

*Recommendations for a Methodology  
for Allocation of Costs between  
Regulated and Non-Regulated Activities  
for Gazifère Inc.*

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*Presented to the  
Régie de l'énergie  
March 29, 2016*

**BDR**

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Original: 2016-03-29

GI-20  
Document 2  
15 pages  
Requête 3924-2015

# Introduction

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**Gazifère does the following unregulated, revenue-producing activities:**

- **maintenance and cleaning of natural gas appliances;**
  - **funding program for natural gas appliances;**
  - **call center and dispatch service under a contract with an affiliate, and;**
  - **rental of natural gas water heaters and furnaces.**
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- **Gazifère uses staff and facilities shared with the regulated business to carry out these activities, but most of the work is outsourced;**
  - **Gazifère is using a methodology approved by the Régie in 2000 to allocate the costs;**
  - **Gazifère wishes to update the methodology to reflect best practices and current data.**

# Consultant's Scope of Work

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To assist Gazifère in developing a cost-based, fair method of allocating costs between regulated and unregulated activities, including:

- review the existing approved methodology and the basis on which shared services are provided to the regulated and unregulated activities;
- review comparable practice in other utilities in Québec and in other jurisdictions;
- consider the ability of Gazifère's (or its affiliates') systems and resources to support alternative methodologies;
- on the basis of comparable practice and the data available, recommend a methodology consistent with accepted principles of cost allocation;
- prepare a report for filing with the Régie and;
- explain the recommendations to the Régie and stakeholders in public hearing.

# Marginal vs. “Fully Allocated” Cost Approach

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- A marginal approach would allocate to the unregulated business only those costs that would not be incurred if the unregulated business did not exist
  - *Regulated rate-payers receive no benefit from sharing services with the unregulated business*
- In a “fully allocated” approach, the unregulated business pays both the added costs it incurs, and a share of the cost for all the resources it uses, even if the total cost is no higher than it would be for the regulated business alone
  - *Regulated rate-payers benefit through cost reductions, from sharing resources with the unregulated business*
- The methodology recommended by BDR is a fully allocated approach.

# NOT included in BDR Scope

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Assignment did not include:

- Review of any services provided by Gazifère's affiliates, including the nature or value of the services or the method of allocation;
- make any independent audit of Gazifère's accounts;
- independently review any of its operations; or
- Benchmark, or assess the reasonableness of the level of cost incurred by Gazifère to carry out any activity or provide any service to customers.

*BDR received from Gazifère information as to the nature and amounts of costs subject to allocation, and accepted that information for purposes of the review.*

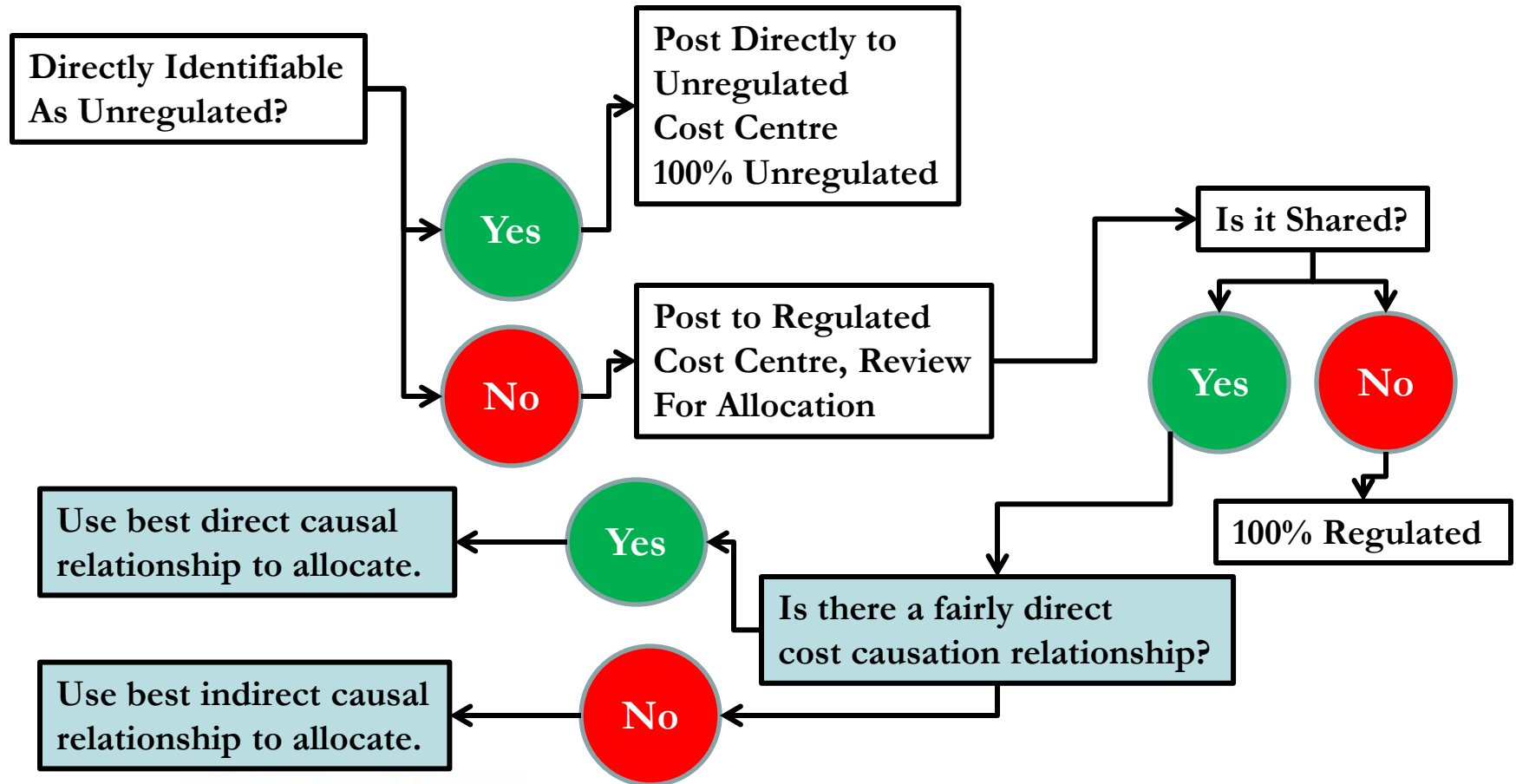
# How the Study was Carried Out

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- **Gazifère explained how the company is organized, what the unregulated businesses are, what services they need, how those services are delivered, what resources are used;**
- **Gazifère management gathered cost data, to produce a spreadsheet showing each type of cost as a line item, very detailed;**
- **Consultants recommended an allocation approach for each line item;**
- **Gazifère management gathered data to compute the allocation factors and completed the spreadsheet;**
- **Consultants reviewed several precedent studies including Gaz Metro;**
- **Consultants reviewed spreadsheet, confirmed understanding of resource sharing, and finalized recommendations.**

# Allocation Mechanism and Decision Process



# Factors Considered in Recommending Methodology

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- Allocation factors are simple and transparent to apply;
- Data supporting the allocation factor is gathered in the ordinary course of business, or can be gathered without unreasonable effort and cost;
- Use direct assignment where possible in preference to allocation, and a direct factor in preference to an indirect factor;
- Approaches are used by other utilities and accepted by stakeholders;
- Internally consistent – similar costs receive similar treatment;
- Results in a “fully allocated” approach – all shared resources are accounted for;
- Satisfies a high level sense of fairness.



# Precedents from Other Utilities

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- **BDR has performed more than 10 similar studies for clients in Ontario;**
- **Learned that sharing of services is different in each company, so there is no single approach that is best in all situations:**
  - Whether the unregulated services are within the utility company or within an affiliated corporation;
  - The type of business, scale and scope of the unregulated business(es);
  - The type of services that are shared or provided between the regulated and unregulated businesses; and
  - Whether the shared services are provided by the regulated business to the unregulated, by the unregulated business to the regulated, or by separate service company to both businesses.

*It is our opinion that the methodology proposed for Gazifère is consistent with practice used by other utilities and accepted by stakeholders.*

# Costs of, or Supporting, Employee Work

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- Employee salaries and benefits accounts for a high proportion of Gazifère's costs;
- Employee time is also the basis for allocation of the costs of supporting facilities including building, furniture, computers and software, and various departmental expenses;
- Where employees record their time in the work order system, these records were used. BDR considered this a direct assignment.;
- Employees who could identify their activities as for the regulated or the unregulated business, were asked to provide an estimate;
- For employee work with a shared benefit, a causal factor was identified (e.g. FTE's for human resource activities).

# Employee Time Allocation Factors

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- Engineering, construction and operations staff in utilities typically record their time to work orders, which can be identified as to the business that benefits;
- In BDR's experience it is not typical for other utility employees to keep a time log;
- No historical time logs were available in Gazifère to support this study;
- The allocation of employee time was therefore determined by overall estimates, or by task-related estimates, in most cases for each employee individually;

*BDR considers an estimate, which is based on the expected or typical work load, to be the appropriate basis to apply to the future test year.*

# Time Logs

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BDR does not recommend that the Régie order time logs for Gazifère's management and administrative employees because:

- Much of their time cannot be clearly identified as only for regulated, or only for unregulated activity;
- Activities with shared benefit require a judgment based allocation, or judgment in selecting an output-based allocation factor;
- Time units spent on one tasks are very small, according to studies by management experts (change task about every 9 minutes);
- Variety of activities is probably higher in small organizations like Gazifère, because the staff cannot specialize as they would in large organizations.

*As a result, while a time log would give a more detailed allocation, it would not necessarily give a more accurate allocation.*

# Costs with No Relationship to Employee Work

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These types of cost include:

- External audit fees;
- Insurance;
- Postage for administrative purposes (not billing);
- General advertising and listings (e.g. Yellow Pages);
- Bank charges;
- Bad debt provision, and;
- Internal charges.

*Each received a specific treatment based on the best information available.*

# Treatment of Assets

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- In order to qualify as a “fully allocated” approach, the cost of assets must be allocated, in addition to OM&A expenses;
- Cost of assets in the revenue requirement include depreciation, interest, income taxes and return on equity;
- By allocating a portion of the assets to the unregulated business, a proportionate share of all the related cost components are taken out of regulated costs;
- The distribution system plant is 100% regulated;
- Shared assets include leasehold improvements, office equipment, vehicles, communications, computers and software;
- Gazifère does not own its office/warehouse building;
- Assets receive the same allocation treatment as related OM&A.

## Recommendation

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*It is the opinion of the BDR consulting team that the methodology documented in our report and proposed by Gazifère is a “fully allocated” cost approach, which reflects cost causation and which is consistent with accepted principles of cost allocation.*

*We are therefore recommending that the Régie de l'énergie approve this methodology and the resulting allocation of costs for use by Gazifère in its 2017 test year, and until the issue is re-examined in a future proceeding.*