Shared Services and Cost Allocation: A Brief Regulatory Insight

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Shared services help utility holding companies operate more efficiently but they also create regulatory scrutiny around whether companies properly assign costs, whether they fairly allocate them to the beneficiaries of those services, and the costs of the services provided.

Shared services are commonly used to provide necessary business support to multiple regulated, and sometimes non-regulated operating affiliates. Under this arrangement, an entity, usually but not always a centralized service company, provides services to affiliates within the same utility holding company structure. These services may include executive and management support, legal and external affairs, human resources, finance and accounting, rates and regulatory support, customer service, information technology ("IT"), and supply chain management. Centralizing these functions can help utilities achieve benefits that the individual affiliates may not be able to realize on their own, and when designed and administered effectively, shared services can help utilities develop specialized expertise, realize economies of scale, eliminate redundancy, and standardize best practices across affiliated companies.

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Concentric advises and supports our clients on a broad spectrum of shared services and cost allocation matters, from establishing shared services organizations and cost allocation policies, to providing independent expert testimony on cost allocation practices, industry standards, and benchmarks. Please contact the authors if you would like to learn more.

When a service company provides services to affiliates, it incurs costs that must be billed to the affiliates that benefitted from those services. This process is intended to ensure that each affiliate is charged an appropriate share of costs incurred by the service company.

The costs incurred by a service company are either directly assigned or allocated to the benefiting affiliates. Direct assignment occurs when a cost can be clearly attributed to the affiliate that benefited from the associated service; in other words, there is a clear and direct relationship between the service provided and the beneficiary of that service.

When a service company provides homogenous services to multiple affiliates, each affiliate is generally allocated an appropriate share of the costs incurred based on an approved allocation methodology. An example of costs typically allocated are IT-related costs. Several utility holding companies consolidate IT functions in a department or group within their respective service company. As a result, the costs incurred by the IT organization for provision of service to multiple affiliates within the same utility holding company must be allocated across all the affiliates served.

Other examples of costs a service company may allocate to its affiliates are costs related to customer service activities, financial and accounting services, management oversight and corporate expenses, human resources, and regulatory and government affairs. In allocating[1] the costs, the service company should employ reasonable, clear, and supportable allocation methods that can withstand regulatory scrutiny.

Several jurisdictional regulatory authorities[2] in the United States, including the Federal Energy Regulatory Commission ("FERC") generally require that the services provided by a shared service provider be charged to affiliates at the lower of cost or the market rates.[3] There is also often a requirement for the service company to maintain a Cost Allocation Manual or equivalent written guideline.

These requirements are intended to help protect captive ratepayers from bearing inappropriate or unnecessary costs. A regulated public utility seeking to recover its service company expenses from ratepayers typically must demonstrate, or otherwise support, that the expenses charged by its affiliated service company are reasonable, lower than the market cost for comparable services, appropriately allocated, and those services are necessary to operate the regulated public utility. In conclusion, utilities are encouraged to govern these arrangements through clear and transparent policies and supportable cost allocation methods.

Endnotes

1 Some commonly used and accepted allocators include but are not limited to: number of computer workstations, number of software/user licenses, number of customers, square footage, and the Massachusetts formular. The decision to use a specific allocator for cost assignment primarily depends on the nature of the activity responsible for the costs.

2 For example: New Jersey (New Jersey Admin. Code 14:4-4.5 (g)); Oregon (Oregon Admin. Code 860-027-0048 (4) (e)); Oklahoma (Oklahoma. Admin Code 165:35-31-20); Florida (Florida Admin. Code 25-6.1351 (3)(c)).

3 18 CFR § 367.4570 - Account 457, Services rendered to associate companies

Concentric Energy Advisors was founded over two decades ago, and many of our team members have been forging paths together since the 1980s. Throughout this time, we have remained both passionate about and deeply committed to serving the energy industry.

We take great pride in leading a dedicated team of professionals who are bright, energetic, and possess an insatiable thirst for knowledge, along with an unwavering work ethic. A defining characteristic of Concentric is the collective willingness of our entire team, from the Chairman of the Board to the newest hire, to roll up their sleeves, engage deeply with their work, and deliver impactful results.

Our commitment to continuous learning is embodied in our labyrinth, where we continuously reflect on challenges, discover solutions, apply them strategically, and repeat this process to enhance the value we provide to our clients. This cycle—navigating the path, generating solutions, delivering value, and repeating the process— captures our team's commitment to service excellence and continuous improvement.

Information about Concentric Energy Advisors is available at www.ceadvisors.com.