change in legal counsel and other reasons, all of which necessitated Staff examine matters outside of the audit period. Staff conceded that its investigations

went beyond the defined audit period and that its recommendations are based on the totality of its inquiries. (Staff Reply Br. at 11-14.)

Staff argued that, even though the Commission ordered audits for specified periods, the Commission also directed Staff to conduct its audit "to identify and review the purchasing policies employed by the company in its procurement of gas supplies" without restricting that review to the audit period. In addition, Staff argued it has the statutory authority under R.C. 4903.02 to examine all books, contracts, records, documents, and papers of any public utility at any time and allows Staff to examine issues it has identified as far forward as possible. Staff also reasoned that its expanded investigation in these cases was warranted based on the Commission's findings that the Companies had benefitted from undesirable market conduct ,and because the Commission directed Staff to monitor closely the actions of the Companies to ensure that the Companies are in compliance with the rules and regulations, as well as the stipulation in the *2010 GCR Audit Cases*. (Staff Reply Br. at 15-16.)

In the January 23, 2012 Entry in these cases, we directed that a financial audit of the Companies be undertaken. The time period for Northeast's audit was from March 1, 2010, to February 29, 2012, and the time period for Orwell's audit was from July 1, 2010, to June 30, 2012. The record shows that Staff audited Orwell for that time period; however, Staff continued its examination of financial matters beyond the time period initially set forth in the Commission's entry. We do not believe that Staff's more thorough examination of the Companies in this audit prejudices the Companies, as the financial information gleaned from Staff's extended review was for the gas purchases of Northeast. The gas purchases made and the prices paid by the Companies for those gas purchases are facts and do not change depending on whether they are reviewed in the context of this audit or the next audit. Thus, we do not believe that Northeast was prejudiced by the Staff's review of those gas purchases. We also do not believe that Staff exceeded its statutory authority by continuing its review beyond the time period initially identified in the audit, based on the unique circumstances related to the findings related to the Companies' gas purchasing practices identified in the *2010 GCR Audit Cases*, the conduct of the Companies discovered during the *2010 GCR Audit Cases* related to those gas purchases, the totality of the findings in the last audit, and our directives in the Order in the *2010 GCR Audit Cases*. Nevertheless, in order to ensure that only the appropriate adjustments are made for the audit period for the Companies and their GCR customers, all ordered financial adjustments must be recalculated by Staff to only account for the effective time periods of the prescribed audit periods of March 1, 2010, through February 29, 2012, for Northeast and July 1, 2010, through June 30, 2012, for Orwell.

4. Conclusion on Additional Evidence Resulting in Adjustments to the GCR

Based on the evidence, the premiums paid to JDOG, which the Companies have passed on through the GCR should be disallowed and an adjustment to the GCR should be made in the customers' favor for Northeast of $583,417.80 and for Orwell of $224,991.60, and that this adjustment should be applied in the first GCR filing following the Opinion and Order in these cases. Further, based on the evidence, we find the processing fees charged to Northeast in the amount of $145,363 should be disallowed and an adjustment to Northeast's GCR in this amount should be made in the customers' favor, and that this adjustment should be applied in the first GCR filing following the Opinion and Order in these cases. We also determined that all ordered financial adjustments must be recalculated by Staff to only account for the effective time periods of the prescribed audit periods of March 1, 2010, through February 29, 2012, for Northeast and July 1, 2010, through June 30, 2012, for Orwell.

D. Consideration of Practices by the Companies and Affiliates

In this section, we review evidence related to corporate separation of the regulated utilities and their affiliates and related parties, the internal controls of the Companies, the propriety of the Companies' compensation system, allegations regarding management actions of the Companies, and the propriety of the Companies' GCR filings. In conclusion, we determine that an investigative audit of the Companies is necessary.

1. Corporate Separation

Staff questioned whether there is a true corporate separation of the Companies from their affiliates. Staff pointed to the volume of "Osborne-related entities" that are subject to the Commission's regulatory authority including the LDCs (Brainard, Northeast, and Orwell) and pipeline companies [Cobra, OTP, and Spelman Pipeline Holdings, LLC (Spelman)]. Staff noted that the list of unregulated Osborne-related companies is not known, but include, at a minimum, GP Exploration, Oz Gas Ltd., JDOG, and Gas Natural Service Company, LLC. Staff cited to evidence that related entities had access to the books, records, and offices of the Companies. Staff explained that, while some of the related entities were eventually moved to a separate physical location, such access remained a problem during the audit period. (Staff Br. at 22-23.) Further, Staff pointed to the testimony of the Companies' witness Howell, who admitted that, as president of Cobra, she had access to the EFC financial accounting system, but she claimed she only had read access (Tr. IV at 958).

The evidence demonstrates the Companies blurred the lines of corporate separation by allowing affiliates and related entities access to the records of the regulated companies and by not ensuring that adequate security measures were in place. Ms. Howell testified that some JDOG personnel had access to LDC facilities and some LDC personnel had access to JDOG facilities (Tr. II at 302). The Companies' witness Rolf similarly testified that employees of Gas Natural had access to the records and books of the Companies and were not restricted in any way. According to Ms. Rolf: "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." (Tr. II at 338). Ms. Lipnis, a former employee of the Companies, pointed out that, while president of Cobra, Ms. Howell had access to the books, records, and accounting system of the LDCs (Tr. III at 535). Ms. Lipnis emphasized that she brought this to the attention of Jed Hawthorn and lawyers at the Companies (Tr. III at 568-569). Ms. Howell acknowledged that the LDCs and ONG marketing worked out of the same office and all of the employees had access to other floors (Tr. II at 288).

Notwithstanding the concerns raised by Staff with unfettered access, the evidence shows that one of the more serious lapses of judgment involved the Companies' decision to request and permit Ms. Howell, a senior employee of an affiliate pipeline company, to review the GCR filings of the LDCs. The Companies' witness Ms. Howell acknowledged that, while president of Cobra, and not employed by Orwell or Northeast, she was asked by Mr. Smith, president of the Companies, to review the GCR filings of the Companies and she accessed the accounting books and records of the Companies; even though she had never prepared a GCR filing and was not responsible for providing input into the GCR calculations. (Tr. IV at 925, 959, 962, 965.) She admitted that she was also asked by Mr. Smith to assist in various filings by Northeast management (Co. Ex. 8 at 1). Such conduct was clearly inappropriate, yet appears to have been the norm.

The evidence also demonstrates that the Companies exhibited a general indifference and unawareness of positional titles held by management within the Companies and the accompanying fiduciary duties and responsibilities. The evidence also illustrates a pattern of blurred lines of authority and responsibility and a general lack of accountability. Staff maintained that many of the witnesses held multiple senior titles and positions within these affiliated and related companies. Staff cited to Mr. Smith who testified that he was president of Northeast and Orwell as well as president of Great Plains, and formerly president, but still currently director, of John D. Oil and Gas Exploration, president of Gas Natural, where he is supposed to be providing service to the distribution companies of which he is also the president of Spelman Pipeline, vice president of OsAir, and has been president of OTP, Cobra, and Lightning. (Tr. IV at 847, 849-850, 853, 860, 946.) Staff pointed out that Mr. Smith

testified that, in all of these capacities, he reported to Mr. Osborne (Tr. IV at 870). Staff maintained that Mr. Osborne exerts the authority and control over the Companies and their related entities and the extent of his involvement is pervasive, yet reporting lines are not entirely clear. Staff also noted that accountants for the Companies reported to the controller of the Ohio utilities, an Energy West employee, and the Ohio controller would report to the controller for the holding company, who would then report to the chief financial officer, Mr. Smith, who was also the vice president of Energy West, as well as the president of Gas Natural. Staff insisted that the lack of accountability and circular reporting poses fundamental problems and evidences a need for a full review by an auditor. (Tr. II at 252-253; Tr. IV at 852, 902; Staff Br. at 24.) The Commission agrees.

The evidence shows that there is a severe organizational dysfunction within the Companies and between the regulated companies and their nonregulated affiliates. We need only look to the evidence regarding management unawareness of positional titles within the Companies and related companies. This is most notable in the testimony of Mr. Smith, who admitted he was unaware of whether he held corporate titles, including president, to various related companies of Northeast and Orwell, including Spelman, Lightning, and Gas Natural. He testified that he was president of Cobra, but acknowledged that he had no functional involvement; was president of OTP, but did not oversee the operations or accounting, and did not recall who was the functional head of the company; was president of Spelman but was unaware of its customers; and was president of two related companies, Great Plains and Lighting, which are "shell" holding companies designed to shield Mr. Osborne from liability and for which no one reported. He also indicated that he thought he was president of Gas Natural "...but I can't be certain" and when referring to JDOG, he stated: "I don't recall whether I was an officer of that or not." (Tr. IV at 848-860.) The fiduciary lapses were also demonstrated in the evidence related to GCR filings. Ms Howell, as controller and senior accountant of Northeast and Orwell, testified that she never reviewed the accounting calculations of the Companies' GCRs, because she believed that Mr. Smith and Mr. Osborne reviewed the GCRs (Tr. I at 296; Tr. IV at 933). Yet, she also testified that, as president of Cobra, she was asked to review the calculations of the Companies' GCR filings and had access to the Companies' books and records. Mr. Osborne did not testify in these proceedings and Mr. Smith acknowledged that he was responsible for reviewing GCR filings, but did not review such filings, was unaware of the audit period of these cases, how to prepare a GCR calculation, what information was used to make that calculation, whether there was any prescribed method of calculating the GCR, and was unaware of the components of the GCR. (Tr. IV at 909, 912-913.)

2. Internal Controls

Another concern raised by Staff was the lack of internal controls at the Companies. Staff referenced The Sarbanes-Oxley Act of 2002 (SOX), that set standards for all United States public company boards, management, and public accounting firms; as a result of SOX, top management are required to individually certify the accuracy of financial information (Staff Br. at 33). Staff pointed to the testimony of the Companies' witness Ms. Howell who acknowledged her responsibility as corporate controller and defines her responsibility as reviewing financial statements and presenting financial statements accurately. However, she admitted that she was unaware who was responsible for SOX compliance at the Companies (Tr. IV at 966). Staff also pointed out three witnesses who had various positions within the Companies but who admit ignorance on this subject. Ms. Noce, the assistant controller testified she was familiar with SOX, but unaware of whom the compliance officer for SOX was at Northeast, Orwell, or Gas Natural (Tr. IV at 994). Ms. Rolf testified that the Companies had internal auditing controls, but these controls were not followed and no one was designated to make sure those controls were implemented (Tr. II at 356). Ms. Lipnis, a former employee of the Companies, confirmed that Ms. Howell's access was an inappropriate practice under SOX. Staff also contended that, while the Companies witnesses testified that independent external audits had been performed on the Companies, the Companies failed to produce any audit report showing that their internal controls had either been assessed by management or were effective. For example, the Companies witness Whalen testified that, while he was aware that the Companies go through an annual audit process, he was unaware of the results of any of those audits (Tr. I at 115; Staff Br. at 33-35.)

Staff also cited to problems at the Companies with auditing safeguards. Staff pointed to the testimony of the Companies' witness Rolf who indicated that she was the employee responsible for SOX compliance, but she was fired by the Companies and the Companies were unable to provide evidence as to who replaced her in those duties (Tr. II at 350 Tr. IV at 994). Staff argued that a high turnover rate among controllers was a factor contributing to lapses in internal controls (Staff Br. at 37; Tr. III at 566). The Companies witness Smith acknowledged that there were at least four controllers for the Ohio companies during the period from 2005 to 2013; and that Gas Natural had three controllers during a four- or five-year period (Tr. IV at 874). Staff also surmised that it was possible that the controllers hired by the Companies were not qualified or did not understand their job responsibilities. Staff cited to Gas Natural, which hired Ms. Howell as a controller even though she not a certified public accountant (CPA), and which hired Anita Noce, who did not hold a bachelor's degree; rather than Ms. Rolf, who held a masters degree in accounting and experience with SOX and internal auditing, or Ms. Lipnis who was a CPA. (Tr. II at 278, 331-332;

Tr. III at 517.) Staff also cited to the evidence that Mr. Smith was replaced by Ms. Howell, even though Mr. Smith was a CPA (Tr. IV at 847-848). (Staff Br. at 36-38.)

The evidence shows the Companies had internal auditing controls, but these controls were disregarded and none of the Companies' witnesses were aware of the individual responsible to make sure those controls were implemented. Further, the evidence shows that senior management were unaware of who the SOX compliance officer was at Northeast, Orwell, or Gas Natural. In addition, although the Companies claim that there had been independent external audits of the Companies, no evidence was produced by the Companies of any such audit report showing that their internal controls had either been assessed by management or were effective. The evidence also demonstrates that, in many cases, Company management placed individuals in positions of responsibility for ensuring proper accountability, yet these individuals were not performing in a manner to ensure such controls were followed. This evidence points to a culture of indifference among management of the Companies as it relates to internal controls.

3. Compensation System

While Staff and OCC cited to evidence of access and internal controls, another area of concern raised by the evidence relates to the compensation system of the Companies which appears to distort most commonly accepted business practices. There was testimony from a number of senior management officers acknowledging that they were compensated, not by the Companies they performed work for, but by entities related to or affiliated with the Companies for which they provided no service. Mr. Smith testified that, from 2005 to 2013, while serving in various capacities for Cobra, OTP, JDOG, GP Exploration, Gas Natural, and Energy West, he was, at times, compensated by Northeast and, for the last several years, was compensated by Energy West. (Tr. IV at 860-862.) Ms. Howell testified that, at times, she was on Orwell's payroll but performed work for Northeast, ONG, and Brainard (Tr. II at 280). In addition, Ms. Rolf testified that, while she was an accountant for and on Orwell's payroll, she performed no accounting for Orwell, but she did the accounting for Northeast (Tr. II at 333-334). The Companies acknowledge that there was no allocation of these salaries and work performed and they presented no evidence to suggest their compensation system is anything other than what was portrayed by these witnesses (Tr. IV at 861). Thus, we conclude the Companies employ a disjointed compensation system unrelated to duties, work performed, and presents another troubling aspect to the Companies' operating practices.

4. Allegations Related to Management Actions

There were several allegations related to examples of the Companies' financial treatment of situations that further raise questions as to responsible fiduciary conduct. Staff cited to evidence where the Companies purchased and were paying for a Cadillac Escalade for one of Mr. Osborne's sons, who was not an employee and that the accounting treatment was corrected by making that individual an employee of the Companies. Staff also noted the evidence that preferential treatment was given to affiliates and related companies when invoices were paid, specifically Cobra. In addition, Staff indicated that there was testimony that the Companies made personal loans to Mr. Osborne, who ultimately determined which payable should be paid in any given week. Further, Staff asserted that the evidence reveals that checks would be cut and held because there were no funds available to pay them and that receivables were given a similar treatment with invoices to related parties left unpaid for, at times, more that a year. There was also evidence that the Companies regularly "flushed accounts," inappropriately offsetting payables and receivables (Tr. I at 115; Tr. III at 543-545, 548, 579, 597, 642-643, 654-656; Staff Br. at 36).

The Commission finds that the fact that these allegations were not disputed by the Companies raises additional questions about the judgment of the current management of the Companies and whether they are sufficiently responsible and capable to continue to manage a public utility in accordance with acceptable business practices, Commission rules and orders, and Ohio statutory requirements.

5. Allegations Related to Propriety of GCR Filings

Lastly, there was testimony from two individuals who previously worked for the Companies alleging manipulation of GCR filings. Heather Lipnis, an analyst for Energy West and corporate controller for Gas Natural, testified that, on one occasion, prior to November 2010, she overheard Ms. Howell direct Dawn Opara to increase 2010 GCR rates and, according to Ms. Lipnis, when Ms. Opara indicated she did not know how Ms. Howell made the change. Ms. Lipnis also testified that Ms. Howell told Ms. Opara to prepare the reconciliation the following month with an incorrect number (Tr. III at 612-616). She claimed she reported this incident to the president of Energy West, but she had no knowledge what, if any, action was taken (Tr. III at 597, 617). The Companies' witness Howell disputed that this event occurred, denies that she advocated the reporting of any numbers that did not reflect an accurate GCR estimate or actual adjustment, and denies that she told anyone to provide false information in a GCR estimate (Co. Ex. 8 at 3-4).

Cindy Rolf, a staff accountant for the Companies, testified that she was responsible for filing GCR reports for Northeast and Orwell with the Commission and that once, in 2012, Mr. Smith, the president of Northeast and Orwell, asked her to modify the GCR rate to be higher than it should have been (Tr. II at 352). She also alleged that there was a second instance involving OTP when company management requested that she find an instance where the Companies had been charged for less gas than received, so that an additional invoice could be issued and the pipeline company could receive more money (Tr. II at 352-353). The Companies witness Smith disputed that he ever attempted to provide false information to the Commission or that he ever attempted to have Ms. Rolf falsify information submitted to the Commission. He also denied that he told Ms. Rolf to decrease the natural gas sales numbers for the GCR so the GCR rate would be higher. He acknowledged that, from time to time, he would have her make adjustments to her initial calculations of the GCR to reflect his estimates. (Co. Ex. 7 at 2- 3; Tr. IV at 879.)

Ms. Rolf also alleged that Mr. Larry Brainard, the Ohio controller for the Companies, requested her to find a situation where they could issue an invoice to show the Companies purchased less gas than it sold, which would create a greater cash inflow in that current period (Tr. II at 381). She testified that she brought it to the attention of Mr. Brainard and then a meeting was called where she advised both Ms. Howell and Mr. Smith as to the situation and she submitted the recalculated GCR, which showed the lower sales numbers. (Tr. II at 388.) Mr. Brainard did not testify at the hearing.

Lastly, Ms. Lipnis testified that, in what she believes was 2009, when she was reconciling the accounts receivable and accounts payable, she discovered invoices showing Northeast purchased gas from Constellation for JDOG. It was gas that Northeast used, then paid JDOG for, and this created an open receivable on the Companies' books (Tr. III at 561, 622-627). She reported this to her supervisors and documented this in a report provided to her supervisors (Tr. III at 631, 633). Ms. Lipnis also alleged that Ms. Noce, an accountant for the Companies, advised her that JDOG was using Northeast's storage facilities and there were accounts receivable to show that JDOG owed Northeast money because they withdrew gas from Northeast's storage (Tr. III at 559). Ms. Noce disputed that she ever had a conversation with Ms. Lipnis about this and claimed she did not work with Ms. Lipnis in July 2009 and states she did not work with her until May 2010. Ms. Noce claimed she was unaware of any transaction between Northeast, Constellation, and JDOG where Northeast paid for the same volume of gas twice. She submitted that she was responsible for the accuracy of Northeast's books, that any error discovered would have been corrected, and that no independent auditor ever alerted Northeast to any alleged improper transaction of this sort. (Co. Ex. 9 at 1-3.)

The Companies asserted that Staff and OCC spent an inordinate amount of time addressing these issues and that these areas are not properly the subject of a GCR audit. The Companies suggested that Staff and OCC have "strayed far beyond the scope of GCR hearing in their post hearing briefs and much of this irrelevant and prejudicial information would not even be permitted in scope of a management performance audit." (Co. Reply Br. at 16). We find the Companies' arguments to be without merit.

Allegations that employees or senior management of the Companies attempted to manipulate GCR filings or that the Companies were engaged in practices that would affect GCR filings are absolutely within the realm of review in these GCR proceedings and are to be taken very seriously. In these cases, evidence was presented at the hearing of allegations related to the manipulation of GCR filings by senior management. The Companies, in turn, provided evidence in rebuttal denying such allegations. Following our review into these allegations, we find insufficient evidence to warrant any further review in these proceedings; however, we believe that such matters should be fully investigated in the context of the investigative audit.

6. Conclusion on Practices by the Companies and Affiliates

In our Order in the *2010 GCR Audit Cases*, we stated our concerns "about the Companies' failure to provide the appropriate consumer protections for the regulated ratepayers, as evidenced through Staff's GCR audit findings and the testimony presented at the hearing." Unfortunately, those concerns remain as true today as they were in 2010 and appear to be symptomatic. We are concerned that the evidence shows a pattern of behavior favoring affiliates of the Companies and appearing not at arms-length. The Companies paid an affiliate for gas processing when the Companies cannot demonstrate that any such processing was undertaken. It also appears no effort was made by the Companies and, in particular its management, to ensure that all processing charges incurred on behalf of GCR customers were warranted. The Companies paid excessive premiums to an affiliate for the purchase of local production, where the evidence does not demonstrate such premiums were for services received by the Companies. The evidence also shows that, when an employee of the Companies attempted to investigate whether such charges were appropriate, that employee was fired.

As to the prudency of gas purchases, it appears that the Companies merely paid the invoices presented to them, without verifying any of the charges or conducting any type of review or analysis of their gas costs or alternatives. In addition, we are concerned that the evidence shows that senior management of the regulated

Companies were paid by other related companies for which they have no functional duties. Senior employees had positional titles with related companies that have no employees. In addition, Mr. Smith admitted that Great Plains was "a shell holding company in a virtual acquisition shielded the owner from liability," that owner being Mr. Osborne (Tr. Vol. IV at 849-850). Employees held senior positional titles, yet had no knowledge of the fiduciary duties and responsibilities associated with those titles. We are also concerned that the Companies failed to elicit advice of Staff on going forward with the RFP, after JDOG was selected as the winning bidder of the RFP.

We are troubled by the evidence that shows records and information of the Companies were accessible to their nonregulated affiliates and related companies. Noteworthy is the evidence that the Companies had internal auditing controls but failed to ensure that the controls necessary for internal auditing were followed. In addition, there is evidence that the Companies gave dubious accounting treatment to a company vehicle owned by a relative of the owner of the Companies, gave preferential treatment to invoice payments from related or affiliated companies over those of nonrelated companies, and gave personal loans to senior management. The extent of the unawareness and negligence of the senior management of the Companies to their managerial and fiduciary duties and responsibilities, the failure to enforce internal controls, the lack of control over access to company records, the impropriety of the compensation system for employees of the Companies, and the functional absence of responsible persons serving in management positions, all of these situational deficiencies appear to be the norm, rather than the exception, and raise sufficient legitimate concerns that warrant more than a customary management performance (m/p) audit in accordance with R.C. 4905.302, and Ohio Admin.Code 4901:1-14-07.

OCC has urged the Commission to order a Commission-ordered investigation (COI). According to OCC, a COI is warranted because of the utilities' management practices and natural gas purchasing practices and policies, and the imprudent actions over the course of the audit in the *2010 GCR Audit Cases* and the current GCR cases. OCC cites to a COI involving Columbia Gas of Ohio, *Columbia Gas of Ohio, Inc.*, Case No. 83-135-GA-COI, et al., Opinion and Order (Oct. 8, 1985) (*Columbia Investigation Case*). In that proceeding, the Commission examined Columbia's gas purchasing practices where the affiliate relationship between Columbia and its main pipeline supplier, TCO, was at issue. OCC emphasized that a COI is necessary because the Companies misused their affiliates by over-payment for natural gas supplies and company management failed to analyze whether the insertion of JDOG into the gas purchasing process provided any benefit to GCR customers. OCC also maintained that a COI is warranted because: the Companies management has demonstrated an alarming lack of regard for the best interests of its customer and has put the interest of ownership ahead of customers; senior management lacked basic utility experience; the

Companies failed to provide information as to whether gas charged a processing fee was processed; senior management of the Companies failed to understand the functions of its affiliate service company; and company management failed to possess sufficient accounting expertise, yet are in charge of accounting functions for the Companies (OCC Br. at 39, 41, 43-46). Lastly, we are struck by the allegations of multiple former employees that senior management directed employees to manipulate GCR filings. While these allegations were denied, they raise an ominous specter of questionable practices and managerial competence and are serious causes for concern.

Staff recommended that the Commission order an investigation into the management practices of the Companies. Staff urged the Commission to not only inquire into the Companies, but to include their related and affiliated regulated companies, as well. Staff emphasized that this is, in fact, an unprecedented recommendation; however, it comes following a series of extremely frustrating audits of the Companies, rife with self-dealing that demonstrates a remarkable lack of control. (Staff Br. at 16-17.)

The Companies contended that a wide-ranging m/p audit at the cost of the Companies is unreasonable and violates Ohio law. The Companies claimed that Staff and OCC have not shown good cause for the Commission to impose the costs of a management or performance audit. The Companies rejected the comparison to the *Columbia Investigation Case* because they submitted that proceeding was an m/p audit and not a financial audit for a GCR, and the utility's shareholders were not paying for the COI; rather the Commission instructed the utility's shareholders to pay for the corrective actions as a result of the order in the COI case. The Companies offered that ordering an m/p audit of nonparty utilities also constitutes a violation of the nonparties' due process rights, because they were not named as parties, not given notice of or the opportunity to participate in any hearings or briefing, not given the opportunity to present or cross-examine witnesses, and not permitted to present evidence in their defense. In addition, the Companies asserted it would be improper to hold nonparty affiliates of the Companies responsible for the alleged misdeeds or actions of their related and affiliated companies under Ohio law. According to the Companies, simply because the nonparty affiliates share officers and directors with Orwell and Northeast is irrelevant (Co. Reply Br. at 22-23, 25-26).

The evidentiary record in these cases demonstrates a clear need for sweeping action. The Commission has the authority to make whatever changes are necessary to ensure that the Companies operate in the best interests of their customers and in accordance with the law. Staff similarly cited to the COI in the *Columbia Investigation Case* where questions arose regarding the independence of Columbia's decision-making. In that case, the Commission ordered the establishment of an independent

board of directors to live or work in the company's service territory. 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, an m/p audit and a forensic financial audit to more clearly identify areas that should be corrected (Staff Br. at 16-17).

The Commission finds that an investigative audit of the Companies and all affiliated and related companies should be undertaken by an outside auditor. The outlines and extent of the investigative audit shall be proposed by Staff based on the evidence of record from this audit. As we have previously determined that the RFP and the results were flawed, we believe that the evidence demands that another RFP should be undertaken with the consent of Staff and OCC and final approval of Staff. In addition, as we ordered in the *2010 GCR Audit Cases*, all contracts with JDOG shall be voided and the Companies will commence all local and interstate gas purchases using in-house personnel. In the context of the investigative audit, we direct the Companies to fully cooperate with any and all requests for information made by Staff and auditor. In addition, any parties named to be part of this investigative audit will be given notice of the proceeding and the opportunity to participate in any hearings, the opportunity to present or cross-examine witnesses, and permitted to present evidence on any subject to be examined at the hearing. In the event we determine, based on the findings of the investigative audit that a COI should be opened, we will open such a COI.

R.C. 4905.302(C)(3)(b) provides that, unless otherwise ordered by the Commission for good cause shown, the Commission shall not impose upon such company any fee, expense, or costs of such audit or other investigation under this section. Based on the evidence in these proceedings, we find that good cause exists to warrant imposing the costs of the ordered audit upon the Companies. The extent of the allegations of misconduct that were not rebutted by the Companies, the failure to provide information to Staff upon request, and the failure to ensure that the prices paid by its GCR customers were prudent all lead us to this conclusion. We have rarely observed regulated companies operated in the manner evidenced here. Accordingly, we believe that, pursuant to R.C. 4905.302(C)(3)(b), good cause exists to impose the costs of this investigative audit on the Companies.

E. Consideration of Additional Evidence Not Affecting the GCR Calculation

In this section, we review evidence related to termination of purchase contracts in accordance with the *2010 GCR Audit Cases* and Orwell's provision of transportation

service. In conclusion, we find that Northeast should be subject to a civil forfeiture of $26,000 and Orwell should be subject to a civil forfeiture of $50,000.

1. Termination of Purchase Contracts

OCC concluded that, in the Opinion and Order in the *2010 GCR Audit Cases*, the Commission directed the Companies to terminate their affiliate gas supply contracts upon approval of the stipulation or October 26, 2011; however, the Companies did not replace those contracts until November 28, 2012, over 13 months after approval of the stipulation (OCC Ex. 7). According to OCC, during that 13-month period, the Companies continued to operate under the prior contacts that should have been terminated in accordance with the Commission's order (Tr. II at 434; OCC Ex. 15). OCC maintained that, by continuing to use those contracts for another 13 months, the Companies violated R.C. 4905.54. OCC urged the Commission to impose a penalty of no less than $10,000 per month for each month that the affiliate contracts remained in place beyond when they were ordered to be terminated by the Commission, a total of $130,000. (OCC Br. at 34.) Staff witness Sarver testified that Staff recommended in the *2010 GCR Audit Cases* that the Companies reject supply and asset management agreements with JDOG. Staff believed these contracts were terminated with the Commission's Opinion and Order issued October 26, 2011, in the *2010 GCR Audit Cases*, in which the Commission adopted the stipulation between the Companies, Staff, and OCC. (Staff Ex. 2 at 6.)

The Companies, initially, asserted that they had no notice of or opportunity to defend against this assertion or OCC's request for a penalty. In addition, the Companies claimed that the Ohio Revised Code and the Commission's rules do not contemplate the assessment of a forfeiture in a GCR proceeding. The Companies maintained that, neither the Commission's rules, nor R.C. 4905.302(C), provide for GCR cases to be anything other than a vehicle for analyzing Northeast's and Orwell's gas utility procurement policies and practices, and to examine the accuracy of the gas costs reflected in the Companies' GCR rates. Further, the Companies argued that Commission rules limit the scope of the Commission's inquiry and analysis and to how these audits and hearings are to be conducted. According to the Companies, OCC recommended penalties that are inappropriate in these types of proceedings and has attempted to transform these proceedings into an enforcement mechanism for assessing forfeitures on Northeast and Orwell (Co. Reply Br. at 28.)

R.C. 4905.54 provides that every public utility shall comply with every order, direction, and requirement of the Commission made under authority of this chapter and R.C. Chapters 4901, 4903, 4907, and 4909, so long as they remain in force. Further, this section provides that the Commission may assess a forfeiture of not more than

$10,000 for each violation or failure against a public utility that violates a provision of those chapters or that, after due notice, fails to comply with an order, direction, or requirement of the Commission that was officially promulgated.

In the stipulation in the *2010 GCR Audit Cases*, the parties agreed that "upon approval of the stipulation Northeast, Orwell and Brainard shall terminate their currently effective contracts for purchases of local production and the arrangement of purchase of natural gas in the interstate market." Those contracts were specifically identified in the attachment to the stipulation and the stipulation was approved by the Commission. The audit report in the instant cases documents that these same contracts were not terminated until November 28, 2012, over 13 months after approval of the stipulation. The Companies have been aware, since at least the time of the filing of the audit report in these cases, that their failure to comply with the Commission's order in the *2010 GCR Audit Cases* is an issue in the instant cases. Moreover, the Companies had every opportunity to present evidence at the hearing on this issue; however, there was no explanation by the Companies as to why they failed to terminate these affiliate contracts in accordance with the Commission's order and no evidence as to why such contracts continued for over a year. The Companies knew that the stipulation included a provision requiring the termination of the contracts upon the approval of the stipulation, and they knew that, once the Commission issued its order approving the stipulation, they were required to comply with the Commission's order. Yet, they elected to not comply with the order and continue those contracts. As a result of continuing these contracts, the affiliate of the Companies was advantaged, and the Companies' customers were disadvantaged. We find, based on the evidence in these cases, that, by failing to terminate these contracts as ordered by the Commission, the Companies violated R.C. 4905.54.

The Companies have asserted that assessing penalties for violating a Commission order is inappropriate in the contest of a GCR proceeding. We disagree. Regardless of whether Staff or OCC recommended the Commission impose a civil penalty or the amount of said penalty, the failure to comply with a Commission order is never warranted, regardless of the type of proceeding, and the Commission is not summarily prohibited by statute from imposing such a penalty. The evidence shows that the Companies clearly were put on notice to terminate, immediately, these contracts yet they chose not to do so for 13 months. We believe such action constitutes a violation of R.C. 4905.54 for each month and that each Company should be assessed a civil forfeiture in the amount of $2,000 for each month, for a total forfeiture of $26,000.

2. Orwell's Residential Transportation Service

In the audit, Staff established that Orwell provided transportation service to 146 customers on its system, with Kraftmaid being its largest transportation customer. Of these 146 transportation customers, approximately 45 are residential transportation customers receiving supplies from JDOG. Staff explained that Orwell does not have any tariff provision allowing for residential transportation service. Upon inquiry from Staff, Orwell agreed it would cease transportation service to these residential customers as of November 2010; however, Staff verified that Orwell ceased providing transportation service to these customers effective May 2011. (Comm. Ord. Ex. 1 at 18.) The Companies did not dispute any of these findings.

OCC argued that, because Orwell provided this residential transportation service without a Commission-approved tariff, it acted in violation of R.C. 4905.30, which provides that public utilities shall print and file with the Commission schedules showing all rates and charges for service of every kind, and R.C. 4905.32, which requires that only rates on file with the Commission may be collected from customers. OCC contended that, because Orwell had no residential transportation tariff on file authorizing the service or charges for such service, its actions violated the requirements of R.C. 4905.30 and 4905.32. (OCC Br. at 30.) OCC maintained that the cessation of this residential service was not part of the stipulation in the *2010 GCR Audit Cases* and that the Commission had been led to believe that the unauthorized residential transportation service had ceased. OCC cited to page 8 of the Commission's Opinion and Order from the *2010 GCR Audit Cases*, which stated that "[a]ccording to Staff, Orwell ceased transportation service to these residential customer in November 2010 and placed them on small general sales service." OCC pointed out that, had Staff and OCC been told that the unauthorized residential transportation program had not been terminated, this issue could have been addressed in the 2010 Stipulation (OCC Br. at 31).

The Companies asserted that the violations of the Ohio Revised Code alleged by OCC have nothing to do with, and are entirely separate issues than, those contemplated by the GCR cases. The Companies argued that the violations of R.C. 4905.30, requiring that printed schedules of rates be filed with the Commission, R.C. 4905.32, requiring that only rates on file with the Commission be collected, R.C. 4905.35, prohibiting utilities from making or giving any undue or unreasonable preference or advantage to any person, and R.C. 4905.54, setting forth forfeiture amounts for violations of Commission orders, are all separate and independent from a GCR case or the inquiry conducted therein. The Companies contended that the fact that a GCR case is pending did not provide Northeast and Orwell with notice of the claims of violations unrelated to the GCR proceedings. In addition, the Companies

offer that OCC's claim that the Companies should be assessed a penalty because they violated R.C. 4905.54 for failing to terminate transportation program, in violation of the Opinion and Order in the *2010 GCR Audit Cases,* is a matter that should be addressed in a separate proceeding where the Companies would have notice of the allegations against them. According to the Companies, that would give them an opportunity to put on a defense, rather than being left to guess which violations, penalties, and forfeitures OCC would seek until OCC filed their initial post hearing brief. (Co. Reply Br. at 28-30.)

As with the Companies' failure to terminate contracts, we similarly find that the Companies failed to comply with statutory requirements to have appropriate tariffs on file for services they provided. We reject the Companies' claim that they received no notice this violation was an issue and that it is unrelated to the GCR proceedings. The Companies were put on notice on February 28, 2013, that their provision of service to residential customers was at issue because it was performed without an approved tariff, as it was noted in the audit report (Comm. Ord. Ex. 1 at 18). For the Companies to now claim that they were not aware of the issues is misleading. The Companies had every opportunity to introduce evidence at the hearing regarding this matter, but they elected to remain silent. Their silence should not constitute a basis for the Commission not to impose a civil penalty for operations that were in violation of their tariff and statutory requirements. To the extent the Companies believe there was error in the Staff's finding, they had over six months in which to conduct discovery and had the opportunity to provide any evidence and exhibits at the hearing on this matter. The Companies failed to provide any evidence on this issue. As we noted previously, an argument by OCC that the Commission should impose a penalty for the Companies' actions or an argument by the Companies that no such penalty should be imposed, does not preclude the Commission from taking such action. The factual portion of the violation, which was not denied or refuted by the Companies is already incorporated into the record in these cases. It is now incumbent on the Commission to determine the appropriate civil forfeiture, in accordance with the parameters of the statute, that should be levied based on the factual evidence.

While the provision of service to these customers would ordinarily warrant some directive by the Commission, it is clear that the Companies, and specifically Orwell, knew that it was improper to provide service to these customers. Furthermore, the evidence shows that Orwell indicated to Staff that it would cease such service on or before November 2010; however, it continued to provide that service until May 1, 2011, without any authority or request to do so or any acknowledgment that it was doing so in contravention of its tariff and the statute. Such actions were in violation of R.C. 4905.30 and 4905.32 for six months and warrant

a civil forfeiture in the amount of $2,000 for each month and for each statutory section for a total forfeiture of $24,000.

3. Conclusion on Evidence Not Affecting the GCR Calculation

Based on the evidence we find that the Companies failed to terminate purchase contracts as ordered by the Commission in the *2010 GCR Audit Cases*, in violation of R.C. 4905.54. We also find that the Companies failed to comply with statutory requirements to have appropriate tariffs on file for services they provided, in violation of R.C. 4905.30 and 4905.32 and we have assessed a civil forfeiture of $26,000 on Northeast and a civil forfeiture of $50,000 on Orwell and, as a result, direct that the Companies should pay the assessed civil forfeitures payable by certified check to the "Treasurer State of Ohio" and delivered to Staff within 30 business days of this Opinion and Order. The Companies may not recover the forfeiture in any pending or subsequent proceeding before the Commission, as set forth by Ohio Admin.Code 4901:1-34-07(C).

CONCLUSION:

In this Opinion and Order, we find that the findings and recommendations of the UEX audit were unopposed by the parties to these proceedings and should be adopted. We also find that, during the GCR audit period, the Companies failed to demonstrate that their purchasing policies and procedures were fair, just, and reasonable or that they resulted in minimum gas prices. We find that Staff's recommendation as to the GCR adjustments for this audit period were reasonable and appropriate and should be adjusted to reflect the audit period directed by the Commission. We find that the Companies' RFP for the purchase of gas was flawed in design and implementation and that the Companies are directed to implement a new RFP for the purchase of gas under the supervision of Staff. Further, we find that the Companies paid a processing fee to an affiliate for gas that was not processed and such fees should be credited back to GCR customers. Similarly, we find that there was insufficient evidence presented by the Companies to warrant the fees paid to the Companies' affiliate JDOG, and that such fees should also be credited back to GCR customers. We find that Orwell provided residential transportation service without proper tariff authority in violation of R.C. 4905.54, and that the Companies failed to terminate contracts previously ordered by the Commission in violation of R.C. 4905.30 and 4905.32. Lastly, we find that the evidence demonstrates that there are sufficient legitimate concerns related to the management structure, personnel responsibilities and decisions and practices of and between the Companies and their affiliates, and the Companies' management structure, all of which warrant an investigative audit be

undertaken of the Companies, as well as all affiliates and related companies. It is the Commission's intent to move expeditiously on this audit.

FINDINGS OF FACT AND CONCLUSIONS OF LAW:

(1) Northeast and Orwell are gas and natural gas companies within the meaning of R.C. 4905.03(A)(5), and, as such, are public utilities subject to the supervision and jurisdiction of this Commission.

(2) By entry issued January 23, 2012, the Commission initiated financial/GCR audits for Northeast, for the period of March 1, 2010, through February 29, 2012, and for Orwell, for the period of July 1, 2010, through June 30, 2012. By that same entry, the Commission initiated audits for the UEX riders for Northeast, for the period January 1, 2010, through December 31, 2011, and Orwell, for the period January 1, 2010, through December 31, 2011.

(3) Staff conducted financial/GCR audits as required by R.C. 4905.302(C), and Ohio Admin.Code 4901:1-14, and filed their report on February 28, 2013. Staff filed its UEX audit reports for Northeast and Orwell on December 7, 2012, and February 14, 2013, respectively.

(4) A public hearing was held on July 8, 9, 10, and 22, 2013, regarding the GCR and UEX audits.

(5) The Companies published notice of the hearing in compliance with Ohio Admin.Code 4901:1-14-08(C).

(6) Northeast and Orwell accurately calculated their UEX rider rates during the UEX audit periods, except to the extent noted in this decision.

(7) Except as otherwise noted in the audit reports and this Order, Northeast and Orwell failed to accurately determine their GCR rates for the audit periods and failed to accurately apply the GCR rates to customer bills in accordance with the financial and procedural aspects of Ohio Admin.Code 4901:1-14. Accordingly, the gas costs

passed through the Companies' GCR rates for the audit periods were not fair, just, and reasonable.

(8) The Companies failed to substantiate that the premiums charged by JDOG were warranted and should be disallowed.

(9) The Companies failed to substantiate that the processing fees charged to Northeast were appropriate and should be disallowed.

(10) Orwell provided transportation services for residential customers during portions of the audit period without a tariff, in violation of R.C. 4905.54.

(11) That the Companies failed to terminate purchase contracts as directed in the 2010 audit in violation of R.C. 4905.30 and 4905.32.

(12) That the RFP undertaken by the Companies was flawed.

(13) All adjustments calculated by Staff be recalculated to only reflect the audit period ordered by the Commission.

It is, therefore,

ORDERED, That Staff's findings and recommendations of the audit report be approved and applied to the Companies subject to the findings of this Opinion and Order. It is, further,

ORDERED, That Northeast and Orwell comply with the recommendations as outlined in this Opinion and Order. It is, further,

ORDERED, That an investigative audit be undertaken of the Companies and all affiliates and related entities. It is, further,

ORDERED, That the Companies coordinate with Staff and OCC to develop and implement an RFP and that Staff oversee the RFP to ensure that it is completed in a timely fashion, as ordered in this Opinion and Order. It is, further,

ORDERED, That the Companies each pay the assessed civil forfeitures as set forth in this Opinion and Order. It is, further,

ORDERED, That nothing in this Opinion and Order shall be binding upon the Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That a copy of this Opinion and Order be served upon each party and interested person of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO

Todd A. Snitchler, Chairman

Steven D. Lesser

Lynn Slaby

M. Beth Trombold

Asim Z. Haque

SEF/sc

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Barcy F. McNeal
Secretary