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Maine Public Utilities Commission

Monitoring of Outsourced Activities

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Statutory Provisions Implicating Outsourcing

- Competitive bids required when:
 - utility outsources construction of facilities located on private property; and
 - facilities will be used exclusive for the individual owner of the private property; and
 - individual owner of private property will pay total cost of construction directly to the utility
- Commission could, theoretically, require outsourcing
 - Except for telephone companies with regards to construction of interexchange facilities (Labor bill)
- The decision of whether to outsource is within the judgment of the Utility's management

Why Might a Utility Outsource ?

- Economic Efficiency
 - Specialized service
 - Uneven need for service
 - Outside vendor possesses economies of scale
- Regulatory Requirement
 - “Qualifying Facility” contracts for generation
 - Long term supply contracts to subsidize green energy
 - Energy Efficiency Programs

Types of Services that Have Been Outsourced

- Rate Case services
 - Attorneys, expert consultants
- Lobbying services
- Tree Trimming
- Customer Billing
- Information Technology (IT) services
- Storm Restoration services
- Account Receivables and Collections services

Commission Review of Outsourcing Arrangements

- Maine Public Utilities Commission (MPUC) does not directly oversee utility outsourcing arrangements
- Cost of outsourced services are reported in Uniform System of Accounts
 - Reporting contains less detail of the underlying costs as compared to utility that relies on in-house employees to perform the function
 - MPUC can obtain further detail from the utility
 - Uniform System of Accounts does not provide information regarding the quality of the outsourced service.

Commission Review of Outsourcing Arrangements

- MPUC does not pre-approve outsourcing arrangements
- MPUC may review outsourcing arrangements
 - in a rate case investigation
 - in the course of a management audit
 - in an investigation
 - in response to a customer complaint
 - on its own initiative

Commission Review of Outsourcing Arrangements

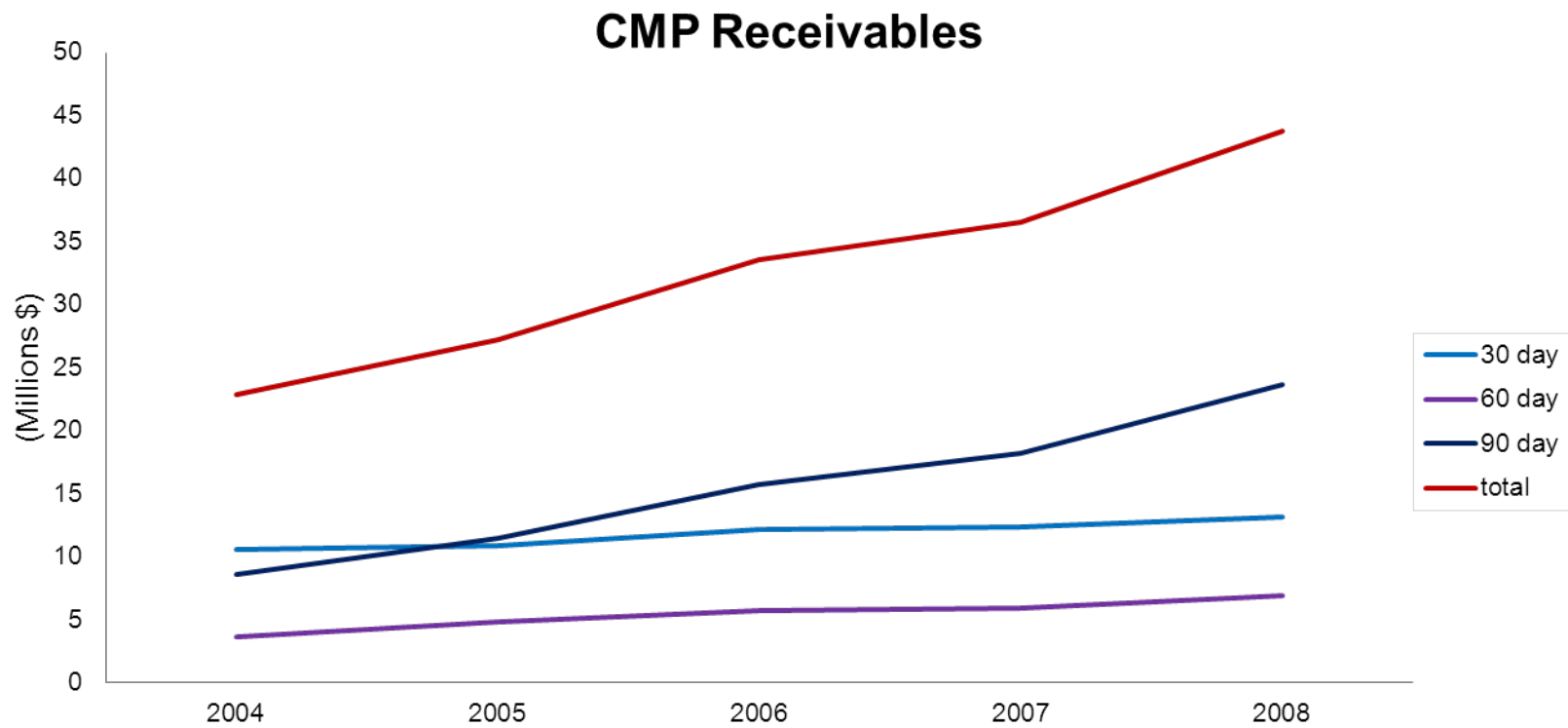
- Is the outsourcing arrangement **Prudent** ?
 - senior executive expected to possess financial and technical expertise
 - prevailing practice relevant, not determinative
 - obligation to provide safe, reasonable, adequate service
 - obligation to operate efficiently, at lowest cost over time
 - analysis of decision-making process on facts then known
 - prudence not based on hindsight
- Is the outsourced service provided by an **Affiliate** of the utility ?
 - risk of cost-shifting from unregulated affiliate to regulated utility
 - risk of jurisdictional shifting of costs
 - Shareholders vs. Ratepayer interests
 - (Presentation of Lucretia Smith and Christine Cook)

Case Study – Outsourcing of Receivables and Collections Services; Central Maine Power (CMP)

- Central Maine Power, a transmission and distribution utility, operated under an incentive-based rate plan
 - Rates fixed for 5 years
 - Operating efficiencies over life of plan benefit both shareholders and ratepayers
 - Service Quality Index (SQI) mechanism, with penalties, designed to ensure that utility would not degrade service quality in order to obtain cost-savings
 - Outage metrics
 - Repair and customer service support response time metrics
 - Customer complaint metrics

CMP's Receivables Account

- In 2004, CMP hires the “First Contact” company to handle inbound and outbound credit and collection activities for residential customers
- By 2008, CMP's accounts receivables increased by 104%, from \$16.6 million to \$34 million
- During the same period of time (in which macroeconomic conditions certainly contributed to heightened customer arrearages) the receivables accounts of Bangor Hydro Electric increased by only 64%



Complaints lodged by T&D customers

- Most complaints lodged with the Commission by customers of T&D utilities concern unresolved billing matters
- Between 2004 and 2008, the number of such complaints lodged by CMP customers increased by 42%
- Between 2004 and 2008, the number of such complaints lodged by BHE customers increased by 60%

Customers Complaints

- The level of customer complaints was not sufficiently high as to trigger an SQI penalty.
- However, in 2009, the utility requested that the MPUC waive the complaint-related SQI metric for the upcoming measurement period, or modify it to remove collection-related complaints. Why ?

The mysterious observation

Q: Why were customer complaints decreasing at the same time that aging receivables are increasing ?

A: Because CMP management placed a higher valuation on avoiding SQI penalties than recovery of account receivables.

Evidence of Imprudent Credit and Collection Efforts

- Results of statistical, regression analysis showed that poor macroeconomic conditions accounted for some, *but not all*, of the observed increase in the utility's charge-offs of its aging receivables.
- At internal utility meetings, management acknowledged that utility had less control over collections efforts since outsourcing that function and that the utility had “no strategy on collections”
- Utility had allowed its staffing levels for meter readers to decline, reducing its ability to issue disconnection notices to delinquent customers

Most Significant Evidence of Imprudence

- The terms of the outsourcing contract
 - performance standards based on “customer satisfaction”
 - vendor bonuses based on number of customer complaints to MPUC
 - no incentive payments based on achieved level of collections
- The outside vendor was not paid on the basis of collected receivables

Concepts relevant to outsourcing

- The concept of imprudence is based on “efficient investment” theory, whereby regulation acts as a surrogate for competition which would charge “inefficiency” to shareholders
- To achieve efficiency through outsourcing, the incentive mechanism requires proper alignment of shareholder and ratepayer interests.