BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Complaint of Orwell Natural Gas Company,	))	Case No. 14-1654-GA-CSS
v.		
Orwell-Trumbull Pipeline Company, LLC.	))	Case No. 15-0637-GA-CSS

REPLY BRIEF
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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I. INTRODUCTION

Orwell Natural Gas ("Orwell") filed these complaints against Orwell-Trumbull Pipeline ("OTP") to seek relief from the unjust and unreasonable rates that were imposed upon ONG and its customers by the then leadership of OTP through a transportation contract signed in July 2008 ("2008 Transportation Contract").[1] OCC has intervened on behalf of the 7,500 residential utility customers of Orwell. OCC requests that the PUCO set aside the contract, set a new tariff rate, and assess certain refunds and penalties for the actions taken by OTP.

II. ARGUMENT

The special arrangement between OTP and ONG that was embodied in the 2008 Transportation Contract was not the product of an arm's length negotiation between two separate utilities, but rather a predatory contract.

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[1] OCC Ex. 2, Attachment GS-5 (Slone Direct Testimony) (November 4, 2015).

In that contract, OTP's leadership (which was the same as Orwell's leadership at the time) took advantage of a distribution company's effectively guaranteed profits to pad their own pockets with unwarranted cash collected from consumers. OTP's lack of any arm's length negotiation or bargaining created significant issues in the original formation of the contract. These issues now provide sufficient grounds for the PUCO, as the proper regulatory authority, to set aside the contract and set a tariff rate for OTP. The OCC has recommended that the PUCO set aside the 2008 Transportation Contract, set a tariff rate of $0.50, and refund to Orwell and the customers the unjust and unreasonable charges.

OTP argues that this case belongs in arbitration, that the Complainants have failed to carry their burden, that modification of the contract is prohibited by the *Mobile Sierra* Doctrine, and that refunds to consumers would be prohibited by the *Keco* case law. OCC's initial brief already established that the PUCO has full authority over this case and that the Complainants carried their burden to show that the actions of OTP were unjust and unreasonable.[2] The OCC now addresses why the *Mobile Sierra* doctrine does not prohibit setting aside or modifying the 2008 Transportation Contract and why refunds are not prohibited under *Keco*. Additionally, OTP's request to dismiss the complaint regarding the two-inch gathering lines should be denied.

A. OCC's recommendations for the PUCO to set aside the contract do not violate the *Mobile-Sierra* Doctrine and benefit consumers.

OCC has recommended that the PUCO set aside the 2008 Transportation Contract and set a tariff rate for OTP's provision of gas transportation service. This recommendation is not a violation of the *Mobile Sierra* doctrine as suggested by OTP.

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[2] *See* Initial Brief, Office of the Ohio Consumers' Counsel, Filed December 16, 2015.

Under existing Supreme Court precedent, issues in the formation of the contract prevent the *Mobile Sierra* Doctrine from applying. However, even if the *Mobile Sierra* doctrine were applied, there is sufficient evidence to show that this contract violates the public interest standard because of the harm that it has caused to Orwell's residential consumers.

1. The *Mobile Sierra* Doctrine does not apply to the 2008 Transportation agreement because it was not the result of an arm's length negotiation.

The *Mobile Sierra* doctrine does not apply to a contract that has significant defects in its formation. The 2008 Transportation Contract is a contract that was not the result of arm's length bargaining, had a harmful effect on consumers, and as articulated in the previous brief, suffered from serious defects in the formation of the original contract. Therefore, under existing US Supreme Court precedent, the *Mobile Sierra* doctrine does not apply.

The *Mobile Sierra* doctrine is a federal constitutional doctrine that allows the Federal Energy Regulatory Commission ("FERC") to change or adjust independently bargained rate setting contracts only when "the rate is so low as to adversely affect the public interest-as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory."[3] This has become an element of PUCO precedent through a decision that adopted this standard for the revision of contracts.[4]

[3] FPC v. Sierra Pacific Power Co., 350 U.S. 348, 355 (1956).

[4] In The Matter of The Application of Ohio Power Company to Cancel Certain Special Power Agreements and For Other Relief, Opinion and Order, Case No. 75-161-EL-SLF at 4 (August 4, 1976).

However, the *Mobile Sierra* doctrine rests on the premise "that the contract rates are the product of fair, arm's length negotiations."[5] Once the activities of the parties have demonstrated that this premise is not true, when there is unfair dealing at the formation stage, FERC has the authority to set aside the contract.[6] The United States Supreme Court in *Morgan Stanley* explained that "[t]o be sure, FERC has ample authority to set aside a contract where there is unfair dealing at the contract formation stage — for instance, if it finds traditional grounds for the abrogation of the contract such as fraud or duress."[7] In this case, the PUCO has the role of FERC, in its authority over an intrastate gas transportation contract. And it is clear that *Mobile Sierra* does not apply because there are fundamental issues in the contract formation stage and a complete lack of the arm's length negotiations that should have protected consumers.[8]

As was detailed in OCC's initial brief and the testimony of OCC witness Slone,[9] the 2008 Transportation contract was not the result of proper arm's length negotiations. There was no separation between the leadership of OTP and Orwell, and Mr. Smith and Mr. Rigo (the individuals who signed the 2008 Transportation Agreement) both simply worked for Richard M. Osborne. Any other distinction was purely secondary.[10]

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[5] Morgan Stanley Capital Group Inc. v. Public Utility District No. 1 of Snohomish County et al., 554 U.S. 527, 554 (2008) ("*Morgan Stanley*").

[6] "FERC has ample authority to set aside a contract where there is unfair dealing at the contract formation stage--for instance, if it finds traditional grounds for the abrogation of the contract such as fraud or duress." *Id.* at 547.

[7] *Morgan Stanley*, 554 US at 547.

[8] *See* OCC Ex. 2 at 11 (Slone Direct).

[9] *See* Initial Brief, Office of the Ohio Consumers' Counsel at 6-8; OCC Ex. 2 at 7-15 (Slone Direct).

[10] OCC Ex. 2 at 11 (Slone Direct).

This contract formation was not the product of arm's length negotiations, and there were significant defects associated formation of this contract—defects that resulted in higher rates for consumers. That the contract terms clearly favor OTP to the detriment of its affiliate, Orwell, and Orwell's retail customers as discussed in detail in the next section below, leads to the reasonable conclusion that duress played an important role in Orwell's negotiation of this contract. Therefore this contract is not entitled to the *Mobile/Sierra* presumption.

2. This contract was so harmful to consumers that even if the greater deference of the *Mobile Sierra* doctrine applied to this Contract, the PUCO has justification to set it aside.

The *Mobile Sierra* doctrine creates a standard of greater deference for privately negotiated contracts that are the result of arms-length bargaining. Even under that higher standard, the PUCO has ample authority to modify this contract. In fact, the original case law allows for the abrogation of contracts when they "cast upon consumers an excessive burden, or [are] unduly discriminatory."[11] These contracts are both unduly discriminatory and cast an excessive burden upon customers.

As was detailed in OCC's initial brief and the testimony of OCC witness Slone, OTP set a price for transportation along its pipeline that was nearly double that of similarly situated pipelines.[12] In addition to imposing an exorbitant price on Orwell (that consumers then paid), OTP also prevented Orwell from being supplied by other systems. Thus, OTP also inhibited the supply diversity that was available to Orwell.[13]

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[11] *Sierra Pacific Power*, 350 U.S. at 355.

[12] OCC Ex. 2 at 16 (Slone Direct).

[13] OCC Ex. 2 at 14, Attachment GS-5 (Slone Direct).

Ensuring a certain amount of supply diversity is a stated goal of the PUCO (for purposes of ensuring reliability and lower costs),[14] and the exclusivity clause of the 15-year agreement flies in the face of that requirement.

In fact, in the 2014 Gas Cost recovery case, the Staff of the PUCO found that Orwell's over reliance on OTP harmed customers. The report stated:

> The Company's [Orwell] focus on supply deliveries from the single supplier into OTP resulted in the exclusion of other supply and alternative delivery path options and ignored earlier market signals. These market signals existed throughout the winter season, yet the company did not pursue nor consider eastern supply options until its system's integrity was in jeopardy.[15]

Orwell was locked into a supply contract that forced it and its customers to take service from OTP. That prevented Orwell from considering or using eastern supply options that may have been available through Dominion.[16] During the period this occurred, Richard M. Osborne was in control of OTP and Orwell,[17] so Orwell's reliance on OTP directly benefitted Mr. Osborne. While customers were paying significantly more for their gas, Richard M. Osborne was benefitting by depriving those same customers of alternative supply options.

The exclusivity clause of the 2008 Transportation Contract placed an excessive burden on consumers and it is unequivocally in the public interest to set aside that

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[14] See In the Matter of the Investigation Into the Gas Purchasing Practices and Policies of Columbia Gas of Ohio, Inc., Case No. 83-135-GA-COI; In the Matter of the Regulation of the Purchased Gas Adjustment Clause Contained Within the Rate Schedules of Columbia Gas of Ohio, Inc. and Related Matters, Case No. 84-6-GA-GCR, Opinion and Order at 20 (October 8, 1985).

[15] In the Matter of the Regulation of the Purchased Gas Adjustment Clauses Contained within the Rate Schedules of Brainard Gas Corporation, Northeast Ohio Gas Corporation, and Orwell Natural Gas Company and Related Matters, Case Nos. 14-206-GA-GCR, 14-209-GA-GCR, 14-212-GA-GCR, Staff Report of the Financial Audit at 15-16 (Jan. 27, 2015).

[16] On or about the time the contract was signed, a number of taps to Dominion' system were disabled. *See* OCC Ex. 2 at 18 (Slone Direct).

[17] Richard M. Osborne only resigned in July of 2014.

contract and allow Orwell to pursue other supply options. While, at times, Orwell may have had less expensive gas from the Chicago market, the issue is not which gas is the lowest cost, but rather the ability of the distribution company (Orwell) to obtain gas from multiple sources. Therefore, even if the *Mobile Sierra* doctrine were applied, the PUCO should find that this contract violates that standard by placing an excessive burden on consumers. Access to competitively-priced gas is a foundational principal of Ohio's retail choice program – a program found to benefit the public interest in Ohio. An affiliated contract that locks a utility a single source of high-priced affiliated supply functionally prevents the utility and its customers from accessing competitively-priced supplies from other sources contrary to the public interest objectives of Ohio's restructuring laws.

B. *Keco* does not prohibit the PUCO from ordering refunds to consumers regarding rates in violation of regulations.

OCC has recommended that the PUCO set a tariff rate of $0.50 an Mcf, which is competitive with the other Orwell pipelines.[18] It is established law in Ohio under the *Keco* doctrine that the PUCO does not have the ability to order restitution with regards to rates that are set by the PUCO.[19] But the rates at issue were not set by the PUCO. These rates were set by special contract. Therefore, because these were not lawful rates set by the PUCO, but rather special contract rates that resulted from an unlawful contract, *Keco* does not preclude the PUCO from ordering refunds.

As OCC laid out in its initial brief and in testimony, there was a complete lack of any arm's length bargaining in the formation of the contract.[20] Additionally, the

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[18] OCC Ex. 2 at 21-22 (Slone Direct).

[19] Keco Industries, Inc. v. Cincinnati & Suburban Bell Tel. Co., 166 Ohio St. 254, 259 (1957).

[20] Initial Brief, Office of the Ohio Consumers' Counsel at 6-8.

leadership of Orwell and OTP at the time misled the PUCO in their application regarding the nature of the relationship between Orwell and OTP.[21] This was in contravention of the rules for approving natural gas transportation contracts that had been promulgated by the PUCO.[22] Furthermore, the special contracts are substantially different from the rate setting mechanisms that are normally utilized by the PUCO because the PUCO itself did not set the rates through a proceeding.[23]

Furthermore, the defects in the original application, which misled the PUCO, distinguish this factual scenario from what occurred in *Keco*. In *Keco*, the PUCO set a rate only to have it declared unjust and unreasonable by the Ohio Supreme Court. After that finding, the plaintiff sought restitution. However, with the 2008 Transportation Contract, the PUCO was misled and was not aware of the substantial issues in the contract upon approval. Therefore, this contract should be set aside, and above market charges to customers should be refunded.

C. To protect consumers, Orwell's Complaint regarding the two-inch gathering lines should not be dismissed

With regards to the complaint concerning the two-inch gathering lines,[24] the PUCO should not dismiss the complaint. And the PUCO should prevent OTP from charging Orwell and its customers for use of these lines that are included on OTP's tariff. This controversy stems from a series of invoices that OTP served on Orwell regarding the

[21] *See* OCC Ex. 2 at 8-9 (Slone Direct).

[22] *See* In the Matter of the Commission Ordered Investigation of the Availability of Gas Transportation Service Provided by Ohio Gas Distribution Utilities to End-Use Customers, Case No. 85-800-GA-COI, Entry at Appendix A, §5(d) (September 14, 1995) (This provision requires the companies to disclose the full nature of any affiliate relationship).

[23] *See* R.C. 4905.31.

[24] See Complaint and Request for Relief, Orwell v. Orwell Trumbull Pipeline, Case No. 14-1654-GA-CSS (Sept. 19, 2014).

use of two-inch gathering lines that should already be covered under OTP's tariff.[25] These invoices were then mysteriously withdrawn right before the evidentiary hearing in this case.[26] The OCC recommends that the PUCO not dismiss the complaint and instead issue an order requiring that OTP not bill Orwell (and by extension its customers), for the two-inch gathering lines in any future proceeding.

III. CONCLUSION

Through its 2008 Transportation Contract and under the cover of a special contract, OTP took advantage of its management of Orwell and its customers to engage in an unjust and unreasonable arrangement. This arrangement forced Orwell GCR customers to pay excess costs for gas transportation that inured to the benefit of OTP. OTP argues that *Mobile Sierra* and *Keco* doctrines prevent the PUCO from setting aside the contract and ordering refunds, however, that is not the case. Therefore the PUCO should set aside the 2008 Transportation Contract, set a tariff rate of $0.50, and refund to Orwell and the customers the unjust and unreasonable charges.

[25] *See* OCC Ex. 2 at 25-31 (Slone Direct).

[26] OTP Ex. 1 (Letter dated October 28, 2015); Tr. I at 7-11.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Reply Brief* has been served upon those persons listed below via electronic service this 8th day of January 2016.

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