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October 1, 2019

VIA ELECTRONIC FILING
Honorable Kathleen H. Burgess
Secretary
New York State Public Service Commission
Three Empire State Plaza

Re: Case 17-G-0317 – Proceeding on Motion of the Commission to Investigate The Brooklyn Union Gas Company d/b/a National Grid NY and KeySpan Gas East Corporation d/b/a National Grid Compliance with Operator Qualification, Performance, and Inspection Requirements with Respect to Work Completed by Company and Contractor Personnel

Dear Secretary Burgess:

The Brooklyn Union Gas Company d/b/a National Grid NY and KeySpan Gas East Corporation d/b/a National Grid submit for filing this response to the "Order Instituting Proceeding and to Show Cause" issued on July 12, 2019 in the above proceeding.

Please contact the undersigned with any questions regarding this filing. Thank you for your time and attention in this matter.

Respectfully submitted,

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission to Investigate The Brooklyn Union Gas Company d/b/a National Grid NY and KeySpan Gas East Corporation d/b/a National Grid Compliance with Operator Qualification, Performance, and Inspection Requirements with Respect to Work Completed by Company and Contractor Personnel	:	**Case 17-G-0317**

RESPONSE OF THE BROOKLYN UNION GAS COMPANY D/B/A NATIONAL GRID NY AND KEYSPAN GAS EAST CORPORATION D/B/A NATIONAL GRID TO ORDER INSTITUTING PROCEEDING AND TO SHOW CAUSE

INTRODUCTION

On July 12, 2019, the New York State Public Service Commission ("PSC" or the "Commission") issued an "Order Instituting Proceeding and to Show Cause" ("Show Cause Order") in the above-referenced proceeding directing The Brooklyn Union Gas Company d/b/a National Grid NY ("KEDNY") and KeySpan Gas East Corporation d/b/a National Grid ("KEDLI") (KEDNY and KEDLI are collectively referred to as the "Companies"), to show cause why the Commission: (i) should not commence an administrative penalty action pursuant to Public Service Law ("PSL") § 25-a for alleged violations of the Commission's gas safety regulations in 16 NYCRR Part 255 and the Commission's "Order Requiring Local Distribution Companies to Follow and Complete Remediation Plans as Modified by this Order and to Implement New Inspection Protocols" in Case 14-G-0212;[1] and (ii) should not commence a prudence proceeding

[1] Case 14-G-0212, *Proceeding on Motion of the Commission to Investigate the Practices of Qualifying Persons to Perform Plastic Fusions on Natural Gas Facilities*, "Order Requiring Local Distribution Companies to Follow and Complete Remediation Plans as Modified by this Order and to Implement New Inspection Protocols" (issued and effective May 15, 2015) ("May 2015 Order").

against the Companies to ensure that the remedial costs to correct the alleged violations are not borne by customers.[2]

For the reasons set forth in this response, the Companies respectfully submit that the Commission should not commence an administrative penalty action pursuant to PSL § 25-a. KEDNY and KEDLI each understand their responsibility to comply fully with the Commission's safety regulations and are committed to achieving full compliance. This commitment is demonstrated, by *inter alia*:

- the Companies' immediate and continuing cooperation with Department of Public Service Staff ("Staff") throughout the ongoing investigation by the Companies and Staff of issues identified in this proceeding;
- the Companies' efforts to identify and remediate the deficiencies as rapidly as possible, including an immediate review of the work completed by contractor Network Infrastructure, Inc. ("Network"), and proactive reviews of work completed by other contractors, re-digs, and, where required, remediation of affected installations;

[2] Case 17-G-0317, *Proceeding on Motion of the Commission to Investigate The Brooklyn Union Gas Company d/b/a National Grid NY and KeySpan Gas East Corporation d/b/a National Grid Compliance with Operator Qualification, Performance, and Inspection Requirements with Respect to Work Completed by Company and Contractor Personnel*, "Order Instituting Proceeding and to Show Cause" (issued and effective July 12, 2019) ("Show Cause Order"), at 3. While the Show Cause Order mentions National Grid USA and directs it to make this filing, it is apparent from the Show Cause Order that the entities that are required to respond are KEDNY and KEDLI. Further, the Commission is not authorized to commence a civil penalty proceeding against National Grid USA, which is a holding company that does not provide any services to New York customers or directly own or operate "gas plant" or "electric plant" as those terms are defined under the Public Service Law. While the Commission has limited jurisdiction over holding companies under PSL § 5(1)(h), that jurisdiction does not authorize the Commission to commence a civil penalty proceeding against a holding company for alleged violations of the Commission's regulations by an operating company. Absent explicit statutory authorization, there is no basis for the Commission to commence a civil penalty proceeding against National Grid USA. *See Niagara Mohawk Power Corp. v. Public Service Commission*, 69 N.Y. 2d 365, 368-69 (1987) (holding that the Commission possesses only those powers expressly delegated by statute, and those incidental to or implied by, its statutory mandate).

- the Companies' commitment to immediately retest internal personnel and contractors on all required written operator qualification ("OQ") tests using enhanced knowledge assessments and testing protocols, which involved tens of thousands of individual assessments;
- the Companies' proactive efforts to identify and immediately disclose plastic fusion work performed during periods of lapsed OQs in compliance with the Commission's "Order Adopting Further Improvements in Plastic Fusion Practices on Natural Gas Systems";[3]

- the Companies' willingness to agree in the joint proposals resolving their most recent base rate proceedings[4] to gas safety regulations performance mechanisms that provide for both significant negative revenue adjustments in the event of non-compliance and a process for ensuring that compliance deficiencies are fully remediated;
- the Companies' ongoing efforts to implement various compliance improvement initiatives, including a comprehensive pipeline safety management system, enhanced training and inspection programs, enhanced compliance monitoring, reporting, and documentation, real-time checks of OQs on-site, and the re-

[3] Case 14-G-0212, *Proceeding on Motion of the Commission to Investigate the Practices of Qualifying Persons to Perform Plastic Fusions on Natural Gas Facilities*, "Order Adopting Further Improvements in Plastic Fusion Practices on Natural Gas Systems" (issued and effective May 18, 2018) ("May 2018 Order").
[4] KEDNY and KEDLI's most recent base rate proceedings were resolved in accordance with the terms of a Joint Proposal dated September 7, 2019 ("2016 KEDNY and KEDLI JP"). *See* Case 16-G-0059 *et al.*, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of The Brooklyn Union Gas Company d/b/a National Grid NY for Gas Service*, "Order Adopting Terms of Joint Proposal and Establishing Gas Rate Plans" (issued and effective December 16, 2016); and Case 16-G-0058 *et al.*, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of KeySpan Gas East Corp. d/b/a National Grid for Gas Service*, "Order Adopting Terms of Joint Proposal and Establishing Gas Rate Plans" (issued and effective December 16, 2016).

structuring of the Companies' Gas Business Unit to further emphasize gas safety performance;

- the substantial improvement that the Companies have made reducing instances of non-compliance with the Commission's gas safety regulations over the past four years;[5] and
- the Companies' continuing efforts to invest billions of dollars in its gas distribution networks to support safe operation.[6]

As discussed more fully below, there are a number of legal and factual reasons why the Commission should refrain from initiating a penalty proceeding against the Companies under PSL § 25-a(3).[7] Moreover, there is no reason for the Commission to establish a prudence proceeding to ensure that the remedial costs to correct the alleged violations are not borne by customers

[5] The Companies have demonstrated continuous improvement through a steady decline in the number of audit violations over the past several years. Indeed, since 2016, KEDNY and KEDLI have shown year-over-year improvements with respect to performance against gas safety compliance requirements. Based on the level of improved performance during 2016, KEDNY earned a 100 percent reduction to the remaining negative revenue adjustments ("NRAs") that resulted from the 2013 and 2014 audits under a mechanism agreed in the 2016 KEDNY and KEDLI JP.

[6] In their pending base rate proceedings in Cases 19-G-0309 and 19-G-0310, KEDNY and KEDLI have proposed to invest approximately $3.8 billion and $2.3 billion, respectively, in their gas distribution networks over the period April 1, 2020 through March 31, 2024 to ensure their continued ability to provide safe and reliable service. *See* Case 19-G-0309, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of The Brooklyn Union Gas Company d/b/a National Grid NY for Gas Service*, Direct Testimony of the Gas Safety Panel (filed April 30, 2019) ("2019 KEDNY Case"), at 6; and Case 19-G-0310, *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of KeySpan Gas East Corp. d/b/a National Grid for Gas Service*, Direct Testimony of the Gas Safety Panel (filed April 30, 2019) ("2019 KEDLI Case"), at 6. In addition, KEDNY and KEDLI have proposed several new gas safety programs and enhancements in their rate filings, many of which directly incorporate recommendations made by Staff. *See* 2019 KEDNY Case at 11-13, and 2019 KEDLI Case at 11-13. One of those programs is the enhanced Contractor Safety Inspection Program, under which one inspector will be assigned to every contractor crew. *See* 2019 KEDNY Case at 20-21; 2019 KEDLI Case at 20-21.

[7] In preparing this response, the Companies have not attempted to address every factual assertion in the Show Cause Order that they would otherwise dispute if the assertion were relevant to the ultimate assessment of a penalty in this proceeding. For example, the Show Cause Order's characterization of events that occurred on December 18, 2015 in connection with an in-line inspection of the Queens Pipeline is not consistent with KEDNY's field findings, investigation, or subsequent factory testing. The Companies reserve the right to challenge all factual assertions relied upon to support the imposition of penalties in this proceeding.

because the Companies agree to bear the incremental costs of addressing the issues identified in the Show Cause Order and have established separate accounting for tracking these costs to ensure they are not borne by customers. The incremental cost to date borne by shareholders is approximately $9.8 million, with a forecast of more than $5 million in additional incremental costs for future work.

KEDNY and KEDLI submit that the resources of Staff and the Companies are far better devoted to remaining on the present path of continued improvement in safety performance without the need for a costly and time-consuming administrative penalty proceeding regarding issues the Companies have already addressed in a manner that has had and will have no financial impact on customers.

BACKGROUND

I. Show Cause Order

The Show Cause Order asserts that Staff identified 1,616 alleged violations of the Commission's gas safety regulations over three years. The alleged violations relate to work performed by Network,[8] a contractor retained by KEDNY and KEDLI, on the Northern Queens Transmission Pipeline ("Queens Pipeline") and other projects in 2015 and 2016. Following the disclosure that Network employees cheated on written OQ exams, the Companies performed hundreds of re-digs of Network's work that the Show Cause Order alleges revealed construction deficiencies in violation of the Commission's gas safety regulations. The Show Cause Order also cites re-digs of work performed by various contractors during periods of lapsed OQs in violation of the May 2015 Order. As the Show Cause Order explains, the total alleged violations is high because of the methodology used by Staff. Specifically, in a majority of instances, Staff pancakes

[8] The Commission imputes Network's non-compliance with the gas safety regulations on KEDNY and KEDLI alleging that Network was an agent of the operating companies. Show Cause Order at 2.

one alleged violation of an inspection regulation on top of an alleged violation of an OQ regulation, and then adds these two alleged violations on top of an alleged violation of an individual Commission regulation.[9]

A. Network's Actions And Their Consequences

KEDNY and KEDLI contracted with Network to perform gas construction work in their service territories, including as the prime contractor on the Queens Pipeline. Network was an experienced independent contractor that also performed work on behalf of Consolidated Edison Company of New York, Inc and other utilities. On November 29, 2016, Staff received an anonymous letter ("November 2016 Letter"), which asserted that Network had engaged in construction practices that were unsafe and not in compliance with applicable Commission regulations and municipal requirements during Network's construction of the Queens Pipeline project. The November 2016 Letter also alleged that Network's employees had cheated on OQ exams administered by the Northeast Gas Association ("NGA").

Following its receipt of the November 2016 Letter and Staff's confirmation that NGA OQ tests had been compromised, Staff notified all local distribution companies ("LDCs") and instructed them to identify the extent of any similar issues to those outlined in the November 2016 Letter, retest workers and contractors who had taken the NGA OQ exams, and submit a workplan to address the issue, including random testing, field assessments, re-digs, and remediation, if necessary.

[9] Show Cause Order at 12, fn. 20. The Show Cause Order contains four categories of alleged violations: 499 OQ violations, 499 inspection violations, 330 underlying violations, and 288 violations of the May 2015 Order. *Id.* at 14-22.

B. The Companies' Investigation and Remediation Efforts

After receipt of the November 2016 Letter, KEDNY and KEDLI took immediate action to investigate the issues associated with Network and to proactively review potential OQ issues with other contractors and in-house personnel. These actions included revamping OQ assessment tests and implementing enhanced protocols for re-testing for the Companies' internal gas construction workforce and contractors. For internal field workers, this meant retesting personnel on all required OQ tasks, which involved more than 37,500 individual assessment tests. The Companies also conducted an internal review of OQs of all of the Companies' employees and contractors, as well as implementing weekly reviews of OQs. Upon completing the internal review, and throughout the course of the review, KEDNY and KEDLI shared the results of the review with Staff along with their remediation plans. At all times, the Companies were transparent with Staff regarding their findings and efforts to resolve the issues identified during their investigations.

Between December 2016 and July 2018, KEDNY and KEDLI completed a review of all work performed by Network during the 2015-2016 time period. KEDLI reviewed the records associated with 2,677 projects and inspected work at 175 locations completed by Network in 2015 and reviewed the records associated with 1,949 projects and inspected work at 178 locations completed by Network in 2016. Network performed one cast iron main replacement project in KEDNY's service territory during this time period, and KEDNY reviewed all 12 locations associated with this project. The review identified a number of issues, none of which presented an imminent threat to the health and safety of the public. A remediation plan was developed for the issues identified, and all of those issues have been remediated.

KEDNY also reviewed third-party utility crossings installed by Network for the Queens Pipeline between April 2017 and December 2018. In total, 438 facility crossings at 137 separate

locations were identified as requiring review. To date, all 137 crossings identified as "elevated risk" have been reviewed and KEDNY has reviewed or is in the process of reviewing the remaining "reduced risk" crossings. KEDNY identified certain instances of non-compliance with the Commission's regulations, none of which presented an imminent threat to the health and safety of the public, and developed a remediation plan for the Queens Pipeline Project. All required remediation has been completed to date, with the exception of 15 known locations that are pending remediation. Those locations are currently in various stages of engineering and design, and, in some cases, require cooperation from third parties as well as certain agency approvals. While it is currently anticipated that remediation activities at these sites will be completed by the end of 2020, the ultimate competition date is dependent upon those external factors and may be subject to change.

Finally, the Companies have performed over 1,000 focused re-digs of work performed by employees and contractors whose OQs had potentially lapsed at the time that the work was performed. In addition to work performed by Network, the focused re-digs reviewed work completed on the Companies' transmission and distribution systems between 2015 and 2018 by its internal employees and certain contractors, including Hallen, Hawkeye, Bancker, and Asplundh. Pursuant to the Commission's May 2018 Order, KEDNY and KEDLI submitted detailed reports on the results of these focused re-digs as well as the associated costs for 2015-2018. All remediation associated with these focused re-digs have been completed.

The Companies believe that these measures will enable KEDNY and KEDLI to achieve full compliance with the Commission's gas safety regulations and orders. The Companies continue to provide updates to Staff, including monthly and annual reporting on plastic fusion inspections in Case 14-G-0212.

C. Costs Incurred By The Companies

While under no legal or regulatory obligation, the Companies committed that customers would not bear any incremental costs associated with the allegations in the Show Cause Order. This commitment has resulted in the Companies' shareholders bearing approximately $9.8 million in costs to date. This amount, and any future incremental costs related to issues identified in the Show Cause Order, which are currently projected to exceed $5 million, will be borne by the Companies' shareholders and not passed to KEDNY and KEDLI's customers. To this end, the Companies have charged all incremental work related to the matters discussed in the Show Cause Order to specific work orders that allocate costs to the Companies' shareholders. As such, these costs are not included in the Companies' proposed revenue requirements in their current base rate proceedings and will not be borne by customers. With regard to focused re-digs related to OQ issues, those costs – totaling more than $0.500 million – have been reported to the Commission in Case 14-G-0212 and, as indicated in those reports, have been similarly recorded in below-the-line accounts. Thus, in total to date, the Companies have borne costs in excess of $10 million to address the issues identified in the Show Cause Order (as shown in the table on the following page) and anticipate incurring additional substantial costs in the near future to remediate the remaining issues.

Table 1 – Summary of Costs Borne by the Companies

Network Related Costs					
	FY17	FY18	FY19	FY20	Total
KEDNY	$175,420	$1,941,543	$3,750,124	$155,094	$6,022,182
KEDLI	$648,712	$1,460,546	$1,139,264	$482,613	$3,731,135
Total	**$824,132**	**$3,402,088**	**$4,889,388**	**$637,708**	**$9,753,317**

Case 14-G-0212 OQ Issues			
	Pre-CY18	CY18	Total
KEDNY	$80,366	$240,833	$321,199
KEDLI	$80,554	$136,421	$216,976
Total	**$160,920**	**$377,254**	**$538,175**

RESPONSE

The Companies respectfully submit that the Commission should not commence an administrative penalty action pursuant to PSL § 25-a(3) against either KEDNY or KEDLI for the alleged violations discussed in the Show Cause Order for a number of reasons. The decision to commence a penalty action under PSL § 25-a(3) is a matter committed to the Commission's discretion. In exercising this discretion, the Commission should recognize KEDNY and KEDLI's (i) efforts to fully cooperate with and respond to Staff's investigation in this matter in a forthright and transparent manner and to achieve full compliance with the Commission's gas safety regulations as rapidly as possible; (ii) consistent improvement in meeting the Commission's gas safety metrics; (iii) enhanced OQ assessments and training protocols for the Companies' internal workforce and contractor employees; (iv) commitment to promoting compliance through training and various compliance improvement initiatives, including programs recommended by Staff; (v) investigation and remedial work with costs borne by the Companies' shareholders, with no

costs to customers; and (vi) willingness to invest billions of dollars to maintain the safety and reliability of its gas distribution networks in New York State, as a basis for the Commission to conclude that it would be a far better use of the resources of the Companies, the Commission, and Staff to continue working in a cooperative manner to achieve the greatest possible level of safety and reliability for KEDNY and KEDLI's distribution system in lieu of commencing and litigating a punitive penalty proceeding.

In addition, there are a number of legal and factual reasons why the Commission should refrain from commencing a penalty proceeding in this case. In this regard, as discussed more fully below:

(i) the Commission does not have authority to commence such an action against KEDNY or KEDLI because PSL § 25-a(3) does not apply to either company;

(ii) if the Commission were to interpret PSL § 25-a(3) as having application to KEDNY or KEDLI, such an interpretation would violate state and federal constitutional guarantees of equal protection;

(iii) under the facts of this case, the Commission does not have authority to institute a penalty proceeding under PSL § 25-a based on the actions of KEDNY and KEDLI's independent contractors;

(iv) the Show Cause Order fails to show that KEDNY or KEDLI did not reasonably comply with many of the regulations cited in the Show Cause Order and/or misapplies the applicable regulations and Commission precedent;

(v) many of the violations alleged in the Show Cause Order inappropriately applied iterative regulations to the same incident and seek multiple penalties for the same alleged conduct; and

(vi) even if the Commission ultimately were to find that any violations of its regulations occurred, any potential penalties for such violations would be fully mitigated under the factors set forth in PSL § 25-a(2)(a).

Additionally, the Commission should not commence a prudence proceeding to review the costs incurred by KEDNY and KEDLI related to this matter, because, since the time these issues were discovered, all incremental costs of the Companies' review and remediation efforts have been, and will continue to be, borne directly by the Companies, not customers.[10]

I. PSL § 25-a(3) Does Not Authorize The Commission To Bring A Penalty Action Against KEDNY Or KEDLI For The Alleged Violations

As an initial matter, PSL § 25-a is penal in nature and, as such, must be strictly construed in favor of the Companies.[11] New York courts have expressly held that PSL § 25, which authorizes the Commission to seek civil penalties in state supreme court is penal, finding that it "should be strictly construed and not extended to cover cases not clearly within its terms."[12] Although the courts have not had occasion to find that PSL § 25-a is a penal statute, the similarities between PSL § 25 and PSL § 25-a require a determination that the courts' earlier holdings concerning PSL § 25 apply with equal force to PSL § 25-a. Both PSL § 25 and § 25-a require a utility to "forfeit a sum . . . constituting a civil penalty" upon a finding of wrongdoing against the utility.[13] The fact

[10] Indeed, it should be noted that in its recently filed testimony in the Companies' current base rate proceedings, neither Staff nor any other party proposed any downward revenue requirement adjustments associated with costs that the Companies incurred in connection with the issues raised in this proceeding.
[11] *People v. Hurley Water Co.*, 84 A.D.2d 615, 616 (3d Dep't 1981) ("*Hurley Water Co.*") (holding PSL § 89-k, the precursor to PSL § 25, "is penal in nature in that it provides for the imposition of a fine for the violation of a PSC order"); *see also People v. Consol. Edison Co. of N.Y., Inc.*, Sup. Ct., Alb. Cty., Klein, J. (Mar. 11, 1983) (finding that PSL § 25 is a penal statute and must be strictly construed).
[12] *People v. Consol. Edison Co. of N.Y., Inc.*, Sup. Ct., Alb. Cty., at 3 ("Where, as here, a clearly penal statute is involved, a Court should not by implication extend the meaning or breadth of the statute."); *see also Hurley Water Co.*, 84 A.D.2d at 616 (strictly construing former PSL § 89-k, the predecessor to PSL § 25).
[13] *See* PSL § 25(2), (3), (4); PSL § 25-a(3), (4), (5), (6).

that civil penalties under PSL § 25-a are imposed by the Commission as opposed to by a court, as is the case under PSL § 25, does not change the penal nature of the statute. Rather, the similarities between PSL § 25 and § 25-a strongly support a finding that PSL § 25-a is also penal in nature.

Statutes that prescribe civil penalties, such as PSL §25-a, have been deemed by New York courts to be "penal in nature."[14] Under the proper construction of a penal statute, the Commission must strictly and carefully construe both the standards for liability under PSL § 25-a and the underlying statute, Commission order, or regulation that is the alleged grounds for the penalty.[15] The New York Court of Appeals has long held that "a statute awarding a penalty is to be strictly construed, and before a recovery can be had a case must be brought clearly within its terms."[16] Therefore, PSL § 25-a, which potentially carries significant penalties, must be strictly construed, and the Commission must resolve any ambiguity or vagueness in the language of the statute itself, or in the regulations relied on as the grounds for an alleged violation, in favor of KEDNY and KEDLI.

[14] *See, e.g. City of New York v. Verizon N.Y., Inc.*, 4 N.Y.3d 255, 259 (2005) ("*Verizon*") (holding that a statute "operates as a penal statute because it imposes civil fines without regard to the City's actual costs"); *People v. Consolidated Edison Co. of N.Y.*, 41 A.D.2d 809, 810 (1st Dep't 1973) ("A statute which prescribes a civil penalty is penal in nature and must be construed strictly in favor of the party against whom the penalty is sought to be imposed."); *see also People v. Whitridge*, 144 A.D. 486, 489 (1st Dep't 1911) (holding that a statute that authorizes a penalty action is "very highly penal") *aff'd* 204 N.Y. 646 (1912).

[15] *See Hurley Water Co.*, 84 A.D.2d at 616.

[16] *Verizon* 4 N.Y.3d at 258-59 (quoting *Goodspeed v. Ithaca St. Ry. Co.*, 184 N.Y. 351, 354 (1906)); *see also* N.Y. Stat. Law § 271 ("Generally, penal statutes are strictly construed against the State and in favor of the accused."); *Hurley Water Co.*, 84 A.D.2d at 616 (3d Dep't 1981) (holding that where a statute is "penal in nature in that it provides for the imposition of a fine for the violation of a PSC order, the related section should be strictly construed and not extended to cover cases not clearly within its terms").

A. PSL § 25-a Does Not Apply To KEDNY Or KEDLI Because They Are Not "Combination Gas and Electric Corporations"

Under PSL § 25-a, the Commission is authorized to assess administrative penalties against "combination gas and electric corporations."[17] A "combination gas and electric corporation," as used in PSL § 25-a, is defined as "any gas corporation operating in New York under common ownership with an electric corporation operating in New York or any electric corporation operating in New York under common ownership with a gas corporation operating in New York."[18] As discussed *supra*, because PSL § 25-a is penal in nature, its terms must be strictly construed, with any ambiguity resolved in favor of the Companies and against the Commission. Under the plain terms of the statute, particularly when strictly construed as required under New York law, neither KEDNY nor KEDLI is a "combination gas and electric corporation." Rather, both KEDNY and KEDLI are gas corporations and "straight gas corporations," as those terms are used in the PSL, and therefore are not subject to PSL § 25-a.[19]

That KEDLI and KEDNY share an indirect corporate parent with Niagara Mohawk Power Corporation ("Niagara Mohawk"), which is an electric corporation under the PSL, does not bring the Companies within the scope of PSL § 25-a. KEDLI is a direct subsidiary of National Grid USA. KEDNY is a direct subsidiary of KeySpan Energy Corporation. Niagara Mohawk is a direct subsidiary of Niagara Mohawk Holdings, Inc. Therefore, neither KEDNY nor KEDLI is under common ownership with Niagara Mohawk, a "combination gas and electric corporation." Rather, each of National Grid USA's New York operating companies are directly owned by separate and distinct parent companies, as shown in the table below.

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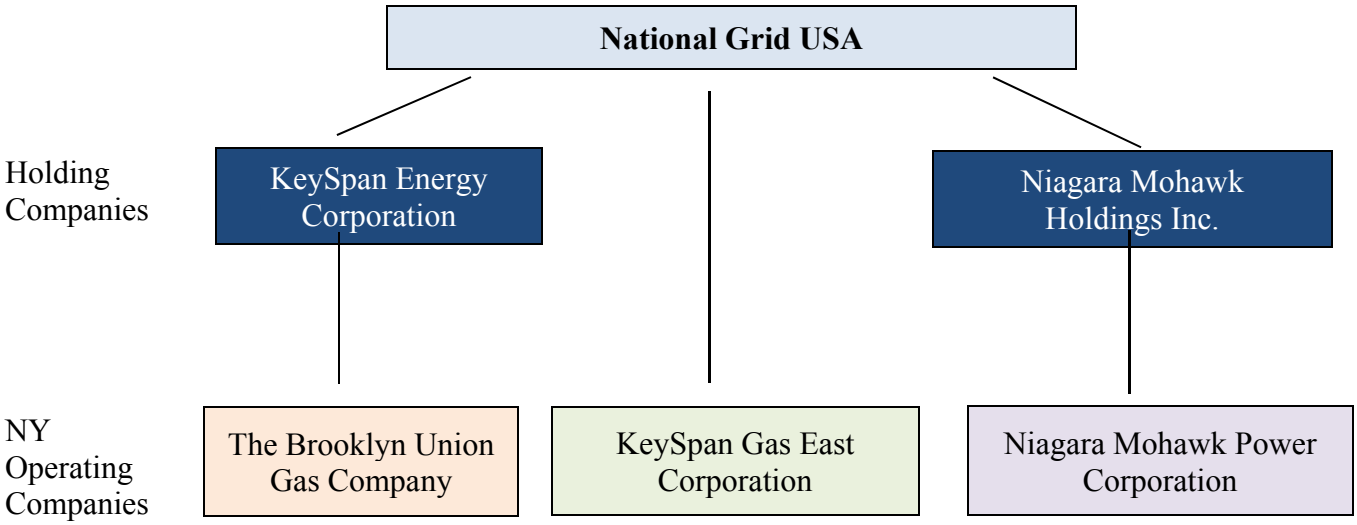
[17] PSL § 25-a.
[18] PSL § 2(14).
[19] *See* PSL § 2(11) (defining a "gas corporation") and § 66(19)(a) (requiring operations and management audits to be conducted every five years for both "combination gas and electric corporations" as well as "straight gas corporations").

Table 2 – National Grid Corporate Structure



The fact that KEDNY and KEDLI share an indirect parent with Niagara Mohawk does not bring either gas operating company within the scope of PSL § 25-a. The legislative history of PSL § 25-a makes clear that the term "combination gas and electric corporation," and by extension the Commission's administrative penalty authority under PSL § 25-a, applies only to legal entities that are both gas corporations and electric corporations at the operating company level. Upstream ownership interests, such as National Grid's ownership of Niagara Mohawk, do not have any effect on whether a separate entity is a "combination gas and electric corporation." Indeed, National Grid is a holding company incorporated in Delaware with its principal place of business in Waltham, Massachusetts. It owns no real estate, gas plant or electric plant in New York, has no office in New York, and does not provide electric or gas service to customers in New York.

PSL § 25-a was enacted primarily on the basis of the recommendations of the Moreland Commission on Utility Storm Preparation and Response ("Moreland Commission").[20] The Moreland Commission was principally concerned with the response of the State's electric utilities to outages caused by Superstorm Sandy, Hurricane Irene, and other severe storms.[21] To that end, the Moreland Commission investigated and made recommendations regarding six investor-owned operating utilities: Con Edison, Orange and Rockland Utilities, Inc., New York State Electric & Gas Corporation ("NYSEG"), Rochester Gas and Electric Corporation, Central Hudson Gas & Electric Corporation, and Niagara Mohawk.[22] The Moreland Reports do not, at any point, mention any of New York's straight gas corporations, including KEDNY, KEDLI, and National Fuel Gas Distribution Corporation ("National Fuel"). Further, although the Moreland Commission expressly discusses Niagara Mohawk's response to the major storms, and makes recommendations for Niagara Mohawk, neither Report notes that Niagara Mohawk shares an indirect parent with two New York gas corporations, KEDLI and KEDNY, or contains any recommendations applicable to KEDNY, KEDLI, or any other straight gas corporation. The complete omission of all straight gas corporations from the Moreland Reports demonstrates that such corporations were

[20] As PSL § 25-a was enacted as part of a state budget act, there is little direct legislative history regarding the section. However, as the section was enacted in response to the Moreland Commission's recommendations, the reports issued by the Moreland Commission provide insight into intent behind the statute, and should be taken into consideration when construing its terms. *See Riley v. County of Broome*, 95 N.Y.2d 455, 463 (2000) ("Pertinent also [to the construction of a statute] are 'the history of the times, the circumstances surrounding the statute's passage, and . . . attempted amendments'") (quoting N.Y. Stat. Law § 124 (McKinney's 2019)).

[21] Moreland Commission, Final Report (June 22, 2013), p. 8 ("Moreland Final Report") ("Governor Andrew M. Cuomo established a commission under the Moreland Act . . . to study New York's power utility companies' response to Hurricanes Irene and Sandy, Tropical Storm Lee, the December 2008 Ice Storm . . . and other major storms impacting the State."), *see also* Moreland Commission, Interim Report (Jan. 7, 2013) ("Moreland Interim Report"). The Moreland Final Report and Moreland Interim Report are hereinafter collectively referred to as the "Moreland Reports" or the "Reports."

[22] Moreland Final Report at p. 14.

not intended to be, and are not, subject to PSL § 25-a, as they are not "combination gas and electric corporations" under the PSL.

The New York Legislature's changes to the PSL amendments initially recommended by Governor Cuomo and the Moreland Commission further illustrate that PSL § 25-a does not apply to KEDNY or KEDLI. Based upon the Moreland Commission's findings, Governor Cuomo recommended amending the PSL to: (a) authorize the Commission to directly assess penalties against *all public utility companies* without going to court; (b) remove the "knowing" standard for liability for penalties; and (c) authorize the Commission to directly assess penalties for any violation of the Commission's regulations.[23] The legislation ultimately passed by the Legislature and signed by the Governor, however, was more restrictive on the grant of authority to the Commission. Although the Legislature authorized the Commission to directly assess penalties, including for violations of the Commission's regulations, this authority extended only to violations by "combination gas and electric corporations"; the Commission is still required to seek penalties against all other utilities in state supreme court.[24] Further, the Legislature changed the standard of liability from "knowing" violations to "failure to reasonably comply" for combination gas and electric corporations, but retained the knowing standard for all other public utilities.[25] The

[23] *See* 2013-14 New York State Executive Budget, Transportation, Economic Development and Environmental Conservation, Article VII Legislation, Part O, § 1 (Jan. 19, 2013) ("Executive Budget Recommendation") (recommending the repeal of PSL §§ 24 and 25 and enactment of a new PSL § 24), *available at* https://www.budget.ny.gov/pubs/archive/fy1314archive/eBudget1314/fy1314artVIIbills/TEDArticleVII.pdf; *see also* 2013-14 New York State Executive Budget, Transportation, Economic Development and Environmental Conservation, Article VII Legislation, Memorandum in Support, Part O (providing that the recommended PSL amendments would authorize the Commission to "initiate administrative proceedings to recover civil penalties against *each public utility company* and obtain increased penalties to ensure adequate deterrence") (emphasis added), *available at* https://www.budget.ny.gov/pubs/archive/fy1314archive/eBudget1314/fy1314artVIIbills/TED_ArticleVII_MS.pdf.

[24] *Compare* PSL § 25 with PSL § 25-a.

[25] *Id.*

Assembly specifically noted that the purpose of its changes to the Governor's recommended amendments was to "restore the 'knowing' standard for violations of [the] Public Service Law."[26] The Legislature's changes to the PSL amendments recommended by the Governor demonstrate the Legislature's intent to limit the scope of the Commission's enhanced penalty authority to only "combination gas and electric corporations" that were subject to the Moreland Commission's investigation. For all other utilities, including KEDNY and KEDLI, the Commission must proceed under PSL § 25 and seek civil penalties, if any are warranted, in state supreme court.

The use of the term "combination gas and electric corporation" elsewhere in the PSL also demonstrates that KEDNY and KEDLI do not fall within the definition of the term. Section 66-o of the PSL requires that "each combination gas and electric corporation shall file an application with the commission to establish a residential tariff for eligible vehicles for the purpose of recharging an eligible vehicle or vehicles."[27] Neither KEDNY nor KEDLI provides electric service, nor do they maintain any electric facilities in their respective service territory. As such, it would be impossible for KEDNY or KEDLI to comply with PSL § 66-o and establish a tariff for electric vehicle recharging. However, if either KEDNY or KEDLI were a "combination gas and electric corporation," PSL § 66-o(2) would require them to do just that. In fact, during the enactment of PSL § 66-o, Staff essentially acknowledged that neither KEDNY nor KEDLI is a "combination gas and electric corporation." In a letter to the Counsel to the Governor supporting the statute, the Staff General Counsel stated that "combination gas and electric corporations:"

[26] New York State Assembly, Ways and Means Committee, Summary of the Assembly Recommended Changes to the Executive Budget Proposal (Mar. 2013) ("Assembly Budget Recommendations"), p. 63-1, *available at* https://nyassembly.gov/Reports/WAM/20130311/.
[27] PSL § 66-o(2).

> include "any gas corporation operating in New York under common ownership with an electric corporation operating in New York or any electric corporation operating in New York under common ownership with a gas corporation operating in New York, or any successor of either such corporation; provided, however, that such term shall not include municipally-owned utilities, and shall not include any generating facilities owned or operated by either such corporation or any common owner thereof, or any subsidiary of such common owner." (PSL §2(14).) There are six combination corporations: Consolidated Edison, Orange & Rockland, Central Hudson Electric & Gas, National Grid, NYS Electric & Gas, and Rochester Electric & Gas.[28]

Notably, this list of six utilities mirrors the six utilities investigated by the Moreland Commission. Further, although Staff refers to "National Grid" in its letter, this reference is clearly intended to mean only Niagara Mohawk, as the listed combination gas and electric corporations consist of operating companies with both gas and electric businesses, not corporate parents. Con Edison and Orange & Rockland are both held by a common parent, Consolidated Edison Company, Inc., and NYSEG and Rochester Gas & Electric are both held by Avangrid Networks, Inc. While it does not share a common parent with other New York utilities, Central Hudson Electric & Gas Corporation is held by Fortis, Inc. However, Staff does not list the corporate parents of New York operating utilities; it lists the operating utilities in New York that have both gas and electric businesses. As such, the reference to "National Grid" can only be read to refer to Niagara Mohawk, an operating utility with both gas and electric businesses.

As penal statutes must be strictly construed, PSL § 25-a may only be applied to KEDNY and KEDLI if there is a clear legislative intent to do so. Here, there is no such clear legislative intent. Moreover, there are several reasons to conclude that the statute applies only to utility corporations that are both electric and gas corporations at the operating company level, regardless of upstream ownership interests or related affiliates. Because ambiguity in the application of the

[28] Letter from Paul Agresta, Staff General Counsel, to Alphonso David, Counsel to the Governor (Aug. 25, 2017), p. 1, note 1 (supporting enactment of PSL § 66-o).

statute must be resolved in favor of KEDNY and KEDLI, PSL § 25-a does not apply to KEDNY or KEDLI and the Commission may not commence an administrative penalty action against either gas operating company.

B. Application of PSL § 25-a To KEDNY And KEDLI Would Violate The Constitutional Guarantee Of Equal Protection

Applying PSL § 25-a to KEDNY and KEDLI would treat those companies in a manner that would create significant constitutional issues related to equal protection. The Court of Appeals has held that, "[w]here the language of a statute is susceptible of two constructions, the courts will adopt that which avoids injustice, hardship, *constitutional doubts* or other objectionable results."[29] The Supreme Court of the United States similarly has held that a statute "must be construed, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional but also grave doubts upon that score."[30] Therefore, the Commission should not apply PSL § 25-a to KEDNY or KEDLI to avoid raising difficult state and federal constitutional equal protection issues in the absence of a clear legislative intent.

Both the United States and New York State Constitution guarantee KEDNY and KEDLI equal protection of the laws.[31] The constitutional guarantee of equal protection requires that all similarly situated persons be treated alike.[32] While a state generally has broad discretion in

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[29] *H. Kauffman & Sons Saddlery Co. v. Miller*, 298 N.Y.38, 44 (1948) (emphasis added); *see also Rector, Church Wardens & Vestrymen of St. Bartholomew's Church v. Comm. to Preserve St. Bartholomew's Church*, 84 A.D.2d 309, 315-16 (1st Dep't 1982) ("It is axiomatic that statutes are to be construed, *inter se*, so as to avoid constitutional conflict.").

[30] *Rust v. Sullivan*, 500 U.S. 173, 191 (1991) (quoting *United States v. Jin Fuey Moy*, 241 U.S. 394, 401 (1916)). The New York Court of Appeals also observes this canon of statutory interpretation. *See Tauza v. Susquehanna Coal Co.*, 220 N.Y. 259, 267 (1917) (quoting *Jin Fuey Moy*, 241 U.S. at 401).

[31] U.S. Const. amend. XIV, § 1 ("No State shall . . . deny to any person within its jurisdiction the equal protection of the laws."); N.Y. Const. art 1, § 11 ("No person shall be denied the equal protection of the laws of this state or any subdivision thereof.").

[32] *See, e.g.*, *Plyler v. Doe*, 457 U.S. 202, 216 (1982) (citing *F. S. Royster Guano Co. v. Virginia*, 253 U.S. 412, 415 (1920)); *Bower Assocs. v. Town of Pleasant Valley*, 2 N.Y.3d 617, 630 (2004) ("The essence of a

establishing classifications in statutes, a state may not "legislate that different treatment be accorded to persons placed by a statute into different classes on the basis of criteria wholly unrelated to the objective of that statute."[33] As such, "equal protection does not require that all persons be dealt with identically, but it does require that a distinction made have some relevance to the purpose for which the classification is made."[34]

Applying PSL § 25-a to KEDNY and KEDLI raises significant issues regarding the state and federal constitutional guarantees of equal protection because it would treat KEDNY and KEDLI differently from other similarly situated New York gas corporations such as National Fuel, and would impose significantly harsher standards on KEDNY and KEDLI as compared to other similarly situated New York gas corporations. First, KEDNY and KEDLI would be subject to increased penalties under PSL § 25-a, based on their operating revenues, while the Commission would be limited to flat statutory penalty amounts under PSL § 25 for other gas-only operating companies.[35] Second, PSL § 25-a would permit the Commission to directly assess administrative penalties against KEDNY and KEDLI, while the Commission would be required to seek civil penalties against other gas-only operating companies in state supreme court. Finally, under PSL § 25-a, the Commission could assess penalties against KEDNY and KEDLI based on a lower "failure to reasonably comply" standard; for other gas-only operating companies, PSL § 25

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violation of the constitutional guarantee of equal protection is, of course, that all persons similarly situated must be treated alike.").

[33] *Johnson v. Robison*, 415 U.S. 361, 374 (1974).

[34] *Neale v. Hayduk*, 35 N.Y.2d 182, 186 (1974); *see also Johnson*, 415 U.S. at 374-75 ("A classification 'must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike.'") (quoting *F.S. Royster Guano Co.*, 253 U.S. at 415).

[35] *Compare* PSL § 25-a(3)-(5) (authorizing the Commission to asses greater penalties based on a combination gas and electric corporation's intrastate gross operating revenue) *and* PSL § 25(2)-(4) (establishing flat limits for penalty amounts).

requires the Commission to establish a "knowing" violation before the court may assess a penalty.[36]

This disparate treatment of KEDNY and KEDLI as compared to other gas-only operating companies would be completely unrelated to the purpose of PSL § 25-a, wholly arbitrary and without rational basis and, therefore, would not pass constitutional muster. There is no rational basis to distinguish KEDNY or KEDLI from other gas-only operating companies such that this disparate treatment would be reasonable. As gas corporations, KEDNY and KEDLI are generally subject to the same rules, regulations, and Commission oversight as other gas-only operating companies in the State. Further, KEDNY and KEDLI's size or operating revenues do not create a reasonable basis to support disparate treatment as compared to National Fuel. KEDLI, KEDNY, and National Fuel are all "Class A" gas utilities under the Commission's regulations that serve more than 500,000 customers through over 8,000 miles of distribution main, and, leaving aside the possible application of PSL § 25-a, are subject to otherwise identical regulations under the PSL and the Commission's regulations.[37] Further, any distinction between KEDNY, KEDLI, and National Fuel based on upstream ownership of KEDNY and KEDLI is arbitrary. While KEDNY and KEDLI may obtain some benefits of its ownership structure (*e.g.*, shared administrative costs), National Fuel receives similar benefits from its upstream ownership as part of a similar holding company structure. Distinguishing KEDNY and KEDLI from National Fuel and other gas-only

[36] *Compare* PSL § 25-a(3-5) (authorizing the Commission to assess penalties when a combination gas and electric corporation "fails to reasonably comply with" an applicable provision of law) *and* PSL § 25(2)-(4) (providing that penalties may be assessed against a utility that "knowingly fails or neglects to obey or comply with" an applicable provision of law). This distinction may be particularly significant in this proceeding given the intentional misconduct and fraud perpetuated by Network against the Companies.

[37] KEDNY, KEDLI, and National Fuel serve approximately 1.2 million, 594,000 and 527,000 customers in New York through 4,100, 8,200 and 9,617 miles of main, respectively.

utilities merely because one of the Companies' affiliates is an electric corporation would be arbitrary and provides no reasonable basis to support disparate treatment under PSL § 25-a.

For these reasons, the application of PSL § 25-a to KEDNY and KEDLI would raise significant state and federal constitutional concerns regarding equal protection. Given these constitutional concerns, as well as the lack of a clear legislative intent that the statute applies to KEDNY and KEDLI, the Commission should find that PSL § 25-a does not apply to KEDNY or KEDLI.

C. Under The Facts Of This Case, The Commission Is Not Authorized To Assess Penalties To The Companies For Actions Of The Companies' Independent Contractors

Even if KEDNY or KEDLI were "combination gas and electric corporations," the Commission is not authorized to assess penalties against the Companies under PSL § 25-a based on the actions of third parties that serve as the Companies' independent contractors, but not their agents, for two reasons. First, under the terms of PSL § 25-a, the Commission does not have authority to assess penalties for the acts of independent contractors that do not serve as the Companies' agents. Second, even if the Companies' contractors were considered agents under PSL § 25-a, rather than independent contractors, the Companies cannot be held liable for actions taken by those agents outside the scope of the agency. As discussed more fully below, the actions alleged to have been taken by the Companies' contractors that are the subject of the Show Cause Order are outside the scope of the contractors' authority.

1. The Commission May Not Assess Penalties Against KEDLI or KEDNY Due to the Actions of Independent Contractors That Are Not Acting As The Companies' Agents

PSL § 25-a(10) states that, "[i]n construing and enforcing the provisions of [the PSL] relating to penalties, the act of any director, officer, *agent* or employee of a combined gas and

electric corporation acting within the scope of his or her official duties or employment shall be deemed to be the act of such corporation."[38] As discussed *supra*, PSL § 25-a must be strictly construed against the Commission and in favor of the Companies, and "not extended to cover cases not clearly within its terms." Because PSL § 25-a, by its plain terms strictly construed, states only that the acts of agents may be imputed to the Companies, the acts of independent contractors that do not serve as agents may not serve as the basis for civil penalties. Because the contractors here, including Network, are independent contractors but not agents, the plain terms of the statute, strictly construed, do not authorize the Commission to assess penalties for the alleged violations committed by the Companies' contractors.

In stating that the contractors are "agents" because they "act[] on behalf of National Grid in its construction work,"[39] the Show Cause Order neglects the "critical factor" in determining whether a party is an agent or independent contractor: "control of the method and means by which work is to be performed."[40] In *Time Warner City Cable v. Adelphi University*, cited by the Show Cause Order, the Second Department makes clear that an agent does not merely act on behalf of another party, but acts "subject to his or her control."[41] While courts in New York have recognized that an independent contractor may be an agent under certain circumstances,[42] an independent

[38] PSL § 25-a(10) (emphasis supplied).
[39] Show Cause Order, at 2 note 2 (citing *Time Warner City Cable v. Adelphi Univ.*, 27 A.D.3d 551, 552 (2d Dept. 2006)).
[40] *Quik Park West 57, LLC v. Bridgewater Operating Corp.*, 148 A.D.3d 444, 445 (1st Dept. 2017). ("As a general rule, control of the method and means by which work is to be performed is a critical factor in determining whether one is an independent contractor or an employee") (citing *Melbourne v New York Life Ins. Co.*, 271 AD2d 296, 297 (1st Dept 2000)).
[41] *Time Warner City Cable*, 27 A.D.3d at 552 ("A principal-agent relationship may be established by evidence of the 'consent of one person to allow another to act on his or her behalf *and subject to his or her control*, and consent by the other so to act . . . .."") (emphasis added).
[42] *See Columbia Broadcasting Sys., Inc. v. Stokely Van-Camp, Inc.*, 522 F.2d 369, 375 ("We also are fully aware that an independent contractor, one who is not subject to the right of another to control his physical conduct in the performance of the undertaking, may or may not be an agent.") (citing Restatement (Second) Agency § 14N (1958)).

contractor is not an agent where it does not have a fiduciary relationship with its employer and "is not controlled by the [employer] nor subject to the [employer's] right to control with respect to his physical conduct in the performance of the undertaking."[43] As such, "non-agent independent contractors" include "builders and others who have contracted to accomplish physical results not under the supervision of the one who has employed them to produce the results."[44] Here, the Companies' independent contractors do not have a fiduciary relationship with the Companies. Rather, the independent contractors are employed by the Companies for specific projects, such as the construction of a pipeline (*i.e.* "to accomplish physical results"). While the independent contractors are required to perform the work in compliance with the Commission's regulations and other applicable laws, and are required to meet the Companies' specifications and observe certain procedures, the contractors are not subject to the degree of control necessary to create an agency relationship. In fact, the Companies' contracts with Network and the other contractors expressly state that each contractor "is, and shall at all times remain an independent contractor," and that the contractor "shall be solely responsible for all construction means, methods, techniques, sequences, procedures, safety, and compliance programs in connection with the performance of the Work."[45]

[43] *See, e.g.*, *Butto v. Collecto Inc.*, 845 F.Supp.2d 491, 497 (E.D.N.Y. 2012) ("There is no doubt that an independent contractor may simultaneously be an agent . . .. However, an agency relationship is 'the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.'") (citing Restatement (Second) Agency § 14N); *Marmolejo v. New York City School Constr. Auth.*, 195 Misc.2d 708, 711 (Sup. Ct., N.Y. Cty. 2003) (quoting *E.B.A. Wholesale Corp. v S. B. Mechanical Corp.*, 127 A.D.2d 737, 739 (2d Dept. 1987)).

[44] *Marmolejo*, 195 Misc.2d at 711 note 3 (quoting Restatement (Second) Agency § 14N, cmt. b).

[45] National Grid Terms and Conditions for Construction Purchase Orders §§ 2.1 and 2.2.

2. The Companies Should Not Be Held Liable for Civil Penalties Arising From Intentional Misconduct and Fraud by Their Agents

Even if the Companies' independent contractors are considered to be agents, the Commission should not impose civil penalties against the Companies for the intentional misconduct and fraud committed by the contractors. The Commission should not impose civil penalties against the Companies where, as here, the contractors abandoned their agency by intentionally defrauding the Companies.[46]

The Court of Appeals has long held that "[w]hen an agent abandons the object of his agency and acts for himself, by committing a fraud for his own exclusive benefit, he ceases to act within the scope of his employment and, to that extent, ceases to act as agent."[47] In *Credit Alliance Corp*., the Court of Appeals held that a corporation could not be held liable for a loan fraudulently obtained by its agent – the president of the corporation – because the corporation "never knew anything about the transaction until long after it had occurred; it never ratified [the president's] act; it had no knowledge whatever either of the transaction itself or of the fact that the money was deposited to its account."[48] Similarly, in *Adler v. Helman*, a case before the Third Department, the court held that a principal was not liable for the fraud of its agent where the sole purpose of the fraud was to benefit the agent and where "the fraud also induced the principal . . . to issue a fee title insurance policy to plaintiff without an exception for the restrictive covenant."[49] Similar to the agents in *Credit Alliance Corp.* and *Adler*, the fraud committed by Network was solely for the

[46] Although courts in New York have found that an employee may be held liable for civil penalties for the acts of an agent (*see City of New York v. Carolla*, 48 Misc. 2d 140, 141 (New York City Court 1965), *City of New York v. Benenson*, 41 Misc. 2d 20, 23 (Civ. Ct., New York City 1963), the Companies submit that these decisions do not apply where, as here, a contractor abandons its agency by intentionally defrauding its principal.

[47] *Credit Alliance Corp. v. Sheridan Theatre Co.*, 241 N.Y. 216, 220 (1925).

[48] *Id.* at 220.

[49] *Adler v. Helman*, 169 A.D.2d 925, 926-27 (3d Dep't 1991).

benefit of the agent. Network's management devised and implemented a scheme to cheat on Operator Qualification exams by taking screenshots of the exams and providing Network's workers with "study guides" that included the actual exam questions and answers. Moreover, the fraudulent cheating scheme conducted by Network was harmful to KEDNY and KEDLI, as it induced the Companies to hire Network and then permitted Network to work on the projects while Network's management actively concealed the cheating from the Companies. Where, as here, the fraudulent actions of an agent are undertaken solely for the benefit of the agent, and are harmful to and against the interests of the principal, the agent is acting outside the scope of its agency and the principal may not be held liable for civil or criminal penalties arising from the agent's conduct. Therefore, the Commission should not impute civil penalties to the Companies based on the intentional misconduct and fraud of their contractors.

II. Contrary To The Allegations In The Show Cause Order, In Many Instances The Companies Reasonably Complied With The Commission's Regulations

A. The Companies Operate Their Systems In Reasonable Compliance With The Commission's Orders And Regulations

PSL § 25-a authorizes the Commission to institute an administrative penalty proceeding where it has determined that a combination gas and electric corporation "failed to reasonably comply as shown by a preponderance of the evidence with a provision of [the PSL], regulation or an order adopted under authority of [the PSL]."[50] Although neither the Commission nor the New York courts have interpreted the standard for liability under PSL § 25-a since the section was enacted in 2013, the statute's phrase "reasonably comply," shows that the Legislature did not intend to impose strict liability or to penalize every potential violation of the PSL or the Commission's regulations or orders. This is further illustrated by the Legislature's changes to the

[50] PSL § 25-a(3), (5) (emphasis added).

Moreland Commission legislation initially recommended by Governor Cuomo. While the Governor's initial recommendation did not include any scienter element or standard for judging liability,[51] the Legislature modified the legislation to provide that a penalty may only be assessed when a combination gas or electric corporation "fails to reasonably comply as shown by a preponderance of the evidence with a provision of [the PSL], regulation or an order adopted under authority of [the PSL]."[52] This clearly shows a legislative intent that the statute would establish a standard of "reasonable compliance," such that a corporation would be penalized only for those actions that fail to "reasonably comply" with such provisions.

Although neither the statute nor case law defines "reasonably comply," New York courts have found that the "reasonably comply" standard was met where an action was not unreasonable under the circumstances.[53] Courts have also treated "reasonable compliance" and "substantial compliance" as synonyms.[54] Finally, the Moreland Interim Report concluded that the Commission should be authorized to assess an administrative penalty "against each utility for violations of PSL orders and regulations upon a finding that such utility has failed to provide safe and adequate service under a 'reasonable business' standard (comparable to the prudence standard)."[55] Under applicable precedent, a "utility's decision is prudent if it acted reasonably based on the information it had and the circumstances that existed at the time."[56] As discussed below, applying these standards, the Companies' actions related to many of the violations alleged in the Show Cause

[51] Executive Budget Recommendation, Part O.
[52] Assembly Budget Recommendations, p. 63-1.
[53] *See Silverberg v. Community Gen. Hosp. of Sullivan Cty.*, 290 A.D.2d 788, 789 (3d Dep't 2002) (finding plaintiff reasonably complied with N.Y. C.P.L.R. 3101).
[54] *See J.G. v. Mills*, No. CV–04–5415 (ARR), 2006 WL 8066678, at *36-37 (E.D.N.Y. 2006) (finding that the New York City Department of Education was in substantial compliance with IDEA Act).
[55] Moreland Interim Report, p. 57.
[56] *National Fuel Gas Distribution Corp. v. Public Service Commission*, 16 N.Y. 3d 360, 368-369 (2012).

Order and/or identified by Staff in its List of Alleged Violations provided to the Companies ("Staff List") were prudent, reasonable, and reasonably complied with the Commission's regulations.

1. 16 NYCRR § 255.604 – Operator Qualifications

The Show Cause Order alleges that the Companies completed construction work "without the workers holding proper operator qualifications" at 499 locations on the Companies' systems and that these allegations form the basis for 499 separate violations of § 255.604 of the Commission's regulations.[57] Specifically, the Staff List claims that because an abnormal operating condition allegedly existed at each of the 499 locations where Staff identified alleged violations of the Commission's regulations, the Companies therefore violated §255.604. However, a "failure to adequately identify an abnormal operating condition," as alleged by the Show Cause Order and Staff List, does not constitute a violation of § 255.604, which governs OQ procedures.

As quoted in the Show Cause Order, § 255.604 requires pipeline operators to "have and follow a written qualification program"[58] and that such program must "ensure through evaluation that individuals performing covered tasks are qualified" and "provide training, as appropriate, to ensure that individuals performing covered tasks have the necessary knowledge and skills to perform the tasks in a manner that ensures the safe operation of pipeline facilities."[59] Section 255.604 does not govern, or even mention, the identification or remediation of abnormal operating conditions. As such, the failure to identify abnormal operating conditions is irrelevant to this section and, cannot serve as the basis for any potential penalties, much less 499 penalties. Moreover, at 73 locations cited by the Staff List, Staff only cited OQ issues, not construction issues. As such, at these locations, there were no abnormal operating conditions identified.

[57] Show Cause Order, at 19.
[58] 16 NYCRR § 255.604(a).
[59] 16 NYCRR § 255.604(a)(2), (8).

Therefore, even if the existence of an abnormal operating condition violated this section, Staff's allegations the Companies failed to identify an abnormal operating condition at these 73 sites are not supported.

Further, the Companies have and follow a written qualification program for their workers in full compliance with the regulation. The Companies' OQ plan is compliant with Pipeline and Hazardous Materials Safety Administration ("PHMSA") guidelines and consistent with industry best practices. By observing PHMSA and industry standards in developing and operating their written qualification program, the Companies reasonably complied with § 255.604. As discussed *supra*, the fact that contractors subverted the existing OQ procedures, committing a fraud upon the Companies in doing so, does not establish that the Companies' OQ procedures were deficient or non-compliant with § 255.604. A particular instance of an individual failing to maintain his or her OQ does not mean that the Companies failed to comply with the requirement under § 255.604 to maintain a written qualification program. As such, the Commission may not institute a penalty proceeding based on these allegations.

Finally, even if the Commission could find that the Companies' written OQ procedures fall short of § 255.604 in some way, which they do not, such a finding could not serve as the basis for 499 separate violations. Rather, there would be only a single violation – the failure to maintain written qualification procedures.

2. 16 NYCRR § 255.305(a) – (c) – Inspection: General

The Show Cause Order also cites 499 instances where the Companies allegedly failed to meet construction standards during various projects.[60] On the basis of these alleged violations, the

[60] Show Cause Order, at 21-22. The 499 alleged violations are as follows: Queen Pipeline – 64 violations; 2015 Network work – 54 violations; 2016 Network work – 56 violations; and OQ focused re-digs – 325.

Show Cause Order surmises the Companies are therefore subject to 499 potential penalties for alleged violations of § 255.305(a)-(c) of the Commission's regulations for failing to "inspect main installations 'at sufficiently frequent intervals to assure the required quality of workmanship.'"[61] The Staff List states that these alleged violations stem from Staff and the Companies' re-inspections of certain facilities where "at least one issue was identified, indicating that there were not proper contractor oversite inspections occurring."[62]

The Show Cause Order, as well as the Staff List, improperly conflate the inspection requirements in § 255.305 with applicable construction standards. Contrary to the allegations in the Show Cause Order and Staff List, § 255.305 does not govern compliance with the Commission's construction regulations. Rather, the regulation requires that the Companies inspect transmission lines and mains during construction and at sufficiently frequent intervals after construction. The Companies' inspection schedule, both currently and at the time of the work identified in the Show Cause Order, is consistent with industry standards and the facilities cited in the Staff List were inspected by the Companies in accordance with this schedule. As such, the Companies reasonably complied with their obligations to inspect their facilities under § 255.305(a) – (c) and, therefore, the Commission should not institute a penalty proceeding based on these alleged violations.

Additionally, out of the 325 locations investigated during the Companies' OQ focused re-digs, only 20 were actually identified to have a construction issue requiring remediation. For approximately 23 locations, there are no other cited violations at all. For these locations, there were no issues, construction or otherwise, so there is no basis for concluding that inspections were not made at sufficiently frequent intervals. For the rest of the locations, the only cited violations

[61] *Id.*
[62] Staff List, at 2, 8, 15, 22.

relate to OQ issues, not construction issues (*i.e.*, alleged violations of §§ 255.604, 255.285(a), and Ordering Clause 7 of the May 15, 2015 Order). Given that there is no alleged violation of a construction standard/requirement, Staff's assertion that inspections were not "made at sufficiently frequent intervals to assure the required quality of workmanship" has no support whatsoever.

Finally, to the extent that the Commission does find that the Companies have violated the inspection requirements under § 255.305, the Commission must reduce the number of potential violations such that there is only one potential violation at each inspected location. In several instances, it appears that the Staff List alleges duplicate violations of the inspection requirement, as the same location is listed two (or more) times, with reinspection dates very close together, or even on the same day. Based on the Companies' review, there appears to be at least 86 instances where an inspection location was listed more than once; removing these duplicates reduces the alleged potential violations from 499 to 413.

3. May 2015 Order, Ordering Clause 7

The Show Cause Order alleges that the Companies completed 288 plastic fuses that were inspected by unqualified persons, which constitute 288 alleged violations of Ordering Clause 7 of the May 2015 Order.[63] The Staff List further alleges that at 26 of these locations, the Companies' inspectors found a plastic fuse that was visually unacceptable during re-inspection, which served as the basis for the alleged violation.[64] At the remaining 262 locations, Staff alleged that "the second inspector was not properly qualified at the time of the fusion and subsequent inspection." These allegations misconstrue the requirements in Ordering Clause 7 and, therefore, do not serve as the basis for a penalty proceeding.

[63] Show Cause Order, at 22-23.
[64] Staff List, at 14, 21, 55.

Ordering Clause 7 of the May 2015 Order requires pipeline operators to "modify and implement all operating procedures involving plastic fusions to (a) require a successful inspection of each plastic fusion by a someone other than the person who completed the plastic fusion and who is qualified to inspect plastic fusions, and (b) record the name of each person who performs each plastic fusion and the name of the person who performed the inspection for each plastic fusions."[65] The plain language of Ordering Clause 7, strictly construed in a penalty proceeding, requires only that pipeline operators, such as the Companies, "modify and implement all operating procedures involving plastic fusions." The Companies modified and implemented new plastic fusion procedures to comply with the requirements of Ordering Clause 7, and filed the new operating procedures with the Commission, on September 1, 2015.[66] As such, the Companies complied with Ordering Clause 7 of the May 2015 Order. Therefore, the Commission should not institute a penalty proceeding based on alleged violations of the May 2015 Order.

Further, the May 2018 Order sets forth the mechanism to address non-compliance with the May 2015 Order. Specifically, the May 2018 Order requires that utilities "report to the Commission immediately upon discovering any work performed during any period of fusion or operator qualification failures related to the fusion or fusion inspection process, including periods of non-compliance due to disqualification pursuant to 16 NYCRR §255.285(d) and this Order."[67] The May 2018 Order further requires that utilities bear the costs incurred for the assessment and remediation of fusions that were completed by non-qualified workers.[68] In compliance with the May 2018 Order, the Company reported the alleged violations and bore the costs of all risks

[65] May 2015 Order, at 29-30, Ordering Clause 7.
[66] Case 14-G-0212, National Grid Compliance Filing, Attachment 2 (Sept. 1, 2015) (providing a copy of the Companies' new procedures – Joining of Plastic Pipe CNST05001 – in compliance with Ordering Clause 7).
[67] May 2018 Order at 41-42, Ordering Clause 5.
[68] *Id.*

assessments and inspections associated with those alleged violations. Therefore, there is no basis for the Commission to institute a penalty proceeding for violations of Ordering Clause 7 of the May 2015 Order.

4. 16 NYCRR § 255.273(c) – General and § 255.281(c) – Plastic Pipe

The Show Cause Order and Staff List allege that, upon re-inspection, the Companies' inspectors found plastic fusions at 26 locations to be "visually unacceptable."[69] The Show Cause Order and Staff List assert that this constituted a violation of the inspection requirements in § 255.273(c) and § 255.281(c). As discussed above, this argument improperly conflates inspection requirements with construction standards. The mere fact that Staff found issues with the Companies' facilities during the re-inspection process does not mean that the Companies failed to inspect the facilities. In fact, the Companies properly inspected their facilities according to the schedules set forth in their operating procedures, which are consistent with industry standards. As such, the Companies reasonably complied with the inspection requirements under § 255.273(c) and § 255.281(c). Therefore, the Commission should not institute a penalty proceeding based on these alleged violations.

5. 16 NYCRR § 255.325(a)

The Show Cause Order and Staff List allege that the Companies failed to provide sufficient clearance between their transmission lines and any other underground structure not associated with the line, in violation of § 255.325(a) of the Commission's regulations.[70] However, the Staff List includes several duplicate locations in its list of alleged violations. Although it is not clear from the Show Cause Order or the Staff List, it appears that Staff has improperly counted a separate violation for each underground structure that encroaches within the required clearance for the

[69] Show Cause Order, at 15, Staff List, at 13-14, 20-21, 54-55.
[70] Show Cause Order, at 17; Staff List, at 5-7.

Companies' transmission line at the location. This results in improper and duplicative violations for at least 18 of the locations identified by Staff. As such, the number of potential penalties should be reduced to remove the 18 duplicative violations.

6. 16 NYCRR 255.285 – Plastic Pipe: Qualifying Persons to Make Joints

The Show Cause Order and Staff List allege that, at 144 locations, the employee or contractor performing work was not properly qualified when a plastic fusion joint was made, resulting in 144 alleged violations of § 255.285 of the Commission's regulations.[71] As discussed *supra*, the Companies should not be held liable for the fraud of their agents, where such fraud was undertaken outside the scope of the agency and solely benefits the interest of the agent. Further, as also discussed *supra*, the Companies already bore the costs associated with the remediation and investigation of this issue, as required by the May 2018 Order. Therefore, the Commission should not institute a penalty proceeding against the Companies for these violations.

7. 16 NYCRR 255.603(c) – General Provisions

The Show Cause Order and the Staff List allege that KEDLI incorrectly mapped the natural gas main or service at one location in its service territory, resulting in an alleged violation of § 255.603(c) of the Commission's regulations. Section 255.603(c) requires KEDLI to "establish and maintain the maps of its transmission lines and distribution mains and maps or records of its service lines as necessary to administer its operating and maintenance plan." KEDLI maintains maps of transmission lines, mains, and services that are sufficient to allow KEDLI to administer its operating and maintenance plan. As an initial matter, given the immense scope of Staff's investigation and the Show Cause Order, which reviewed and re-inspected hundreds of locations on the Companies' facilities, the fact that Staff identified only one inaccuracy on KEDNY and

[71] Show Cause Order, at 15-16; Staff List at 49-53.

KEDLI's maps strongly supports a finding that the Companies have reasonably complied with the requirement to maintain maps and records of their facilities. For that reason alone, the Commission should not institute a penalty proceeding based on a single allegation. Further, while Staff alleges that one location on KEDLI's maps was incorrect, there is no allegation that this inaccuracy has in any way affected KEDLI's ability to administer its operating and maintenance plan. In the absence of proof that the single inaccuracy identified by Staff has affected KEDLI's ability to administer its plan, the Commission should not institute a penalty proceeding based on this alleged violation.

B. The Commission Should Not Assess Duplicative Penalties For The Same Alleged Conduct

While the Show Cause Order and Staff List cite to 18 different regulations and/or subsections thereof and one Commission order, as the basis for the alleged violations, several of the cited provisions govern the same conduct: inspection of facilities. Specifically, the Show Cause Order and Staff allege that the Companies have violated sections 255.273(c) (26 alleged violations), 255.281(c) (26 alleged violations), 255.305(a)-(c) (499 alleged violations), and Ordering Clause 7 of the May 2015 Order (26 alleged inspection violations) because they failed to inspect their facilities at certain specified locations. In many instances, Staff has alleged that the Companies failed to inspect a certain location and argues that this alleged failure serves as the basis for multiple penalties. As such, the Show Cause Order and the Staff List seek to penalize the Companies multiple times for the exact same conduct at several locations. As noted *supra*, the Staff List includes at least 86 instances where an inspection location was listed more than once in its § 255.305(a)-(c) allegations; removing these duplicates reduces the alleged potential violations from 499 to 413. Further, the same 26 locations are identified for alleged "failure to inspect" violations of § 255.273(c), § 255.281(c), and Ordering Clause 7. Should these allegations have merit, and the Companies maintain they do not, the Commission should only assess penalties for

26 violations, one for each location, rather than the tripled 78 violations sought by Staff for the same conduct.[72]

III. Any Penalties That Might Be Assessed Against KEDNY And KEDLI In This Proceeding Would Be Fully Mitigated

Even if the Commission were to find that KEDNY and KEDLI's actions in certain instances identified in the Show Cause Order failed to meet the threshold standard of reasonable compliance, the Commission should determine that commencing a penalty proceeding is unnecessary in this case because the potential penalties are fully mitigated by the Companies' efforts to immediately review and remediate the issues, after becoming aware of them as well as other facts the Commission must consider in determining whether to assess penalties under PSL § 25-a. Under PSL § 25-a, the Commission must consider the following factors before a penalty may be assessed: (i) the seriousness of the violation for which a penalty is sought; (ii) the nature and extent of any previous violations for which penalties have been assessed against the corporation or officer; (iii) whether there was knowledge of the violation; (iv) the gross revenues and financial status of the corporation; and (v) such other factors as the commission may deem appropriate and relevant.[73] Applying these statutory criteria, it is apparent that there are several factors that would clearly mitigate any potential penalty to be assessed against KEDLI and KEDNY, including:

[72] Indeed, in a similar situation involving National Fuel, the Commission acknowledged that it is appropriate to refrain from penalizing a utility for redundant violations based on the same facts. *See* Case 13-G-0136, *Proceeding on Motion of the Commission as to the Rates Charges Rules and Regulations of National Fuel Gas Distribution Corporation For Gas Service*, "Order on Appeal" (Issued and Effective August 28, 2017) at p. 8.

[73] PSL § 25-a(2)(a).

A. The Alleged Violations Did Not Result In Any Harm To People Or Property

KEDNY and KEDLI take very seriously the responsibilities imposed by the Commission's gas safety regulations and strive, at all times, to achieve full compliance. Notwithstanding that commitment, KEDNY and KEDLI note that the particular violations alleged here did not create any incident or result in any harm to people or property or any interruption of gas service during any critical period. Nor is there any evidence that any of the alleged violations of the Commission's regulations at any time created the likelihood of imminent harm to people or property. While KEDNY and KEDLI fully understand their responsibility to fully comply with the Commission's safety regulations, the absence of harm associated with the violations alleged in this proceeding should, consistent with the explicit terms of PSL § 25-a(2)(a), be recognized as a factor that would mitigate any penalty that the Commission might assess in this proceeding.

B. KEDNY And KEDLI Have Never Been Assessed Penalties For Violations Of The Commission's Regulations Identified In The Show Cause Order

KEDNY and KEDLI have not previously been assessed penalties for violations of the regulations identified in the Show Cause Order. Moreover, as discussed *supra*, the Companies have undertaken significant effort in cooperation with Staff's investigation to develop procedures and processes to identify and remediate existing conditions and to prevent the occurrence of similar issues in the future. In addition, as discussed *supra*, the Companies have demonstrated continuous improvement in achieving compliance with the Commission's safety regulations over the past several years. This substantial effort towards full compliance and the Companies full transparency and cooperation with Staff should be considered a factor that mitigates any penalties that might be assessed in this proceeding.

C. KEDNY And KEDLI's Senior Management Had No Knowledge Of Network's Fraud Or Any Of The Violations Prior To The Anonymous Letter And Took All Reasonable Steps To Identify And Remediate Issues On Their Systems In A Manner That Was Fully Cooperative With And Transparent To Staff

The senior management for KEDNY and KEDLI were not, and could not have been, aware of the allegations concerning Network prior to receiving notice of the November 2016 Letter. Upon being advised of the issues with OQs, the Companies took immediate action to proactively review its current OQ practices and procedures, investigate the qualifications of contractors and internal employees who are currently, or have in the past, performed work on the Companies' systems, and remediate any issues that were identified. At all times the Companies were cooperative and transparent in assisting Staff's investigation and efforts to remediate deficiencies. In assessing civil penalties, administrative agencies typically give significant credit to parties that exhibit exemplary cooperation in context of an enforcement proceeding.[74] The Companies submit that their cooperation in Staff's investigation in this matter has met this standard and that, as such, any penalty that might be assessed in this proceeding would be significantly mitigated.

D. KEDNY And KEDLI Have Established Procedures To Ensure That These Issues Will Not Re-Occur

As discussed *supra*, the Companies have implemented several proactive quality control measures to ensure the issues identified in the Show Cause Order will not re-occur. The Companies' commitment to establishing and maintaining processes to ensure that the issues

[74] *See, e.g.*, *Enforcement of Statutes, Orders, Rules and Regulations*, 123 FERC 61,156 at ¶¶ 65-68 (2008); *Report of Investigation Pursuant to Section 21(A) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions*, SEC Release No. 1470 (October 23, 2001); *Commodity Futures Trading Commission Enforcement Advisory*, "Cooperation Factors in Enforcing Division Sanction Recommendations." https://www.cftc.gov/sites/default/files/idc/groups/public/@cpdisciplinaryhistory/documents/file/enfcooperation-advisory.pdf; *Memorandum for Deputy Attorney General Larry D. Thompson to Heads of Department Components and United States Attorneys*, "Principles of Federal Prosecution of Business Organizations" (Jan. 20, 2003); *Effective Compliance and Ethics Programs*, U.S. Sentencing Guidelines Manual § 8B2.1 (U.S. Sentencing Comm'n 2004).

identified in the Show Cause Order will not arise again, coupled with the Companies' willingness to incur negative revenue adjustments for future violations of the Commission's safety regulations provides further support for the Commission to decline to impose civil penalties in this case. The Companies have demonstrated that they are fully engaged in efforts to achieve continuous full compliance with the Commission's safety regulations.

E. There Is No Need For The Commission To Impose A Civil Penalty Because The Companies Have Borne The Incremental Costs Of Investigating The Issues That Arose In This Case

As discussed *supra*, to date the Companies' shareholders have borne approximately $9.8 million in costs associated with addressing the issues identified in the Show Cause Order and expect that they will bear an additional $5 million of costs, and possibly more, to fully address these issues. The incremental costs associated with the re-digs and remediation have been charged to specific work orders and have been excluded from the revenue requirements proposed in the Companies' pending rate proceedings. Additionally, as required by the May 2018 Order, the Companies track costs incurred to remediate failed fusions installed by contractors with lapsed OQs. These costs were recorded in below-the-line accounts and also excluded from the Companies' proposed revenue requirements in their current base rate proceedings. Assessing further civil penalties will not create any greater deterrent than the costs the Companies have incurred and will incur to address these issues. The Companies respectfully request that the Commission recognize that the Companies' willingness to bear substantial costs associated with the matters at issue in this proceeding eliminate the need for the Commission to assess additional civil penalties in this case. The fact that the Companies have borne the costs also renders it unnecessary for the Commission to establish a separate prudence inquiry concerning this matter.

CONCLUSION

For the reasons set forth above, KEDNY and KEDLI respectfully request that the Commission not commence an administrative penalty action pursuant to PSL § 25-a(3) in connection with the alleged violations of the Commission's gas safety regulations and orders discussed in the Show Cause Order. In addition, the Commission should not commence a prudence proceeding against KEDNY and KEDLI for the reasons set forth herein.

Respectfully submitted,

KEYSPAN GAS EAST CORPORATION D/B/A NATIONAL GRID

THE BROOKLYN UNION GAS COMPANY D/B/A NATIONAL GRID NY

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