Centra Gas 2024/25 General Rate Application

CAC Information Requests of Deloitte Expense Allocation Methodology Review

Responses of Deloitte LLP[1]

January 27, 2025

CAC/DEL I-1: Reference:

Deloitte ICAM Report, Part 5, Section 5.4, pgs. 18 and 19 and Order 6/24, Appendix B, PUB ICAM review Scope of Work, paragraphs 2 (b)(c) and 3 (a)(b).

Preamble:

Deloitte provides a list of the 4 procedures or steps that it undertook to review the cost allocation for O&A expenses (Section 5.4. pgs. 18 and 19):

1. Reviewed the underlying data and cost studies used to determine cost weights for each of the corporate cost drivers used in the ICAM methodology over the last 5 years;
2. Held discussions with Manitoba Hydro to understand any discretionary overrides applied to cost driver data based on management judgement and in keeping with the ICAM principles of stability and consistency;
3. Verified the cost allocation process for all settlement orders to check for the application of correct cost weights consistent with the description of the cost categories and with the findings of the underlying cost studies; and
4. Held discussions with Manitoba Hydro to understand the rationale for mismatches between the expected cost weight and applied cost weight and changes in cost driver allocation over time and obtained explanations for all cost weights that are determined using management estimates.

The PUB Scope of Work for the Deloitte ICAM review is contained in Appendix B of Order 6/24.

In addition to other deliverables, the PUB ICAM Scope of Work specified the following:

"2. Assess the appropriateness of the current methodology used for the inter-utility allocation of costs. The matters to be considered may include the following:

b) confirmation that the service upon which the costs are based is required by Centra is required by Centra as an independent utility;

[1] The defined terms used in Deloitte's Expense Allocation Methodology Review dated October 25, 2024, are also utilized in the responses in this document.

c) the level of service required by Centra;

3. Assess the appropriateness and reasonableness of the costs allocated to Centra. In doing so, consider the following issues, if appropriate:

a) the shared services profile and service level, by cost category, for a utility the size and complexity of Centra;

b) the reasonableness of the services received.

Question:

a) Please confirm that the 4 steps or procedures that are listed in the preamble are a complete list of the Deloitte assessment of the allocation of common or shared O&A costs between Manitoba Hydro and Centra. If not confirmed, please provide a detailed description of other steps or procedures performed and specific references in the Deloitte ICAM report where these procedures are described and the resulting opinions by Deloitte.
b) Recognizing the words “may” and “if appropriate” in the above preamble, please explain if Deloitte conducted the assessments listed in the PUB Scope of Work under items 2 (b) (c) and 3 (a) (b), with respect to the requirements of shared services, the level of services required and the overall reasonableness of the shared services received by Centra. If so, please provide specific references in the Deloitte ICAM report, with respect to the procedures carried out for these assessments and the resulting opinions by Deloitte.

Rationale for the Question:

To understand the scope of the work undertaken by Deloitte in the ICAM review in relation to the potential scope outlined in the PUB Scope of Work.

Response:

a) The four procedures listed in Section 5.4 of our report (pgs. 18 and 19) outline the steps taken to assess the allocation methodology used to allocate shared O&A costs between Manitoba Hydro and Centra. We also took into consideration the results of our benchmarking analysis, as described in sections 4 and 5.6 of our report, when concluding that the current cost allocation is “reasonable, practical, transparent, adaptable, and consistent with costing methodologies used at comparable utilities.”

b) The scope of our review was to assess the appropriateness and reasonableness of the ***methodology employed*** to allocate the various shared costs between the electric and gas lines of business, rather than assessing whether the actual quanta of each of the various costs were reasonable and appropriate. Our review did not indicate that a consideration of the matters and issues referenced in items 2 (b) (c) and 3 (a) (b) was necessary.

   Our benchmarking analysis focused on a review of the ***cost allocation methodologies*** employed at comparable utilities, and not on a comparison of the relative cost structure and service levels of those utilities with those of Centra and Manitoba Hydro.

CAC/DEL I-2: Reference:

Deloitte ICAM Report, Part 3, Section 3.2, pg. 12 and PUB ICAM review Scope of Work, paragraph 2 (f).

Preamble:

Deloitte indicates that in performing the ICAM review it adopted overall guiding principles and attributes including "Acceptable in a Regulatory Context" - in which it specifies that cost allocation in a regulatory context requires a greater level of rigour in both development and design as the results of the methodology have a potential effect on a much larger group of people, including the average consumer (Section 3.2, pg. 12).

The PUB Scope of Work outlined in paragraph 2 (f), that the matters to be considered in the ICAM review may include benchmark industry best practices for cost allocation in similar utility settings, including emerging issues and alternative cost drivers.

Question:

a) Please explain if Deloitte considered the potential revenue requirement and rate impacts to gas customers that flow from the allocation of shared costs to Centra through the ICAM as part of its review of the reasonableness of the ICAM and the criteria of Acceptable in a Regulatory Context. If so, please provide specific references in the Deloitte ICAM report, with respect to the procedures carried out for this assessment and the resulting opinion by Deloitte.
b) Please explain if Deloitte considered the potential for a rate spiral (rising costs to be recovered over flat or declining natural gas volumes) as a result of the energy transition, to be an emerging issue as part of its review of the reasonableness of the ICAM. If so, please provide specific references in the Deloitte ICAM report, with respect to the procedures carried out for this assessment and the resulting opinion by Deloitte.

Rationale for the Question:

To understand the scope of the work undertaken by Deloitte in the ICAM review and the application of criteria for the review.

Response:

a) The scope of our review was to assess the appropriateness and reasonableness of the methodology employed to allocate the various shared costs between the electric and gas lines of business, rather than assessing the actual quanta of each of the various costs. Our benchmarking analysis focused on a review of the cost allocation methodologies employed at comparable utilities, and not on a comparison of the relative cost structure and service levels of those utilities with those of Centra and Manitoba Hydro.

   Our review focused on understanding whether the ***methodology used to allocate*** the various component cost elements and settlement orders within the O&A and FD&T expenses between the two lines of business was appropriate and reasonable, and acceptable in a regulatory context i.e., rigorous in design and aligned with guidelines and generally accepted industry standards or practices as summarized in the benchmarking analysis outlined in section 4 of our report.

b) We did not consider the potential for a rate spiral as a result of the energy transition in our assessment of the appropriateness and reasonableness of the ICAM methodology. We reviewed benchmark industry best practices employed as part of the ***methodology used to allocate shared costs*** at other similar rate-regulated utilities, and not emerging issues with regards to operational efficiency and industry and market changes. We question the relevance of a rate spiral to the assessment of the current state of the ICAM.

CAC/DEL I-3: Reference:

Deloitte ICAM Report, Part 4, pg. 14 to 17 and Appendix E, pg. 42.

Preamble:

Deloitte opines that its review of information from other Canadian utilities (Algonquin, BC Hydro, Corix, Fortis, ENMAX, Hydro One and Hydro Ottawa) researched, indicated that they follow "similar" principles of cost causality to Manitoba Hydro (Part 4, pg. 14) and that the allocation methodology used by Manitoba Hydro is "relatively" consistent with those used by other Canadian utilities that it reviewed (Part 4, pg. 17).

Deloitte provides information that suggests that 23% ($56.7/$250.2) of Manitoba Hydro common costs are allocated through management estimates and 44% ($110.0/$250.2) of Manitoba Hydro common costs are allocated by corporate activity charges (Appendix E, pg. 42).

Question:

a) Please explain in detail Deloitte's caveats that the allocation methodology used by Manitoba Hydro was "similar" and "relatively" consistent with those used by the other Canadian utilities that it reviewed.
b) Please explain in detail, the areas where Manitoba Hydro's allocation methodology is not consistent with those used by the other Canadian utilities that it reviewed.
c) Please explain if Manitoba Hydro's use of corporate activity charges as a cost driver as compared to other Canadian utilities use of headcount or number of employees - is consistent or inconsistent with those used by the other Canadian utilities that it reviewed.
d) Please explain (i) if any of the other Canadian utilities that Deloitte reviewed have similar situations to Manitoba Hydro and Centra, with respect to integrated operations/FTEs that must be allocated between different lines of business (ii) if any of the other Canadian utilities will similar integrated operations/FTEs use corporate activity charges to allocate common or shared costs and (iii) if any of the other Canadian utilities reviewed use corporate activity charges to allocate common or shared costs.
e) Please explain if the degree of use of management estimates by Manitoba Hydro (23%) to allocate shared costs is consistent or inconsistent with those used by the other Canadian utilities that Deloitte reviewed.
f) Please explain if the degree of use of corporate activity charges by Manitoba Hydro (44%) to allocated shared costs is consistent or inconsistent with those used by the other Canadian utilities that Deloitte reviewed.
g) Please confirm (or explain otherwise) that the BC Hydro information provided in Section 4.3.2, pg. 15 of the Deloitte report is a diagram of cost allocation for the purposes of allocating costs between customer rate classes and not an example of an internal cost allocation methodology to allocate shared costs between different lines of business.
h) Please provide information on the factors used in ENMAX universal cost allocator that is referred to in Section 4.3.5, pg. 16 of the Deloitte report.

Rationale for the Question:

To understand the degree of consistency or inconsistency between the Manitoba Hydro cost allocation methodology and other Canadian utilities reviewed by Deloitte.

Response:

a) Our commentary regarding the comparable utilities being "similar" and "relatively" consistent reflect that we are of the opinion that they are reasonable comparable utilities for purposes of our analysis.

b) We note in our report where the allocation methodologies are not consistent with Centra's ICAM with specific examples being the Massachusetts Formula (3 factor vs 2 factor hybrid allocator) and the use of FTEs as an allocator which is not possible for Centra due to the FTEs not being tagged to a specific entity.

c) Centra uses corporate activity charges as a cost driver to allocate costs where there is a strong causal relationship with the staff working on Electric and Gas. The reviewed comparable utilities typically use cost weights based on employee headcount or FTEs to allocate shared costs in such instances. This is not feasible at Centra since employees are not allocated to individual lines of business. We do note that there are some instances, as reported in section 4, of comparable utilities using cost drivers other than employee/FTE count to allocate costs that are strongly linked to staff. These include payroll expenses, estimated work effort, or direct time studies to estimate time spent across the various utilities.

d) Based on our review we did not note any other utilities that had the same situation as Centra with regards to not being able to allocate based on headcount. However, the aforementioned alternate cost drivers (in response I-3(c)), while not exactly the same as corporate activity charges, are similar in spirit, in that they capture the relative share of labour input across the various lines of business. This is particularly true of payroll expenses which capture labour input as measured in value terms i.e., effort/time x charge rate.

e) The level of detail available in the publicly filed reports of the comparable entities is insufficient to be able to make this comparison. We are of the opinion that the use of the management estimates allocator is appropriate.

f) The level of detail available in the publicly filed reports of the comparable entities is insufficient to be able to make this comparison. We are of the opinion that the use of the corporate activity allocator is appropriate.

g) The BC Hydro information provided in Section 4.3.2, pg. 15 of the Deloitte report is a diagram of cost allocation.

h) We performed an extensive review of Enmax's public filings, and our review indicated that if a cost cannot be directly assigned or allocated based on cost causation, a universal allocator is used. This allocation is based on the forecast test period ratio, rounded to whole numbers.

CAC/DEL I-4: Reference:

Deloitte ICAM Report, Part 6, Section 6.1, pg. 20.

Preamble:

Deloitte asserts that the cost allocation methodology has yielded stable allocation amounts over the last 3 fiscal years (2021/22 to 2023/24) (Section 6.1, pg. 20).

Question:

a) Please explain if Deloitte reviewed the total allocation of common or shared costs to Centra over the period between the last Centra GRA (2019/20) and the current GRA (2024/25 Test Year).
b) Please explain if Deloitte is aware of or considered in performing its assessment of the ICAM, that the allocation of organizational support costs to Centra has increased from $15.5 to $32.5 (an increase of $17.0 million or 110%) between 2019/20 and 2024/25 and that the currently approved Centra non-gas revenue requirement is in the order of $145 million, such that a $17.0 million increase in shared costs is approximately a 12% ($17/$145) increase in non-gas revenue requirements.

Rationale for the Question:

To understand Deloitte's opinion that the cost allocation methodology has yielded stable allocation amounts.

Response:

a) The statement on page 20 of our report should have read "stable allocation *shares.*" The allocation methodology was reviewed to check for alignment with the principles outlined in section 3 of the report. What is meant by the statement on page 20 was that our review of the allocation methodology found that the relative share of O&A costs allocated based on each the various drivers has remained consistent i.e., there haven't been large swings in the overall cost structure (or the underlying cost weights).

b) The scope of our work was to assess the appropriateness and reasonableness of the ***methodology employed*** to allocate the various shared costs between the electric and gas lines of business, rather than assessing whether the actual quanta of each of the various costs were reasonable and appropriate.

   While not in the scope of our review, we would refer the CAC to section 3.4.2 (p.19) of Order No. 125/24, wherein Centra notes that O&A costs, and labour costs in particular, have increased substantially since the last GRA.

CAC/DEL I-5: Reference:

Deloitte ICAM Report, Part 6, Section 6.1, Figure 5, pg. 22 and pg. 23.

Preamble:

Deloitte provides a breakdown of shared cost allocations across management estimates sub-categories that appears to suggest that Relative % of Time estimates to perform tasks represent approximately 89.9% of the shared costs allocated to Centra through management estimates for 2023/24 (Section 6.1, Figure 5, pg. 22).

Deloitte opines that the rationale for the application of management estimates for the various cost drivers was reasonable (Section 6.1, pg. 23).

Question:

a) Please confirm (or otherwise explain) that Relative % of Time represents approximately 89.9% of the shared costs allocated to Centra through management estimates for 2023/24.
b) Please (i) explain the procedures and basis for Deloitte's opinion that that the rationale for the application of management estimates for the various cost drivers was reasonable. For instance, did Deloitte review the Relative % of Time estimates using some objective measures to assess whether the time estimates developed by Manitoba Hydro management were reasonable or was the basis of this finding based on the consistency of the Manitoba Hydro estimates over the fiscal years. If Deloitte used some objective measures to assess the reasonableness of the relative time estimates – then (ii) please provide an analysis of the objective measures and the assessment of the related Manitoba Hydro time estimates.
c) Please provide Deloitte's views on whether data driven cost drivers/allocators are more transparent, objective, verifiable, less prone to errors and administratively simpler - than management estimates and work effort allocations such as Relative % of Time - which are often only updated on a periodic or ad hoc basis.

Rationale for the Question:
To understand the basis of Deloitte's opinion that the application of management estimates for the various cost drivers was reasonable and obtains its general views on merits of using data driven cost estimates or management estimates to allocate common costs.

Response:

a) Of the $13.2 million in shared costs allocated to Centra through management estimates, approximately 89.9% i.e., $11.9 million, was from cost centres that were allocated between the electric and gas lines of business based on estimates of the relative % of time spent on each of the two utilities.

b) The review of the approximately 750 cost centres/settlement orders over the last three fiscal years (FY 21/22 – FY 23/24) allocated using management estimates included the following steps:

- Gaining an understanding of the various cost centres/settlement orders and the types of costs included in each.
- Understanding the type of management estimate used to allocate costs between the two lines of business for each of the cost centers/settlement orders, and assessing whether such a driver was reasonable and appropriate given the nature of costs contained in each cost centre/settlement order.
- Checking for the consistency in the application of these drivers to the cost centers/settlement orders, and for the relative stability of the underlying estimated cost weights for each of the cost centers/settlement orders across the three fiscal years reviewed.

c) In our assessment, the cost weights calculated as management estimates are also often data driven, and therefore provide a similar level of transparency, and objectivity. The difference is that the data used to calculate these estimates is more granular and specific to the individual cost centre compared to the data used to calculate the cost weights for the broader drivers (i.e., number of customers, hybrid corporate assets/corporate activity charges, corporate activity chargers).

For example, cost centres/settlements orders focusing on overall organizational support and customer service tasks that cover the combined entity (such as cash management, public affairs, and general marketing) are allocated to the two lines of business using the customer cost driver. Cost weights for this driver are calculated annually using the customer count for each of the two lines of business, across the entire province. On the other hand, cost centres/settlement orders focused on customer service and organizational support tasks specific to the various customer service zones (such as billing, dispatch services, work order processing specific to each customer service centre zone) are allocated using a management estimate and the cost weights for these settlement orders are calculated based on the electric/gas customer count for each of the specific customer service centre zones.

That said, there are other management estimates which are based on management judgement, such as the 50-50 allocation for settlement orders related to line locates in regions with both gas and electric services. This is based on management assessment of the relative time and effort required to locate gas and electric lines.

While data-driven cost allocators are more transparent, objective, and verifiable, they may not always be administratively simpler. For instance, estimating a more precise data driven split of the relative time and effort required for gas line locates compared to electric line locates would require a more detailed study that would entail obtaining data on the time spent on each such call for a line locate, the relative incidence of calls for electric line locates and gas line locates, the relative frequency of calls to locate both simultaneously, etc.