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June 10, 2002

Secretary of the  
Missouri Public Service Commission  
200 Madison Street, Suite 100  
P.O. Box 360  
Jefferson City, Missouri 65102-0360

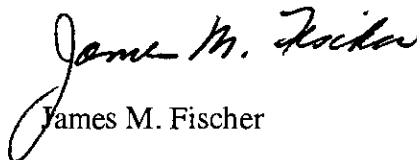
RE: *Laclede Gas Company*, Case No. GO-2002-1099

Dear Mr. Roberts:

Enclosed for filing in the above-referenced matter are the original and eight (8) copies of Laclede Gas Company's Verified Response in Opposition to Staff's Motion. A copy of the foregoing document has been hand-delivered or mailed this date to each party of record.

Thank you for your attention to this matter.

Sincerely,

  
James M. Fischer

/jr  
Enclosures

cc: All Parties of Record

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of Laclede Gas Company's	)	
transfer of its Gas Supply function	)	<b><u>Case No. GO-2002-1099</u></b>
to a separate corporation	)	

**VERIFIED RESPONSE IN OPPOSITION TO STAFF'S MOTION**

**COMES NOW** Laclede Gas Company ("Laclede" or "Company") and for its Response In Opposition to Staff's Motion (the "Motion") to Investigate Laclede's Transfer of its Gas Supply Function filed in the above captioned matter on May 31, 2002, respectfully states as follows:

1. In its Motion, Staff asserts that Laclede has transferred its gas supply function to a new corporation, Laclede Energy Services, Inc. ("LES"). Staff then moves the Commission to open an investigation based upon a number of speculative assertions, including: (i) whether the Commission has jurisdiction over the transaction, (ii) whether Laclede was required by law to obtain Commission approval prior to such transaction, (iii) the impact of such a transaction on Staff's ability to access "fuel, power," and gas-related information, (iv) whether the transaction will be detrimental to the public interest, (v) whether there is "any likelihood" that gas supply costs will be increased, (vi) whether Laclede has violated the Stipulation and Agreement in Case No. GM-2001-342 by the sale, lease, assignment or transfer of utility assets, (vii) whether this transaction could affect Laclede's credit rating or financial stability if LES has financial losses, (viii) whether LES is obligated to make prudent purchases on behalf of Laclede and its customers, (ix) the potential financial consequences if LES should transfer its duties to

another corporation, and (x) whether there are any detriments from potential diversion of natural gas away from Laclede customers to higher paying customers.

2. In this Response, Laclede will address each of the matters raised by Staff. Laclede will show that it was not required to obtain Commission approval prior to delegating duties to an affiliated service company, because under any reasonable interpretation of Section 393.190 (R.S.Mo) such act is not a transfer of Laclede's franchise, works or system. Further, Laclede will show that, under existing statutes, while the Commission is certainly authorized to examine Laclede and keep informed as to the methods, practices, regulations and property employed by Laclede in the transaction of its business, and to prescribe just and reasonable rates, charges, acts and regulations, it is well recognized in the law that the Commission is not authorized to dictate the manner in which Laclede runs its business.

3. Notwithstanding the jurisdictional matters, Laclede will also demonstrate that the Commission should have no concerns over the formation of LES, because Laclede is still the entity responsible for all matters involving the gas supply function, including gas supply administrative matters, and the Commission has a number of regulatory tools with which to ensure proper allocation of costs to Laclede, including the PGA, rate audits, and, in accordance with the Stipulation and Agreement in Case No. GM-2001-342, Laclede's Cost Allocation Manual ("CAM").

#### **Background**

4. First and foremost, contrary to Staff's assertion, Laclede has not transferred its gas supply function to LES. Instead, Laclede has delegated to LES certain administrative services in connection with the gas supply function, along with

administration of risk management activities. The corporate officer most directly responsible for gas supply matters (i.e. the Assistant Vice President-Gas Supply) remains an employee of Laclede Gas Company and in that position continues to oversee the procurement and management of the Company's gas supply assets. Moreover, all gas supply and transportation contracts required to provide service will continue to be negotiated by, or under the supervision of, Laclede's Assistant Vice-President-Gas Supply, and will be held by Laclede.

5. LES, on the other hand, will perform gas supply administrative and related risk management services on behalf of Laclede. These services include management of supply and transportation agreements, daily spot purchasing and sales functions, nominations and scheduling, gas accounting and administration of risk management activities. The Gas Supply department of Laclede Gas Company will continue to be ultimately responsible for these functions.

6. Less than a year ago, the Commission's Natural Gas Commodity Price Task Force issued a recommendation in which it generally favored consideration of outsourcing of gas supply functions by local distribution companies ("LDCs"). In Section 3.d of the Task Force Report, issued August 29, 2001, "Outsourcing" is described as an agreement where a third party, such as a marketer, takes over an LDC's entire gas supply function, including operation of gas supply, transportation and storage assets. This section of the Task Force Report was supported by four Commission Staff members by an average vote of 6.5 (on a scale of 0-10). In the present case, Laclede has not outsourced the entire gas supply function, but only gas supply administrative services. Further, Laclede has not outsourced such services to an unaffiliated third party, but to an

affiliate. Given the fact that Staff members were not overly concerned with a complete outsourcing of the gas supply function to a third party marketer, Laclede is at a loss to understand why Staff would be concerned with the far more limited transaction in this case.

**Delegation of Gas Supply Administrative Duties to LES is Not a Transfer that Requires Commission Approval.**

7. Section 393.190.1 (R.S.Mo. 2002) provides that no gas corporation shall assign or transfer “the whole or any part of its franchise, works, or system...without having first secured from the commission an order authorizing it so to do.” Further, Section V.2 of the Unanimous Stipulation and Agreement (the “Stipulation”), executed on July 9, 2001, in Case No. GM-2001-342 provides that Laclede shall not sell, lease, assign or transfer to any affiliate or third party any of its utility assets that are used and useful in the performance of Laclede’s public utility obligations without obtaining commission approval.

8. The gas supply administrative duties assumed by LES can in no way be considered an assignment or transfer of Laclede’s franchise, works or system under Section 393.190.1. Laclede’s franchise to provide gas service in eastern Missouri is completely unaffected by the activation of LES. The works that comprise Laclede’s gas plant are likewise unaffected, as is the system used by Laclede to provide public utility service. Laclede’s dealings with LES are simply not covered by any reasonable interpretation of the statute.

9. Regarding the Stipulation, Laclede’s assignment of certain gas supply administrative duties to LES cannot possibly be an assignment of a utility asset. These duties constitute a job not an asset. Nor can the employees who will perform these duties

for LES be considered assets. Laclede does not “own” these employees. This distinction was recognized by the Commission itself in its various Orders of Rulemaking which adopted the Commission’s affiliate transaction rules. *See e.g.* 4 CSR 240-40.015. In its Orders of Rulemaking, the Commission separately identified and distinguished employees as something entirely different from a utility “asset” and explicitly declined to include employees in the list of items that could be transferred between affiliates only pursuant to special rules (*see* paragraph (2)(A)2)). In refusing to limit employee transfers between affiliates or apply pricing standards to these transfers, the Commission specifically noted that cost allocation protections, rather than Commission imposed restrictions, were the appropriate measures for ensuring that employee transfers did not have a detrimental impact on utility customers. As the Commission stated:

“...any payment appears to be more of a penalty or a handicap to an incumbent utility and its affiliate entities than a means to prevent cost shifting or unfair preferential treatment. The standards are properly directed at preventing cost shifting and subsidies. *This purpose can be accomplished by focusing on the pricing of information and fair access to information. Employee transfers do not have to be restricted, penalized or compensated to accomplish this purpose.*”

(*emphasis supplied*).

10. In paragraph 1 of the Motion, Staff cites the case of *State ex rel. Martigney Creek Sewer Co. v. PSC*, 537 S.W. 2d 388 (Mo. banc 1988) as standing for the proposition that the Commission’s authority to regulate the sale, transfer or disposition of any part of a utility’s franchise, works or system is broad. The *Martigney Creek* case has no application whatsoever to this matter. First, the Commission’s authority cannot be any broader than the clear language in Section 393.190, and that language covers the transfer of a utility’s “franchise, works or system.” Second, not only does the *Martigney*

*Creek* case not attempt to broaden the Commission's authority in this area, but it does not even pertain to the transfer contemplated in Section 393.190. In fact, *Martigney* is a case involving whether a utility can include donated plant in its rate base in order to earn a return on it. The issue regarding a sale, transfer or disposition of utility property was raised by Martigney Creek only as a hypothetical in making an argument within the context of the main issue. After merely citing the language contained in Section 393.190, the Court concluded nevertheless that "The question [of a utility asset transfer] is not directly involved in this case because no sale of assets has taken place and the court will not speculate on a hypothetical situation." (*Martigney Creek* at 399.) As a consequence, *Martigney* lends absolutely no support to Staff's position that this is a proper matter to investigate.

11. In fact, the cases decided under Section 393.190.1 regarding transfer of a utility's franchise, works or system invariably revolve around the sale of assets or the utility's business. No cases were found where a Commission evaluated a utility's outsourcing of a function or duties as a transfer of its franchise, works or system.

12. As previously noted, there is no doubt that the Commission is authorized to examine Laclede and keep informed as to the methods, practices, regulations and property employed by Laclede in the transaction of its business, and to prescribe just and reasonable rates, charges, acts and regulations to be done by it. (Section 393.140.5) However, as stated by the Missouri Supreme Court, the Commission's authority to regulate does not include the right to dictate the manner in which the Company shall conduct its business. (*State ex rel. City of St. Joseph v. PSC*, 30 S.W. 2d 8, 36 (Mo.

1930); *State ex rel. Kansas City Transit, Inc. v. PSC*, 406 S.W.2d 5 (Mo. 1966). In *City of St. Joseph*, the Court stated:

“The customers of a public utility have a right to demand efficient service at a reasonable rate, but they have no right to dictate the methods which the utility must employ in the rendition of that service. It is no concern of either the customers of the water company or the Commission, if the water company obtains necessary material, labor, supplies, etc., from the holding company so long as the quality and price of the service rendered by the water company are what the law says they should be.”

11. The Commission has repeatedly followed this principle. Regarding Southwestern Bell’s business meal expenses, the Commission stated: “It is not the function of the Commission to tell SWB how to run its business; rather, its duty is to set just and reasonable rates.” (*PSC Staff v. Southwestern Bell Telephone Co.*, 2 Mo. P.S.C. 3d 479, Case No. TC-93-224 (1993)). The Commission has also explicitly recognized this principle in connection with management functions relating to a gas corporation’s procurement and management of gas supplies and associated transportation services. As the Commission stated nearly 15 years ago in declining a proposal that it determine the specific mix of gas procured by an LDC:

Although the Commission has the authority to regulate local distribution companies, it does not have the “authority to take over the general management of any utility.” *State ex rel. Laclede Gas Company v. P.S.C.*, 600 S.W.2d 222, 228 (1980). “The utility retains the lawful right to manage its own affairs and to conduct its business as it may choose, as long as performs its legal duties, complies with lawful regulation and does no harm to public welfare.” *State ex rel. Harline v. Public Service Commission of Missouri*, 343 S.W.2d 177, 182 (Mo. App. 1960). The Commission finds that a company’s choice of the appropriate mix of gas to procure is a management decision and is properly left to the company. The Commission may review for prudence the management decisions made in connection with said procurement as it does other management decisions, in the company’s rate cases.



***In the matter of the investigation of developments in the transportation of natural gas and their relevance to the regulation of natural gas corporations in Missouri, 29 Mo.PSC (N.S.) 137, 143 (1987).***

12. Applying these principles to the instant case, the Commission may not dictate the manner in which Laclede acquires and manages the administrative services associated with its gas supply function. Indeed, to Laclede's knowledge the Commission has never even attempted to assert jurisdiction over issues such as whether a utility should use in-house legal services versus outside counsel, have its own accounting staff or use outside accounting services, or use its own employees to install utility facilities versus hiring an outside contractor to perform such work. The Commission has refrained from doing so for good reason -- namely because such an intrusion would strike at the very heart of a utility's recognized right to manage its business. Yet it is the very premise that the Commission may exercise such authority, and solely that premise, which underlies Staff's request for an investigation. Consistent with decades of regulatory practice, such an approach should once again be rejected by the Commission.

**Even if the Commission had jurisdiction over Delegation of Gas Supply Administrative Duties to LES, the Commission Should Have No Concern Over This Transaction.**

13. Laclede is still the entity responsible for all matters involving the gas supply function, including gas supply administrative matters, and the Commission has a number of regulatory tools with which to ensure proper allocation of costs to Laclede. These tools include the PGA, rate audits, and, in accordance with the Stipulation, Laclede's Cost Allocation Manual ("CAM").<sup>1</sup> The CAM sets forth the guidelines that

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<sup>1</sup> The Stipulation actually contemplates a service organization such as LES. Section VII.6 of the Stipulation recites that nothing in the Stipulation shall affect in any way the Commission's authority "over ratemaking issues that may arise as the result of the formation of a service company." Further, the Stipulation recognizes the Commission's authority, through the lawful exercise of its ratemaking powers, to

cover the pricing of transactions between Laclede and an affiliate. Laclede's utilization of the CAM provides an additional vehicle for the Commission to exercise any concerns regarding the relationship between Laclede and LES, and its effect on customers. Using these tools, the Commission can be assured that delegation of gas supply administrative duties to LES will not be detrimental to the public interest, will not have "any likelihood" of increasing gas supply costs, and will not impact Laclede's credit rating or financial stability.

14. In addition, the Commission should not be concerned with the fact that Laclede employees are assisted by an agent in performing gas supply administrative duties, because only in recent years have such duties been performed solely by Laclede employees. Prior to 1997, the Gas Supply Department was assisted in these functions by an affiliate of the Mississippi River Transmission Corporation ("MRT") pursuant to an agency agreement. There is no record of Staff having filed a complaint during the years leading up to 1997 on its access to information, increased gas supply costs or other "potential financial consequences"<sup>2</sup> owing to the agency agreement with the MRT affiliate.<sup>3</sup>

15. For all of the reasons set forth in this section, the Commission should not entertain a "shotgun" motion to conduct an investigation into matters that are

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ensure that the rates charged by Laclede for regulated utility service are not increased as a result of Laclede affiliates' unregulated activities. (See Section III.8 of the Stipulation.)

<sup>2</sup> See paragraph 9 of the Motion.

<sup>3</sup> Further, Laclede's delegation of these duties to an affiliate is no different than that performed by many other multi-functional corporations, including Ameren, Southwestern Bell and Utilicorp. Centralized functions are all handled the same way for these companies: by examining allocation issues, not by questioning the formation of the affiliate. For example, after Utilicorp centralized in 1995, it provided approximately 20 centralized functions to both Missouri Public Service, a regulated utility, and to non-regulated divisions. Rather than question the propriety of these functions, Staff instead merely examined the propriety of the allocations proposed by Utilicorp. (*In the Matter of Missouri Public Service*, Case No. ER-97-374, ET-98-103, EC-98-126, Report and Order (1998).

hypothetical and not fact-based, and over which the Commission already has adequate remedial tools (i.e. the PGA, rate case filings and the CAM) to pursue any substantive matter affecting Laclede and its customers.

**Conclusion.**

16. In conclusion, Staff's Motion should be denied. The Commission has no jurisdiction over Laclede's delegation to LES of gas supply administrative functions, because such delegation is not a transfer of any part of Laclede's franchise, works or system. Moreover, even if the Commission had jurisdiction, there would be no reason to exercise it, given the fact that the Commission has a number of regulatory tools with which to ensure proper allocation of LES' costs to Laclede. Therefore, opening a very general investigation of Laclede's delegation to LES of the gas supply administrative function, based solely on hypothetical speculation, serves no worthwhile purpose.

**WHEREFORE**, for the foregoing reasons, Laclede respectfully requests that the Commission deny Staff's Motion.

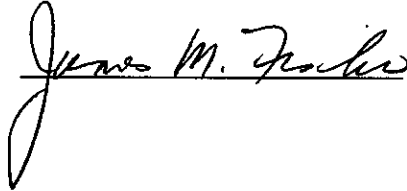
Respectfully submitted,

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**CERTIFICATE OF SERVICE**

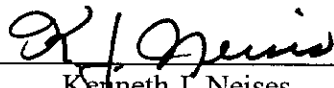
The undersigned hereby certifies that the foregoing Response has been duly served upon the General Counsel of the Staff of the Public Service Commission, Office of the Public Counsel and all other parties of record in this case by placing a copy thereof in the United States mail, postage prepaid, on this 10th day of June, 2002.

A handwritten signature in cursive script, reading "James M. Fisher", is written over a horizontal line.

STATE OF MISSOURI     )  
                                  ) SS.  
CITY OF ST. LOUIS     )

**VERIFICATION**

Kenneth J. Neises, being duly sworn, on his oath states that he is Executive Vice President-Energy & Administrative Services of Laclede Gas Company, that he has read Laclede Gas Company's Response to Staff's Motion to Open a Case to Investigate Laclede's Transfer of its Gas Supply Function and that the matters set forth therein are true and correct to the best of his knowledge, information and belief.

  
\_\_\_\_\_  
Kenneth J. Neises

Subscribed and sworn to before a Notary Public in the City of St. Louis, State of Missouri, this 7th day of June, 2002.

JOYCE L. JANSEN  
Notary Public — Notary Seal  
STATE OF MISSOURI  
ST. CHARLES COUNTY  
My Commission Expires: July 2, 2005

My commission expires: \_\_\_\_\_

  
\_\_\_\_\_  
Notary Public

