

FOR CONSIDERATION

March 29, 2021

TO: The Board of Trustees

FROM: Thomas Falcone

SUBJECT: Consideration of the Adoption of Recommendations for Affiliate Services

Requested Action

The Board of Trustees (the “Board”) of the Long Island Power Authority (“LIPA”) is requested to adopt a resolution approving recommendations for the use of affiliate services to provide Shared Services, as defined in the Operations Services Agreement (“OSA”) by and between LIPA and PSEG Long Island (the “Recommendation for Affiliates”), which resolution attached hereto as **Exhibit “A”**.

Background

LIPA has a Pass-Through Expenditure obligation pursuant to Section 5.2(A)(7) of the OSA for certain costs incurred by the Service Provider in connection with the use of other PSE&G subsidiaries, commonly referred to as “affiliate” costs. Section 5.2(A)(7) of the OSA provides:

- (i) in the case of transactions with an Affiliate under which the Affiliate agrees to provide an Operations Service set forth in Section 4.2 hereof as a Shared Service, the Service Provider’s Total Costs incurred in connection with such transaction (including reasonable and demonstrated costs incurred which are necessary to integrate ServCo with such Affiliate, subject, however, to cost substantiation as provided in Section 1.1(E) hereof), which will not include a profit or mark-up component for the Affiliate

Pursuant to Section 4.4(16), Rights and Responsibilities of LIPA, of the OSA, LIPA, in part, has the right to “make recommendations to the Service Provider, in each case as may be reasonably necessary or appropriate to perform LIPA’s oversight responsibilities and obligations with respect to the provision of Operations Services under this Agreement and as may otherwise be necessary or appropriate to comply with LIPA’s legal, contractual and fiduciary obligations. . .”

The use of PSE&G subsidiaries as “affiliates” is permitted under the terms of the OSA. The services that PSEG Long Island typically uses affiliates to perform include: IT system support, IT project support, Human Resources, Procurement, Treasury, and Legal Services. Affiliate costs are charged to PSEG Long Island, and therefore funded by LIPA.

However, the current procedures relating to the use of affiliates do not provide LIPA with sufficient detail to accurately determine whether the use of such affiliates is the most economic approach and in the best interest of LIPA’s customers. LIPA reimbursed PSEG Long Island a total of \$23 million for all affiliate related services in 2020, including IT system and project support, support for the processing of Tropical Storm Isaias food and medicine spoilage claims, and for handling overflow customer calls and other support during Tropical Storm Isaias. Furthermore, \$17 million, or 75 percent of the total affiliate costs are allocated based on a formula that assigns Long Island a percentage of aggregated “pooled” costs. As a result, LIPA has little accounting detail on the majority of the affiliate costs. Lastly, affiliate costs typically come with a premium due to facility, support, and administrative overhead costs being added to direct labor costs. A “fully-loaded” affiliate cost is typically higher than the cost of PSEG Long Island in-house personnel.

Recommendation

To address these issues, LIPA Staff has developed the following recommendations for the Board’s consideration. LIPA recommends that PSEG Long Island prepare enhanced reporting and policies to govern the use of affiliates to increase accountability and transparency. The specific recommendations were provided to PSEG Long Island in a letter and are listed below:

1. Enhanced Affiliate Budget Transparency

a. Cost Benefit Justification

- PSEG Long Island should prepare cost and benefit justifications for affiliate use as part of the 2022 annual budget development process. Include in the cost justification an alternative analysis comparing the cost and benefit of providing the service through an affiliate as compared to the same service using PSEG Long Island in-house employees or by a third-party vendor. The analysis should reference the assumed ServCo employee costs, contracted rates, or proposals from vendors to perform similar work.
- For affiliate services identified that would be less costly if provided by ServCo employees or a vendor, PSEG Long Island should identify the steps it will take to secure these savings for Long Island electric customers.

b. Transactional Cost Allocation

- PSEG Long Island should minimize the use of transactional cost allocation. For service areas that use a transactional cost allocation methodology, LIPA expects these areas to shift to a direct, or “Professional” cost allocation methodology as a way to provide for increased accountability and transparency. Where a direct cost allocation is not feasible, PSEG Long Island must provide a justification as to why it is necessary to continue to utilize a transactional method. Further, this should include a review of the basis of the allocation percentage to ensure that Long Island customers are not subsidizing New Jersey services. The detailed transactional cost information should delineate labor costs and hours by title and the use of contractors and their associated roles.

c. IT Services

- Over 25 percent of total affiliate charges are associated with IT Customer Support and IT Client Project Support. Therefore, the budget plan needs to document the specific projects the affiliate will be working on in the upcoming year, the estimated affiliate cost by project, as well as the affiliate role in supporting the project.
- d. Activity/Billing Hourly Rates
 - The budget submission must include supporting documentation reflecting the calculation of the Activity/Billing Hourly Rates. This should include itemizing titles and their average salaries that comprise the Activity/Billing Rate as well as include any data and formulas that reflects any adjustments to or weighting of average salaries in the calculation of the Activity/Billing Rate. The calculation should ensure rates are an accurate representation of labor costs incurred and are not disproportionately impacted by inclusion of high salary positions in a particular Activity/Billing Rate. Positions with salaries outside a reasonable range from the average should be moved to a separate activity type.
- e. Submission Due Date
 - The affiliate cost and justification must be furnished to LIPA for review no later than August 15, 2021.

2. Enhanced Affiliate Actual Cost Transparency

- a. Budget Variance Report
 - PSEG Long Island must provide LIPA with a quarterly affiliate report, detailing actual use of affiliates as compared to budget including variance explanations that are grounded in the budget details provided to LIPA pursuant to Recommendation 1 (above).
- b. Full-time Affiliate Positions
 - As part of the quarterly Budget Variance Report, detailed support must be provided for positions utilized to support PSEG Long Island at a level equivalent to one full-time equivalent. The ServCo model anticipates a workforce dedicated to supporting PSEG Long Island at a full-time level to be a PSEG Long Island employee. An explanation should accompany this analysis that confirms the employee's transition to PSEG Long Island or a justification as to why this is not possible and why the particular PSEG employee is used to support PSEG Long Island on a full-time basis.

3. Former ServCo Employees

- a. LIPA requires PSEG Long Island immediately request approval for hiring former ServCo positions as affiliates, pursuant to its contractual obligations. The request for approval must include the work the position will perform, why it is necessary or beneficial for the affiliate to hire the person, and how PSEG Long Island will ensure that any affiliate charges to PSEG Long Island for the position will not exceed what LIPA would have paid had the positions remained with ServCo. The

request will also include an estimate of time dedicated to PSEG Long Island as an affiliate.

Based upon the foregoing, I recommend approval of the above requested action by adoption of a resolution in the form attached hereto.

Attachments

Exhibit "A" Resolution

RESOLUTION ADOPTING RECOMMENDATIONS FOR AFFILIATE SERVICES

WHEREAS, pursuant to Section 4.4(16), Rights and Responsibilities of LIPA, of the Amended and Restated Operations Services Agreement (“OSA”), LIPA, in part, has the right to “make recommendations to the Service Provider, in each case as may be reasonably necessary or appropriate to perform LIPA’s oversight responsibilities and obligations with respect to the provision of Operations Services under this Agreement and as may otherwise be necessary or appropriate to comply with LIPA’s legal, contractual and fiduciary obligations. . .”; and

WHEREAS, the use of PSE&G subsidiaries as “Affiliates” is permitted under the terms of the OSA; and

WHEREAS, the services that PSEG Long Island typically uses Affiliates to perform include IT system support, IT project support, Human Resources, Procurement, Treasury, and Legal Services. Affiliate costs are charged to PSEG Long Island, and therefore funded by LIPA; and

WHEREAS, LIPA reimbursed PSEG Long Island a total of \$23 million for all Affiliate related services in 2020, including IT system and project support, support for the processing of Tropical Storm Isaias food and medicine spoilage claim processing as well as for handling overflow customer calls and other support during Tropical Storm Isaias; and

WHEREAS, since a majority of these costs include little accounting detail, LIPA has limited information on and oversight of the functional use of Affiliates; and

WHEREAS, LIPA has developed a recommendation to incorporate into the budget development process a thorough cost justification review of Affiliate work plans and costs; and

NOW, THEREFORE, BE IT RESOLVED, the Board hereby adopts Recommendations for Affiliate Services; and

BE IT FURTHER RESOLVED, that the Board hereby directs LIPA Staff, together with PSEG Long Island, to implement the Recommendations for Affiliate Services, including the creation of Implementation Plans in advance of the Board’s May 2021 meeting.

Dated: March 29, 2021