6.5 Please explain how the method of allocating costs between FEI and FBC (i.e. based on the number of employees) was chosen and determined to be appropriate.

Response:

This IR response addresses BCUC IRs 1.6.5 through 1.6.5.3.

Given the company-wide focus of the project and the impact on employees (i.e., users of the SAP system), FBC and FEI determined that using the number of employees within each company is a fair and reasonable cost allocation methodology to share the SAP Integration costs between the two regulated entities. The number of employees as a cost allocator is representative of the drivers of the costs being incurred for the project and is consistent with the cost-causality approach (i.e., causal relationship between the cost driver and the costs incurred). For example, the employees in each of FEI and FBC are the primary users of the paperless expense management and single sign on module of the SAP integration project, which supports the number of employees as an appropriate cost driver for the project costs.

This cost allocation approach is an approach that is often used for shared IT platforms that are used internally by both organizations. This approach was also used for the Training and Development initiative, a company-wide process implemented in 2015 which involved employees of each company, with the costs allocated between the two utilities using the number of employees of each company.[1] However, the choice of the appropriate methodology and cost driver to allocate common costs that cannot be directly assigned does need to be considered based on the circumstances of the situation. While the number of employees between FEI and FBC was determined to be the appropriate cost driver to allocate costs, three other methods of allocating the SAP Integration Project costs were considered.

First, the application of the Massachusetts Formula to allocate costs is extensively used in the utility industry and has been previously approved by the Commission in Order G-139-14. The Massachusetts Formula is composed of the arithmetical average of (1) operating revenue, (2) payroll, and (3) average net book value of capital assets plus inventories. The use of these factors represents the total activity of all business segments as a means to allocate costs that cannot be directly assigned. Using the Massachusetts Formula would result in approximately 24 percent of the SAP Integration costs being allocated to FBC with 76 percent to FEI. The Massachusetts Formula is approved by the Commission for allocating pooled Executive Management costs between FEI and FBC. The Massachusetts Formula would result in an allocation similar to that using the number of employees.

Second, the number of customers for each company was considered as another method of allocating the SAP Integration costs. As at December 31, 2016, FBC reported approximately 133 thousand customers compared to approximately 994 thousand customers for FEI. This would have resulted in an allocation of approximately 88 percent of the costs to FEI and approximately 12 percent of the costs to FBC. However, this allocation method was not

[1] FBC 2017 Annual Review – BCUC IR 1.3.2.

considered appropriate since the costs of the SAP Integration project are not influenced by the number of customers for each company.

Third, the benefits to be derived from the project were considered as a potential cost allocation driver. The O&M savings forecast to be attributed to FEI and FBC are approximately 63 percent and 37 percent, respectively. While these forecast O&M savings derived are an important factor in proceeding with the SAP integration project, there are other qualitative benefits expected to be derived such as:

- the reduction in redundancy when implementing process changes across the companies;
- allowing for consistent reporting across both companies;
- alignment of processes such as payment of invoices, credit card expense reconciliations, preparation and reimbursement of employee expenses, and time entry;
- elimination of the more manual and time-intensive process for intercompany cross-charging and allocation of costs in a more-timely manner; and
- the implementation of financial reporting software, which will allow for better integrity of data through increased controls and logging of changes to financial information.

All of the above provide qualitative benefits in the form of efficiencies for the primary users of the system (employees), but do not necessarily provide quantitative O&M savings. The qualitative benefits of the project are more closely aligned with the efficiencies provided to the end users, which supports the use of number of employees in the respective utilities as a driver of cost allocation.

Having reviewed all of the cost allocation methods discussed above, FBC and FEI concluded that number of employees is the most appropriate, given that it best reflects the driver of the costs. Given the circumstances regarding the SAP Integration initiative, FEI and FBC believe that using the cost driver of number of employees within each company will provide a fair and reasonable allocation of the project costs.

Finally, as requested in BCUC IR 1.6.5.2, FBC confirms that its proposed cost allocation approach using the number of employees within each company is consistent with the Commission approved FEI All-Inclusive Code of Conduct (COC) and Transfer Pricing Policy (TPP) which provides guidance on interactions between FEI and its affiliated natural monopoly utility, FBC. The policy states:

> Where is an agreement between FortisBC Energy and its Affiliate with respect to the sharing or provision of services, resources, or personnel that has been reviewed by the Commission, the terms of that agreement will govern.

In its Decision in Order G-110-12 related to FBC's 2012-2013 Revenue Requirements Application, the Commission determined that "Cross charges between FortisBC and its affiliates

Source: FBC Annual Review for 2018 Rates, Response to BCUC IR 1.6.5

regulated by the Commission are approved to be based on fully loaded costs, not including overhead." The proposed cost allocation approach for SAP Integration costs excluding overhead is consistent with the direction provided by this Decision.