

THE PUBLIC UTILITIES COMMISSION OF OHIO

IN THE MATTER OF THE INVESTIGATIVE
AUDIT OF NORTHEAST OHIO NATURAL
GAS CORPORATION, ORWELL NATURAL
GAS COMPANY, AND BRAINARD GAS
CORPORATION.

CASE NO. 14-205-GA-COI

OPINION AND ORDER

Entered in the Journal on June 1, 2016

I. SUMMARY

{¶ 1} This Opinion and Order adopts and approves the stipulation and recommendation between Northeast Ohio Natural Gas Corporation, Orwell Natural Gas Company, Brainard Gas Corporation, and Staff.

II. HISTORY OF THE PROCEEDING

{¶ 2} Northeast Ohio Natural Gas Corporation (Northeast), Orwell Natural Gas Company (Orwell), and Brainard Gas Corporation (Brainard) (collectively, the Companies) are natural gas companies, as defined in R.C. 4905.03, and public utilities as defined in R.C. 4905.02. As such, the Companies are subject to the jurisdiction of this Commission, in accordance with R.C. 4905.04 and 4905.05.

{¶ 3} On November 13, 2013, the Commission issued an Opinion and Order in *In re Northeast Ohio Natural Gas Corp. and Orwell Natural Gas Co.*, Case No. 12-209-GA-GCR, et al., adopting Staff's recommendations with regard to the uncollectible expense and gas cost recovery (GCR) audits for Northeast and Orwell. In the Opinion and Order, the Commission disallowed certain fees for nonprocessed gas and premium payments to an affiliate and found that Northeast and Orwell failed to demonstrate that their purchasing policies and procedures were fair, just, and reasonable or that they resulted in minimum gas prices. The Commission also found that Northeast's and Orwell's request for proposal (RFP) for the purchase of gas was flawed in design and implementation and directed

Northeast and Orwell to implement a new RFP for the purchase of gas under the supervision of Staff. Further, the Commission found that Orwell provided residential transportation service without proper tariff authority in violation of R.C. 4905.54; that Northeast and Orwell failed to terminate contracts, as previously ordered by the Commission in violation of R.C. 4905.30 and 4905.32; and that Northeast and Orwell should pay civil forfeitures. In addition, the Commission found that the evidence demonstrated that there were sufficient legitimate concerns related to the management structure, personnel responsibilities, and decisions and practices of and between Northeast and Orwell and their affiliates, as well as allegations regarding manipulation of GCR filings.

{¶ 4} By Entry issued April 2, 2014, in the above-captioned proceeding, the Commission initiated an investigative audit (Audit) of the Companies and their affiliates. By Entry of May 12, 2014, the Ohio Consumers' Counsel's (OCC) motion to intervene was granted. On May 21, 2014, the Commission selected Rehmann Corporate Investigative Services, LLC (Rehmann) to perform the Audit. During the month of June 2014, Richard Osborne, the individual who had been the chief executive officer of Gas Natural, Inc., the holding company for the Companies, was removed from the board of directors. Mr. Osborne was also removed as the chairman of the board and chief executive officer, in which he had served in those capacities for the Companies from 2005 until 2014, including the period of time during the 2012 GCR audits of the Companies. On January 23, 2015, Rehmann filed its Audit Report (Rehmann Audit Report). By Entry issued March 30, 2015, the attorney examiner directed that interested persons file comments related to the Rehmann Audit Report. On April 30, 2015, OCC filed comments in response to the Rehmann Audit Report. On October 30, 2015, Staff and the Companies filed a stipulation and recommendation (Stipulation) in this case. On May 3, 2016, OCC filed a notice that it does not oppose the Stipulation. On May 10, 2016, a hearing was held in this matter.

III. REHMANN FINDINGS AND RECOMMENDATIONS

{¶ 5} Rehmann indicated that the audit focused on several areas including: corporate separation and management structure, internal regulatory and financial controls, compensation system, gas purchasing transactions and practices related to GCR calculations, and financial and accounting statements filed with regulatory agencies. The findings of Rehmann were noteworthy in part, because all of the issues identified with respect to the operations and management of the Companies, took place during the time Richard Osborne was CEO and chairman of the board of directors of the Companies. (Rehmann Audit Report at 23-24.)

{¶ 6} Following its review of the management structure of the Companies, Rehmann found duplication of functions among the Companies. It also found that the organizational structure is not conducive to companies operating both regulated and unregulated business where affiliate transactions occur and is contrary to other multi-state utility companies that hold both regulated and unregulated business. In addition, Rehmann indicated that the regulated and unregulated entities are organizationally commingled, creating the potential for intentional and unintentional preferential treatment to affiliates; ratepayers' subsidization of unregulated utility affiliates; fostering an environment for potential self-dealing; and subversion of how an incumbent utility should conduct business with an affiliate. (Rehmann Audit Report at 21-22.)

{¶ 7} Rehmann further noted that there is a lack of adequate management structure in the form of policies and procedures and compliance oversight. Rehmann found that there is risk that the Ohio utilities may be charged more than market rate for services and, therefore, subsidize the operations of one of their subsidiaries. In addition, Rehmann found several areas of concern. These included: suspect loans and manipulating invoices for loans, missing documentation for bank deposits and for accounts payable, questionable business relationships between utilities, suspicions that certain entities received free gas, inappropriate invoice submissions, inappropriate record keeping for

transfers of gas and invoicing of gas, extraction of money from the Companies by upper management, and manipulating GCR calculations. (Rehmann Audit Report at 25, 31-35.)

{¶ 8} Rehmann also found numerous instances where erroneous data was included in the GCR calculations of the Companies, which directly impacted the GCR rates paid by customers. Rehmann pointed out that, after it analyzed the GCR filings from January 2011 through June 2014, it became aware that there was a considerable amount of change regarding the individuals who were responsible for preparing and approving the GCR calculations on a monthly basis. Rehmann found a number of reoccurring discrepancies, including that the cost basis for gas delivered was not provided, current month volumes were inaccurate, and numbers were transposed. In addition, Rehmann noted numerous other areas of concern, particularly related to the lack of competitive bidding and lack of adequate controls over related-party transactions, particularly prior to 2014. (Rehmann Audit Report at 2, 7, 15-16.)

{¶ 9} Rehmann made numerous recommendations to the existing internal control structures and other processes. Rehmann recommended that a reorganization strategy be developed to provide greater efficiency, accountability, and transparency and that all intercompany expenditure and sales transactions be supported by an intercompany agreement. Rehmann also recommended that the Companies work with the Commission to develop a new spreadsheet to assist in the calculation of the GCR. Rehmann recommended that the Companies create a secure database to contain historical figures and develop a protected server to save the final version of the Excel workbooks used to perform the GCR calculations. Rehmann also recommended that the Companies establish procedures to verify that all new employees have formal job descriptions for management personnel and that they consider establishing an in-house internal audit department. In addition, Rehmann recommended that the Companies develop a reorganization strategy that provides greater efficiency, accountability, and transparency. (Rehmann Audit Report at 37-40.)

IV. STIPULATION AND RECOMMENDATION

{¶ 10} On October 30, 2015, the Companies and Staff filed a Stipulation that, if adopted, would resolve all of the issues in this proceeding. OCC does not oppose the Stipulation. The following is a summary of the Stipulation and does not supersede or replace the Stipulation:

- (1) The Companies will maintain documentation and work papers in a consistent manner for future GCR audits. The Companies have implemented a policy that prohibits employees from performing certain manual adjustments to a GCR Excel spreadsheet and will also develop a written policy within six months of a final Order adopting the Stipulation that documents the remaining practices and procedures.
- (2) The Companies will develop a secure database to store historical information by January 1, 2016.
- (3) The Companies will maintain and provide the OCC and Staff the policy that addresses free gas and a list of customers that are provided free gas in future GCR audits.
- (4) The Companies will develop a written policy to ensure that the GCR calculation properly reflects all Commission-ordered adjustments within six months of a final Order adopting this Stipulation.
- (5) All gas purchases which are allocated among and between the Companies shall be supported by adequate and clear documentation to ensure that GCR customers receive gas for which they are lawfully charged. All documentation shall be retained by the Companies for a minimum of two GCR auditing cycles.

- (6) The Companies will document the reconciliation between the general ledger and the GCR in writing, and will ensure that these reconciliations are verified and signed-off by the executive management team and retained for a minimum of two GCR auditing cycles.
- (7) Orwell will evaluate the \$66,991 shrinkage cost charged by Orwell-Trumbull Pipeline Company, LLC (OTP) to determine if this charge was consistent with the parties' contractual obligations. Orwell agrees to timely seek reimbursement from OTP if this charge was inconsistent with the terms of the parties' contract.
- (8) Gas Natural Services Company shall no longer procure services for the Companies.
- (9) Written job descriptions for the various positions within the Companies shall be established within six months from the date of a final Order approving the Stipulation. The Companies will also provide a description of how the Companies will record and monitor shared services of employees amongst the Companies to ensure no cross-subsidization occurs.
- (10) The Companies agree that the only individuals allowed to use a Company vehicle are employees of the Companies.
- (11) The Companies have developed policies and procedures for affiliated and related-company transactions.
- (12) The Companies have begun the process of developing a policy regarding access to the utilities records and personnel access to network access rights and key confidential documents of the

Companies. The Companies agree to provide Staff and OCC an update regarding this process within six months of the issuance of a final Order adopting this Stipulation.

- (13) The Companies shall clearly and adequately document in writing the rationale behind any intercompany transactions.
- (14) Internal audits for the Companies will be performed annually based on an audit committee approved audit plan.
- (15) Consistent with the stipulation adopted in Case No. 14-206-GA-GCR, et al., the signatory parties recommend that the Commission order a management performance (m/p) audit conducted by an independent auditor, selected by the Commission, with an audit period of July 1, 2014, through June 30, 2016. The Companies' shareholders and Orwell's and Northeast's customers agree to split the actual cost of the m/p audit. Orwell's and Northeast's customers' share of the cost of the m/p audit (assuming the audit cost is \$100,000) has been paid as a result of the reduction of their respective refund amounts. The cost of the m/p audit will not exceed \$100,000. If the actual cost of the m/p audit is less than \$100,000, the Companies will refund to Orwell's and Northeast's customers an amount that ensures an equal sharing of the cost between the Companies' shareholders and their customers. The m/p audit shall continue in coordination with the GCR audits until the Commission deems it unnecessary.
- (16) The Companies agree that all interstate gas system operators' tariffs shall show the allowed retention/shrinkage percentage.

V. CONCLUSION

{¶ 11} Ohio Adm.Code 4901-1-30 authorizes parties to Commission proceedings to enter into a stipulation. Although not binding upon the Commission, the terms of such an agreement are accorded substantial weight. *Consumers' Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, 125, 592 N.E.2d 1370 (1992), citing *Akron v. Pub. Util. Comm.*, 55 Ohio St.2d 155, 157, 378 N.E.2d 480 (1978). This concept is particularly valid where the stipulation is unopposed by any party and resolves all issues presented in the proceeding in which it is offered.

{¶ 12} The standard of review for considering the reasonableness of a stipulation has been discussed in a number of prior Commission proceedings. *See, e.g., Dominion Retail v. Dayton Power and Light*, Case No. 03-2405-EL-CSS, et al., Opinion and Order (Feb. 9, 2005); *Cincinnati Gas & Elec. Co.*, Case No. 91-410-EL-AIR, Order on Remand (Apr. 14, 1994); *Ohio Edison Co.*, Case No. 91-698-EL-FOR, et al., Opinion and Order (Dec. 30, 1993); *Cleveland Elec. Illum. Co.*, Case No. 88-179-EL-AIR, Opinion and Order (Jan. 31, 1989). The ultimate issue for our consideration is whether the agreement, which embodies considerable time and effort by the signatory parties, is reasonable and should be adopted. In considering the reasonableness of a stipulation, the Commission has used the following criteria:

- (1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?
- (2) Does the settlement, as a package, benefit ratepayers and the public interest?
- (3) Does the settlement package violate any important regulatory principle or practice?

{¶ 13} At the hearing, Martin Whelan, president of Northeast, Brainard, and Orwell, and Staff witness Patrick Donlon provided testimony in support of the

stipulation. Mr. Whelan testified that the Stipulation is the product of serious bargaining among capable, knowledgeable parties. He explained that the Stipulation is the result of months of negotiation between OCC, Staff, and the Companies. He also noted that these parties regularly appear before the Commission and have experience with all of the issues in this case due to their participation in the Companies' prior GCR cases. (Companies' Ex. 2 at 4.) Staff witness Patrick Donlon testified that the signatory parties were parties to the prior stipulations on the Companies' GCR cases and are knowledgeable of regulatory matters before the Commission and regularly participate in rate proceedings. He also noted that, through the Stipulation, concessions were made by the Companies and Staff to mitigate the litigation risk inherent in proceeding to a hearing. (Staff Ex. 1 at 8.)

{¶ 14} The Commission finds that the Stipulation is the product of serious bargaining among capable, knowledgeable parties. We recognize that the counsel for the parties to this case have participated in several other Commission proceedings and are, therefore, familiar with Commission proceedings. (Companies Ex. 2 at 4.) Further, as noted by Staff witness Donlon, through the Stipulation, concessions were made by both parties to mitigate the litigation risk inherent in proceeding to a hearing (Staff Ex. 1 at 8). Consequently, the Commission finds that, based upon the record, the first criterion is satisfied.

{¶ 15} Mr. Whelan testified that the Stipulation benefits ratepayers and the public interest because the Companies have agreed to implement various measures that will ensure accurate and reliable GCR rates, prevent inappropriate affiliate transactions, and avoid potential conflicts of interest. He claimed that the Companies' regulated customers will greatly benefit from the commitments the Companies are making in this case. (Companies' Ex. 2 at 5.) Mr. Donlon testified that the Stipulation identifies, defines, and sets policies and procedures to tighten the internal controls of the Companies according to the results Rehmann found in the course of its investigation. He explained that the goal of this Stipulation was to establish appropriate policies and procedures and that, on a going

forward basis, Staff or a designated independent auditor will audit and verify that the Companies adhered to the policies and procedures through the course of the m/p audit that will be conducted in conjunction with the GCR audits. (Staff Ex. 1 at 9.)

{¶ 16} The Commission finds that, as a package, the Stipulation benefits the public interest by essentially including the recommendations, as set forth in the Rehmann Audit Report. As noted by Mr. Whelan, the Stipulation benefits ratepayers and the public interest because the Companies have agreed to implement various measures that will ensure accurate and reliable GCR rates, prevent inappropriate affiliate transactions, and avoid potential conflicts of interest. (Companies' Ex. 2 at 5.) In addition, as explained by Mr. Donlon, the Stipulation identifies, defines, and sets policies and procedures to tighten the internal controls of the Companies. Further, the benefits of the Stipulation to the public interest include: ensuring the Companies develop written policies that ensure GCR calculations properly reflects all Commission-ordered adjustments; ensuring that the Companies support all gas purchases with adequate and clear documentation so that GCR customers receive gas for which they are lawfully charged; requiring the Companies to develop policies and procedures for affiliated and related company transactions, as well as policies regarding access to the utilities' records for Staff and OCC; requiring internal audits for the Companies and splitting the cost of the next m/p audit between the Companies and not customers. (Staff Ex. 1 at 3-7.) Therefore, based on the record, the second criterion is satisfied.

{¶ 17} Mr. Whelan also testified that the Stipulation does not violate any important regulatory principle or practice. He stated that the Stipulation represents the agreement by the Companies to adopt the vast majority of the recommendations set forth in the Rehmann Audit Report and that Staff agrees to the Companies' plan to implement the recommendations set forth in the Rehmann Audit Report. (Companies' Ex. 2 at 5.) Mr. Donlon similarly testified that the Stipulation complies with all relevant and important principles and practices. (Staff Ex. 1 at 9.)

{¶ 18} The Commission finds that the Stipulation does not violate any important regulatory principle or practice and the conditions contained within the Stipulation properly address the issues raised in the Rehmann Audit Report. In addition, the Stipulation complies with all relevant and important principles and practices and reflects the state policies set forth in R.C. 4929.02. Therefore, based on the record, the third criterion is satisfied.

{¶ 19} The Commission concludes that the terms and conditions contained in the Stipulation represent a reasonable resolution of the issues in this case and, as a package, the Stipulation benefits ratepayers and advances the public interest. Further, the Commission finds that there is no evidence that the Stipulation violates any important regulatory principle or practice. Accordingly, the Stipulation should be adopted in its entirety.

VI. FINDINGS OF FACT AND CONCLUSIONS OF LAW

{¶ 20} The Companies are natural gas companies, as defined in R.C. 4905.03, and public utilities, as defined in R.C. 4905.02. As such, the Companies are subject to the jurisdiction of this Commission.

{¶ 21} By Entry issued April 2, 2014, the Commission initiated the audit of the Companies and their affiliates.

{¶ 22} By Entry of May 12, 2014, OCC's motion to intervene was granted.

{¶ 23} On January 23, 2015, Rehmann submitted its Audit Report to the Commission.

{¶ 24} On October 30, 2015, the Companies and Staff filed the Stipulation.

{¶ 25} On May 3, 2016, OCC filed a notice that it does not oppose the Stipulation.

{¶ 26} On May 10, 2016, a hearing was held in this matter.

{¶ 27} The Stipulation submitted by the parties in this case meets the criteria used by the Commission to evaluate stipulations, represents a just and reasonable resolution of the issues in this proceeding, and should be adopted.

VII. ORDER

{¶ 28} It is, therefore,

{¶ 29} ORDERED, That the Stipulation be adopted and approved. It is, further,

{¶ 30} ORDERED, That a copy of this Opinion and Order be served upon all interested persons and parties of record.

Commissioners Voting: Asim Z. Haque, Chairman; Lynn Slaby; M. Beth Trombold; Thomas W. Johnson.

SEF/sc