

Application No: A-11-11-_____
Exhibit No: _____
Witness: Edward J. Reyes

In the Matter of Application of Southern
California Gas Company (U904G) to
establish a Compression Services Tariff

Application 11-11-_____
(Filed November 3, 2011)

CHAPTER III
PREPARED DIRECT TESTIMONY OF
EDWARD J. REYES

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

November 3, 2011

TABLE OF CONTENTS

I. PURPOSE1

II. TRACKING OF COMPRESSION SERVICES COSTS1

A. Direct Costs 2

 1. Accounting Methods 2

 2. Direct Cost Activities..... 3

B. Overheads..... 5

 1. Labor Overheads 5

 2. Non-Labor Overheads..... 7

 3. Administrative & General (“A&G”) Overhead 7

 4. Fixed Cost Loader (“FCL”) 8

III. TREATMENT OF COMPRESSION SERVICES COSTS8

IV. COMPRESSION SERVICES CHARGES AND REGULATORY ACCOUNTING TREATMENT9

A. Ownership Charge..... 10

B. Calculation of Ownership Charge..... 11

C. O&M Charge 12

V. WITNESS QUALIFICATIONS13

1 **CHAPTER III**

2 **PREPARED DIRECT TESTIMONY OF**

3 **EDWARD J. REYES**

4 **I. PURPOSE**

5 The purpose of this testimony is to describe the accounting procedures and methods that
6 will be used to ensure that all costs associated with the proposed Compression Services Tariff are
7 properly identified, recorded and tracked at fully-loaded costs¹, as needed. The testimony will
8 explain which costs are to be traced directly and by what method. It will describe the types of
9 overheads applied to this service, and will explain the methodology behind the overhead
10 calculation and application. This testimony will also provide an example to show how the
11 Compression Services Tariff charges will be developed and the regulatory accounting treatment
12 of these charges in providing compression services.

13 **II. TRACKING OF COMPRESSION SERVICES COSTS**

14 The cost of completing an activity or project consists of both direct costs, as charged to
15 that activity, and a share of indirect or overhead costs. The sum of these direct costs and
16 overhead costs make up fully-loaded costs. Direct costs are those activities and services that
17 benefit a specific project such as salaries of staff employees (labor costs) and materials required
18 for a specific project (non-labor costs). These costs are charged directly to the project since they
19 are identifiable and can be directly traced. Overhead costs are those activities and services that
20 are associated with direct costs such as payroll taxes and pension and benefits or are costs which
21 benefit a project but which cannot be economically direct charged such as administrative and
22 general overheads.

¹ "Fully-loaded cost" means the direct cost of good or service plus all applicable indirect charges and overheads.

1 **A. Direct Costs**

2 **1. Accounting Methods**

3 Direct costs are defined as the specific labor and/or non-labor costs of each specific work
4 activity performed in the delivery of the proposed tariff services. There are two accounting
5 methods available for capturing the direct costs associated with providing the Compression
6 Services Tariff: (1) direct charging, where the actual labor and non-labor spent in providing or
7 supporting the subject tariff services are recorded; and (2) allocation, where the costs associated
8 with provision of labor and non-labor activities are determined by formula, such as percentage of
9 some portion of direct costs. Southern California Gas Company (“SoCalGas”) will use direct
10 charging to capture all direct costs related to the Compression Services Tariff as the primary
11 method for capturing costs. Since many activities associated with the Compression Services
12 Tariff are identifiable and can be easily tracked, direct charging is the preferable method to
13 account for the costs.

14 To ensure that all costs associated with the Compression Services Tariff are properly
15 identified and segregated, specific internal orders will be created within the SAP financial system
16 to track such costs. For example, a specific internal order will be created to track the costs
17 associated with an individual Compression Services Tariff customer. This process provides the
18 ability to ensure that all costs incurred in providing service under the Compression Services
19 Tariff are properly tracked and ratepayers are credited for any embedded costs already included
20 in general rates, until such time as the miscellaneous revenues received for these services are
21 incorporated into rates. The majority of costs associated with the provision of service under the
22 Compression Services Tariff will be incremental charges from third-party service providers
23 which will be recorded directly to the appropriate internal order including any applicable

1 overheads. Managers of groups providing labor or non-labor will be trained to ensure that any
2 time or material associated with the Compression Services Tariff is properly recorded to
3 Compression Services Tariff internal orders.

4 **2. Direct Cost Activities**

5 Direct costs can be separated into six types of activities: Customer Outreach, Contract
6 Development, Engineering and Cost Estimation, Procurement and Construction, Engineering
7 Oversight, and Operation and Maintenance. As described above, these activities will be directly
8 charged to specific internal orders.

9 **a) Customer Outreach**

10 Customer Outreach costs will relate to efforts by SoCalGas to identify and educate
11 potential customers expressing an interest in the Compression Services Tariff. These costs will
12 include identifying potential customers for the Compression Services Tariff, investigating leads
13 (completing a lead sheet; qualifying the lead, and discussing preliminary results of promising
14 leads with a customer), and the development and production of materials to be used specifically
15 in promoting the Compression Services Tariff similar to those developed to promote other utility
16 tariffs. Customer Outreach costs do not include routine customer information and education
17 activities performed by account executives such as providing customers with general information
18 and education on utility services, programs, rules, and tariffs. The majority of activities related
19 to Customer Outreach will be performed by account managers.

20 **b) Contract Development**

21 Contract Development costs will include costs related to developing the customer-
22 specific elements of the standard form agreement, as well as costs related to customer credit risk
23 analysis. Contract Development costs will also include costs related to contracts with third-party

1 service providers. Staff supporting these activities including legal, procurement, engineering,
2 finance and natural gas vehicle (“NGV”) program staff will direct charge all hours devoted to
3 these activities.

4 **c) Engineering and Cost Estimation**

5 Engineering and Cost Estimation activities will include performing feasibility studies,
6 developing construction drawings, and obtaining permits for final construction drawings.

7 Engineering and Cost Estimation activities will be performed by third-party service providers, or
8 by utility staff, under the supervision of NGV program staff or internal engineering.

9 **d) Procurement and Construction**

10 Procurement and contracting for Engineering, Procurement, and Construction (“EPC”)
11 services will be provided by utility staff. It is expected that construction of the facilities will
12 generally be contracted on a turnkey basis.

13 **e) Engineering Oversight**

14 Engineering Oversight activities will include reviewing preliminary construction
15 drawings, monitoring the design work of the engineering contractor, approving final construction
16 drawings, and monitoring the construction of the facilities. Engineering Oversight activities will
17 be performed by internal engineering staff.

18 **f) Operation and Maintenance**

19 Ongoing operation and maintenance of the facilities will be performed by third-party
20 service providers, or by utility staff.

1 Table I, below, summarizes the types of direct cost activities, the providers of those
2 activities, and the accounting method that will be used in order to segregate these types of costs.

Table I
Types of Direct Cost Activities

Activity	Provider	Accounting Method
Customer Outreach	SoCalGas	Direct
Contract Development	SoCalGas	Direct
Engineering and Cost Estimation	Third-party service provider / SoCalGas	Direct
Procurement and Construction	Third-party service provider / SoCalGas	Direct
Engineering Oversight	SoCalGas	Direct
Operation and Maintenance	Third-party service provider / SoCalGas	Direct

3
4 **B. Overheads**

5 Overhead costs are those activities and services that are associated with direct costs such
6 as payroll taxes and pension and benefits or are costs which benefit a project but which cannot be
7 economically direct charged such as administrative and general overheads. They are expenses
8 that indirectly support activities of the utilities. Overheads will be applied to the direct costs
9 discussed in Section II.A., above, to ensure that those costs are tracked on a fully-loaded basis.
10 Overhead rates for the Compression Services Tariff costs, and application of such rates, will be
11 consistent with the rates and application that SoCalGas uses on a company-wide basis. These
12 rates are adjusted periodically, as needed. The following are the types of overheads that will be
13 applied: labor overheads, non-labor overheads, administrative and general overheads, and a
14 fixed cost loader.

15 **1. Labor Overheads**

16 Labor overheads represent additional indirect costs associated with salaries paid to
17 employees and are loaded on internal labor and labor billed to other parties. The standard labor

1 overheads include Payroll Tax, Incentive Compensation Plan, Workers' Compensation, Public
2 Liability and Property Damage, Pension and Benefits, and Vacation and Sick.

3 **a) Payroll Tax**

4 The Payroll Tax overhead represents the company's portion of required contributions to
5 the state and federal governments for State Unemployment Insurance, Federal Unemployment
6 Insurance, and Federal Retirement and Medicare Insurance. The Payroll Tax overhead will be
7 applied to total direct labor costs and is currently 7.68%.

8 **b) Incentive Compensation Plan ("ICP")**

9 The ICP overhead represents the incentive compensation plan costs paid to employees
10 based on individual employee and company performance as compared to pre-established goals.
11 The ICP overhead will be applied to total direct labor costs and is currently 29.34%.

12 **c) Workers' Compensation ("Workers' Comp")**

13 The Workers' Comp overhead represents the cost of expected payments to employees for
14 work-related injuries, plus the cost of workers' compensation insurance premiums to cover
15 claims over a certain dollar amount. The Workers' Comp overhead will be applied to total direct
16 labor costs and is currently 5.65%.

17 **d) Public Liability and Property Damage ("PLPD")**

18 The PLPD overhead represents the cost of expected payments to third parties for liability
19 and property damage claims submitted to the company plus the cost of insurance premiums to
20 cover claims over a certain dollar limit. The PLPD overhead will be applied to total direct labor
21 costs and is currently 3.25%.

1 **e) Pension and Benefits (“P&B”)**

2 The P&B overhead represents costs paid by the company to provide employee benefits,
3 such as flex health benefit plans, employee pension contributions and expense, the company
4 match portion of contributions to the qualified retirement savings plan 401(k), and retiree health
5 benefits. The P&B overhead will be applied to total direct labor costs and is currently 50.09%.

6 **f) Vacation and Sick (“V&S”)**

7 The V&S overhead represents costs paid by SoCalGas for employees’ non-productive
8 time, such as vacation and sick days, holidays, and jury duty. The V&S overhead will be applied
9 to total direct labor costs and is currently 19.79%.

10 **2. Non-Labor Overheads**

11 The standard non-labor overheads consist solely of the Purchasing overhead rate.

12 **a) Purchasing**

13 The Purchasing overhead rate represents costs related to the procurement activity in
14 obtaining goods and services for the organizations. The Purchasing overhead will be applied to
15 total direct non-labor costs (which generally represent purchased materials and services) and is
16 currently 1.86%.

17 **3. Administrative & General (“A&G”) Overhead**

18 The A&G overhead represents the cost of administrative and general support provided by
19 functional areas such as, Accounting and Finance, Human Resources, Information Technology,
20 and Tax. The A&G overhead will be applied to all total direct costs, both labor and non-labor,
21 and is currently 31.21% and 6.88% for O&M and Capital, respectively.

1 **4. Fixed Cost Loader (“FCL”)**

2 The FCL represents costs for buildings, furniture, computer equipment, software, and
3 miscellaneous equipment which may be used in providing the service to a third party. FCL will
4 be applied to all total direct O&M costs, both labor and non-labor, and is currently 12.76%.

5 Table II, below, summarizes the types of overheads.

Table II
Types of Overheads

Overhead	Loading Base	O&M %	Capital %
Labor Overheads:			
1) Payroll Tax	SoCalGas Labor	7.68%	7.68%
2) Incentive Compensation Plan	SoCalGas Labor	29.34%	29.34%
3) Workers' Compensation	SoCalGas Labor	5.65%	5.65%
4) Public Liability and Property	SoCalGas Labor	3.25%	3.25%
5) Pension & Benefits	SoCalGas Labor	50.09%	50.09%
6) Vacation & Sick	SoCalGas Labor	19.79%	19.79%
Total Labor Overheads		115.80%	115.80%
Non-Labor Overheads:			
7) Purchasing	Total Non-labor	1.86%	1.86%
8) Administrative & General	Total Direct Costs	31.21%	6.88%
9) Fixed Cost Loader	Total Direct Costs	12.76%	-
Total Labor Overheads Applied	1, 2, 3, 4, 5, 6, 8, 9	159.77%	122.68%
Total Non-Labor Overheads	7, 8, 9	45.83%	8.74%

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7 **III. TREATMENT OF COMPRESSION SERVICES COSTS**

8 The accounting methods described above are designed to ensure that the service provided
9 under the tariff for Compression Services Tariff customers are appropriately tracked on a fully-
10 loaded basis and that ratepayers are credited for any costs embedded in general rates, until such
11 time as the miscellaneous revenues received for these services are incorporated into rates. As a

1 result, a portion of the Compression Services Tariff revenues will be subject to balancing
2 account treatment on an interim basis as described in Section IV., b and c.

3 SoCalGas' general rate case ("GRC") filing, currently before the California Public
4 Utilities Commission ("CPUC"), contains no requests for additional funding for the Compression
5 Services Tariff activities in the test year or any forecasted revenues from offering the service.
6 SoCalGas did not undertake any such activities or incur such costs in the historical period upon
7 which the GRC test year forecast was based. Thus, neither authorized base margin nor general
8 base rates in the current GRC will be impacted by the Compression Services Tariff costs. By
9 separately tracking all Compression Services Tariff costs, SoCalGas will ensure that appropriate
10 pricing is developed that is sufficient to recover the costs associated with compression services.

11 **IV. COMPRESSION SERVICES CHARGES AND REGULATORY ACCOUNTING**
12 **TREATMENT**

13 Customers under the Compression Services Tariff will be charged for recovery of the
14 costs and ongoing maintenance of the facilities used in providing service under the proposed
15 tariff. The Compression Services Tariff charges consist of two components: (1) Ownership
16 Charge; and (2) O&M Charge. The table below provides the components of cost to serve a
17 Compression Services Tariff customer with a direct capital cost of \$1 million. Total O&M costs
18 estimated over the life of the agreement are presented in nominal dollars.

Table III
Estimated Costs
(in 2011 dollars)

Capital Costs	Total
Labor	\$50,000
Non-Labor	\$950,000
Overheads	\$144,370
Total Capital Costs	\$1,144,370
O&M Costs	
Labor	\$10,000
Non-Labor	\$250,000
Overheads	\$130,552
Total O&M Costs	\$390,552

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A. Ownership Charge

The Ownership Charge will recover capital-related costs on a monthly basis over the term of the contract and in this example is \$15,057/month for the 10-year term of the contract. The Ownership Charge, as well as the O&M Charge, will vary by customer depending on the terms of the contract. In the example below, provided for illustrative purposes only, the Ownership Charge was derived by determining the constant monthly payment required to achieve the same present value that would occur from ratebasing the facilities on the distribution system (FERC account G-387).

B. Calculation of Ownership Charge

Table IV
Calculation of Ownership Charge (in 2011 dollars)

	Capital-Related	O&M	Total
Present Value of Revenue Requirements	\$1,181,064	\$322,232	\$1,503,297
Contract Term in Years	10	10	10
Annual Discount Rate	8.68%	8.68%	8.68%
Monthly Discount Rate	0.72%	0.72%	0.72%
Term in Months	120	120	120
Annual Payment	\$180,684	\$48,312	\$228,996
Monthly Payment	\$15,057	\$4,026	\$19,083
<u>Notes:</u>			
Estimated Capital Cost (in 2011 dollars)	\$1,144,370		
Annual O&M Expenses	\$48,312		
Discount Rate = Authorized Rate of Return			
Capital costs are estimates only and include indirect costs.			

The estimated annual Ownership Charge is \$15,057/month * 12 months = \$180,684/year. These capital-related costs are not included in the current authorized base margin, and SoCalGas is not asking for additional capital expenditures approved in the GRC Test Year 2012. Revenues from the monthly charge will be recorded as miscellaneous revenues to recover SoCalGas' costs in providing the Compression Services Tariff. However, to the extent the Ownership Charge includes any recovery of the costs for using SoCalGas' existing resources that are currently in authorized base margin, revenues to offset those embedded costs will be credited to the appropriate balancing accounts. SoCalGas plans to allocate such revenues to its Core Fixed Cost Account ("CFCA") and Noncore Fixed Cost Account ("NFCA") based on the relative percentage of revenues from core and noncore Compression Services Tariff customers until these assets are rolled-in authorized ratebase in connection with SoCalGas' next GRC proceeding, at which time miscellaneous revenues forecasts associated with the Compression Services Tariff will be

1 incorporated as a reduction of base rates. This will ensure that revenues from the specific
2 Compression Services Tariff customers in both the interim period and the next GRC cycle cover
3 the cost of providing the service, including a return on investment to the shareholders.

4 **C. O&M Charge**

5 In addition to the Ownership Charge, SoCalGas proposes an O&M-related charge for the
6 Compression Services Tariff. The O&M Charge is based on costs related to Customer Outreach,
7 Contract Development, and the maintenance of the facilities. The maintenance will be
8 performed throughout the term of the contract and will be performed by a third party service
9 provider or by utility staff. The cost associated with the maintenance will be appropriately
10 charged to the customer. The estimated annual O&M charge is $\$4,026/\text{month} * 12 \text{ months} =$
11 $\$48,312/\text{year}$.

12 The Ownership Charge and the O&M Charge comprise the Compression Services Tariff
13 charges. Similar to the Ownership Charge associated with the capital investment described
14 above, SoCalGas is not requesting an increase to its base rates in GRC Test Year 2012 to recover
15 these additional O&M costs. Consistent with the treatment of the Ownership Charge, revenues
16 from the monthly O&M Charge will be used to recover SoCalGas' O&M costs in providing the
17 Compression Services Tariff. However, if the O&M Charge includes any recovery of the costs
18 for using SoCalGas' existing resources that are currently in authorized base margin, revenues to
19 offset those embedded costs will be credited to the appropriate balancing accounts until such
20 time these costs are incorporated in base rates, in connection with SoCalGas' next GRC
21 proceeding, at which time miscellaneous revenues forecasts associated with the Compression
22 Services Tariff will be incorporated as a reduction of base rates. This will ensure that revenues

1 from the specific Compression Services Tariff customers in both the interim period and the next
2 GRC cycle cover the cost of providing the service.

3 **V. WITNESS QUALIFICATIONS**

4 My name is Edward J. Reyes. My business address is 555 West Fifth Street, Los
5 Angeles, California 90013. My current position is Financial Analysis & Strategic Manager for
6 Southern California Gas Company (“SCG”).

7 I received a Bachelor of Science from California State University, Dominguez Hills in
8 May 1994. I was initially employed by SCG in November 1994 and have held various positions
9 of increasing responsibility in the Accounting and Finance areas of the company, including Cost
10 Accounting, Financial Accounting, Accounts Payable, New Business Accounting, Financial
11 Systems and Affiliate Billing & Costing. My responsibilities have included participation and/or
12 supervision of SAP CO month-end closing, affiliate billing, overhead rate studies, plant
13 accounting, system design and implementation, and SAP/Business Warehouse client support.

14 I have been in my current position since January 2011. In my current position my
15 responsibilities include overseeing the financial analysis in support of new investment
16 opportunities, development of revenue requirements and development of financial planning for
17 incremental projects.

18