



December 14, 2023

OPERATIONS AND MAINTENANCE EXPENSES



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- Expert Witness in COS/Rate Design before regulatory agencies in Indiana and Texas
- Teaches national EUCI Class on Water/Wastewater COS and Rate Design Fundamentals
- Faculty member for the National Association of Regulatory Commissioners' (NARUC) National Rate School
- 20+ years' experience

WHAT ARE OPERATIONS AND MAINTENANCE (O&M) EXPENSES?

**Contained on the
Income Statement of
the Utility**

**Reasonable and
necessary costs
incurred (paid) by the
utility for maintaining
and operating the
utility system in good
repair, working order,
and condition**

**Includes reasonable
expenses associated
with management and
administration of the
enterprise**

REVENUE REQUIREMENT FORMULA

$$RR = O + D + T + (R \times B)$$

- RR = Revenue Requirement
- **O = Operating Expenses**
- D = Depreciation
- T = Taxes
- R = Allowed Rate of Return
- B = Rate Base



O&M ACCOUNTS ON CHART OF ACCOUNTS

FERC Accounts

- Electric O&M
 - Accounts 500 to 598
 - Production, Transmission, and Distribution Expense
 - Accounts 900 to 935
 - Customer / G&A Expense
- Gas Utility O&M
 - Accounts 700 to 894
 - Production, Transmission, and Distribution Expense
 - Accounts 900 to 932
 - Customer / G&A Expense

NARUC Accounts

- Water O&M
 - Accounts 601 to 675
- Sewer O&M
 - Accounts 701 to 775

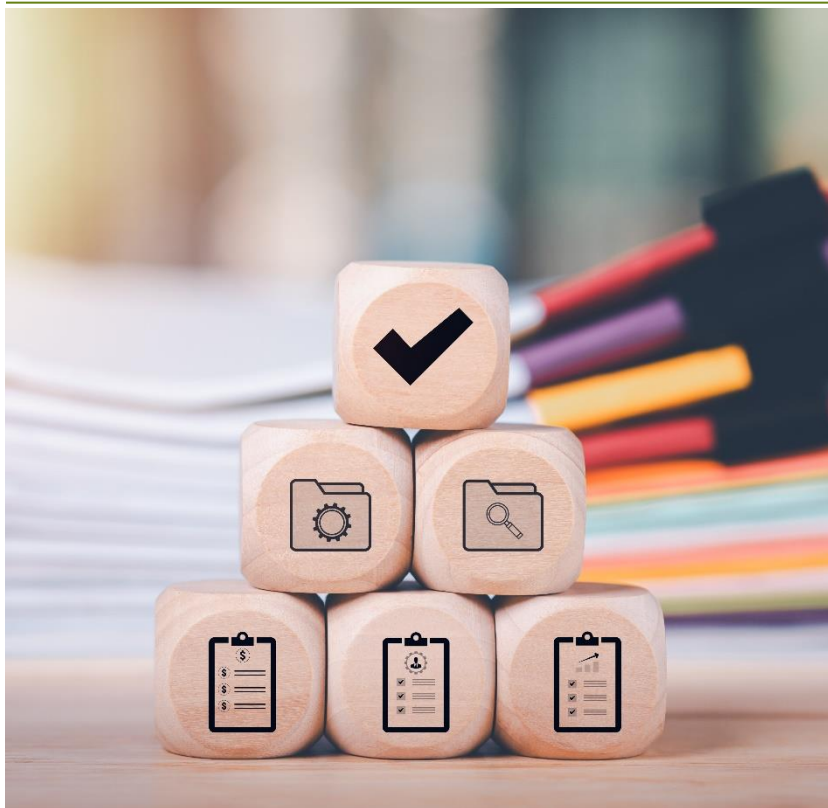
KEY O&M CONCEPTS

- **Test Year** – Represents a specific 12-month period, or annualized period of more or less than one year
 - Historical
 - Projected
 - Pro Forma
- **Normalization** – Adjusting expenses to normal levels, can reflect variances in growth, weather, etc.
- **Annualization** – Adjusting expenses to reflect a full 12 months

KEY O&M CONCEPTS (CONT.)

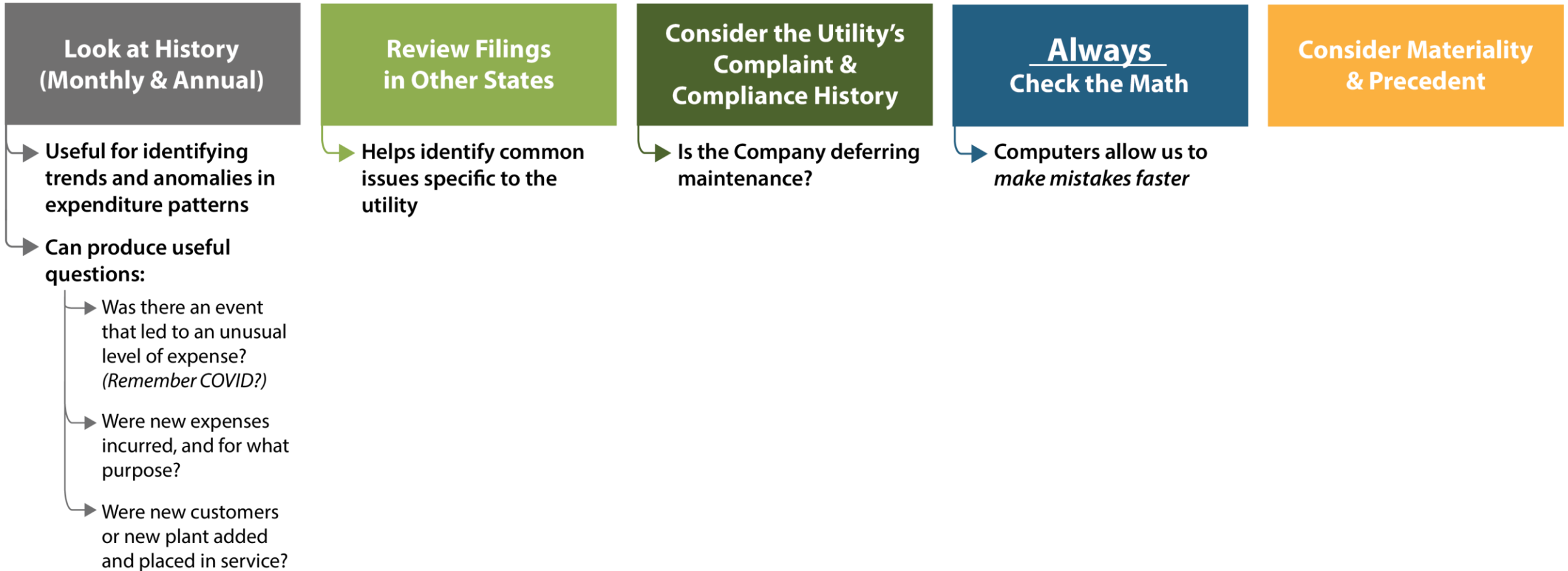
- **Known and Measurable Changes** – Verifiable on the record as to amount and certainty of effectuation
 - Salary Increases
 - Cost increases from electricity / chemical suppliers
- **Capitalization versus Expensed** – Items above a certain monetary threshold and which carry a service life greater than one (1) year should be capitalized

BASIS FOR REVIEWING O&M EXPENSE



- Just and Reasonable
- Prudently Incurred
- Incurred in the provision of service to customers
- Not associated with other non-regulated services
- Contribute to the provision of safe, adequate, and reliable service
- Consistent with regulatory standards / requirements
- Cost effective / efficient

REVIEWING O&M EXPENSE



KEY O&M EXPENSE ITEMS

PERSONNEL (LABOR) EXPENSE

- What positions are included? Are they filled or budgeted?
- Are salary levels reasonable? (Salary surveys)
- Are increases based on cost of living or merit based?
- Are bonuses based on operational or financial standards?
- For executives, are perquisites or extraordinary benefits included?
- Are overtime levels reasonable or should more staff be hired?



KEY O&M EXPENSE ITEMS

PENSION AND OPEB

- Tracked on an accrual basis, not cash basis
- Review the actuarial study – what is the unfunded amount?
- What amortization / recovery period should be utilized?
- Regulatory Asset / Liability used to track performance



KEY O&M EXPENSE ITEMS

INSURANCE

- What has the utility done to mitigate increases? (Quotes / Self-insurance)
- Are current insurance levels appropriate or too much?
- Have higher deductibles or different coverage levels been considered?
- What else is the utility doing specific to risk mitigation?
 - e.g., employee screening, security, proactive maintenance



KEY O&M EXPENSE ITEMS

FUEL, PURCHASED POWER / WATER / GAS

- Can be a significant component of total O&M expense
- What contracts are in place and are their terms and conditions followed?
- What sources are available?
- Are billings from supplier(s) accurate?
- Are costs from supplier(s) reasonable and in line with market?
- Be sure to recognize pass-through treatment



KEY O&M EXPENSE ITEMS OUTSIDE OR CONTRACT SERVICES

- Represents legal, accounting / audit, and consulting fees
- Are expenses already recovered through a rate case surcharge?
- Are expenses associated with compliance matters or other lawsuits?
- Are hourly rates / hours billed reasonable?



KEY O&M EXPENSE ITEMS

EXPENSES TO SCRUTINIZE FURTHER

- Advertising
- Dues / donations / memberships
- Charitable contributions
- Lobbying / legislative advocacy expense
- Inclusion of these expenses will be dependent on rules within the specific jurisdiction




AFFILIATED EXPENSES

- Many utilities utilize a shared services (centralized operations) model
 - Common overhead services (e.g., HR, IT, Finance, etc.) provided by a larger corporate unit
 - Services are allocated down to the operating units through a cost allocation methodology
- Affiliated Transactions typically carry a higher burden of proof
 - Payment must be reasonable and necessary
 - Costs must be specifically stated (shared services agreement, Cost Allocation Model)
 - Costs to affiliated entity under review should be no higher than to other affiliates or non-regulated / non-affiliated entities

COST ALLOCATION

- Utilities under a shared services model should have a clear cost allocation process, generally delineated in a cost allocation manual
- Allocation methodologies will vary, but will likely involve some combination of plant cost, labor expense, revenues, or customer counts
- The goal of the allocation process should be to follow cost causation – costs should be directly assigned where possible, and then allocated based on cost causal factors
- The methodology should be applied consistently across jurisdictions and business units



Any Questions?

QUESTIONS / DISCUSSION

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