Reforming Long Island's Electric Service

January 27, 2021

Long Island Power Authority

LIPA REFORM ACT OF 2013: GOAL WAS EXCELLENCE

LIPA has made great progress since 2013:

- Procured **1,000 megawatts of clean energy**
- Secured a federal grant to **storm harden 1,000 miles** of the Long Island electric grid
- **Record investments in reliability and customer service** – 3x the investments under the prior National Grid management contract
- Secured **four credit rating upgrades** by charting a fiscally responsible course

The **LIPA Reform Act** aimed to deliver an **exceptional utility** for Long Island and the Rockaways

In addition to LIPA's accomplishments, LIPA pays PSEG Long Island a nearly **$80 million premium** for excellent management

FINDINGS FROM LIPA'S TROPICAL STORM ISAIAS INVESTIGATION

645K customers lost power

Critical IT and phone **systems failed**

1M+ calls received busy signals

300K+ text messages bounced back

Website, mobile app, gov't portal **failed**

Additional Findings:

- Failed IT and communication systems caused a **"fog of war"** affecting restoration efforts
- PSEG Long Island DID NOT know how many customers were out of power during event
- Some customers received a **dozen or more inaccurate restoration times**; restoration estimates were **extended by as many as 7 days** denying customers the ability to plan
- Customers were unable to contact PSEG Long Island with **emergency situations**
- Meanwhile, PSEG Long Island line workers and employees were left to perform heroic efforts to cope with failing processes and systems

PSEG LONG ISLAND MANAGEMENT FAILED

Why did this happen?

- PSEG Long Island management knew it was unprepared for the storm before it landed and failed to act

Could this have been prevented?

- LIPA found that all the issues could have been prevented by management

PSEG Long Island management failed to:

- **Act with urgency** to correct a failing outage management system before the storm
- **Put in place manual workarounds before the storm** despite knowing the IT systems were failing
- **Maintain or test the telephone systems per industry practices**
- **Tell LIPA before, during, or after the storm**

> …[The outage management system] is **"NOT even managing on a day-by-day basis and [we] are definitely NOT prepared for [a] weather event.**

Direct quote from a July 16, 2020 email from a PSEG Long Island supervisor to senior management
(three weeks before Isaias)

IS TROPICAL STORM ISAIAS THE ONLY PROBLEM?

Is Tropical Storm Isaias the only problem?

No, simply the most visible and urgent area. Similar management issues can be found in:

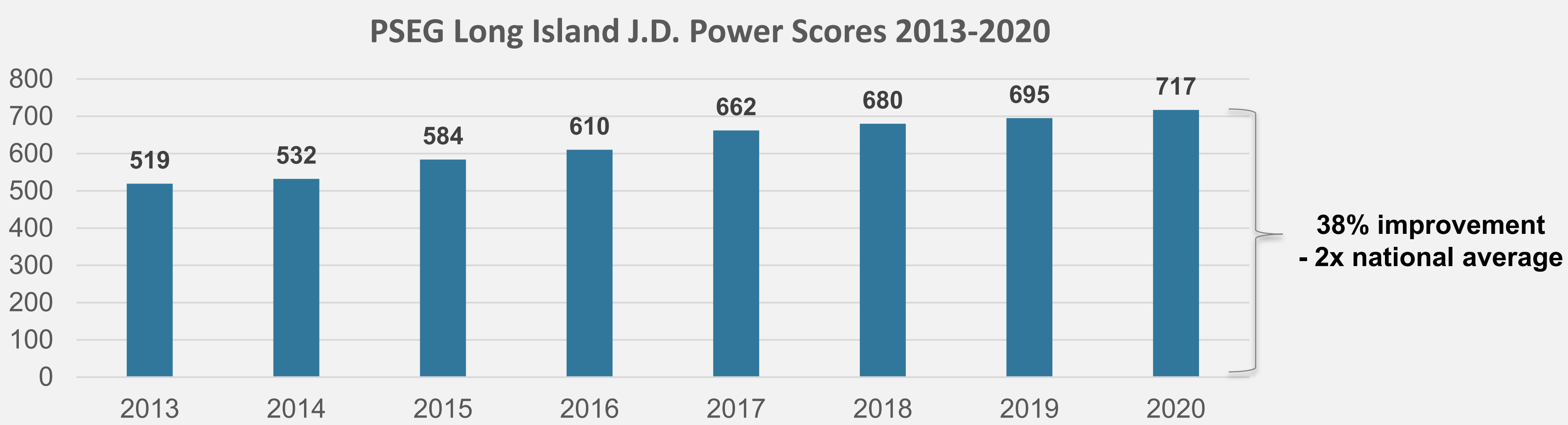
- strategic planning
- enterprise risk management
- asset management
- real estate
- budgets
- information technology systems, among other areas

LIPA's investigation of Tropical Storm Isaias also uncovered a **troubling lack of transparency** about operational issues that likely goes beyond the systems that failed during the storm

CUSTOMER SATISFACTION HAS IMPROVED, BUT STILL LAGS

2013 GOAL: Top 25% utility for customer satisfaction by 2018

	2013		2020
U.S. Rank	#126 of 126	U.S. Rank	#124 of 143
East Large	#17 of 17	East Large	#13 of 17



WHAT CAUSES MANAGEMENT PROBLEMS AT PSEG LONG ISLAND?

LIPA's contract was well intentioned, but experience has shown that **PSEG Long Island is simply not organized or incentivized to put customers first.** There is limited accountability or transparency to the LIPA Board of Trustees, LIPA staff, or DPS

4%

LIPA's contract as a share of PSEG Enterprise earnings. New Jersey management is focused on the other 96%

53

The number of PSEG Long Island managers that report to someone in New Jersey – including the IT that failed during Isaias. Long Island needs management focused on local operations

99.8%

PSEG Long Island has earned $456 million in management fees or 99.8% of possible awards since 2014. The incentive metrics were negotiated in 2011 and require mutual consent to update. They are too easy

WHAT IS LIPA DOING ABOUT ITS INVESTIGATIVE FINDINGS?

- Ordered PSEG Long Island to **implement nearly 100 reforms from LIPA's 30-Day and 90-Day Isaias Reports** to improve **management, emergency management, and information technology**
- Filed a claim for **$70 million in damages** caused by PSEG Long Island's mismanagement
- LIPA Board has ordered staff to simultaneously advance **terminating and renegotiating the PSEG Long Island contract** to provide better accountability to LIPA's customers

WHAT DID THE DPS INVESTIGATION FIND?

- The Department of Public Service, assisted by the Department of Financial Services, separately investigated PSEG Long Island’s storm response and made independent recommendations to the LIPA Board
- The DPS found:
  - **70 possible violations** of PSEG Long Island’s Emergency Restoration Plan
  - The DPS recommended the LIPA Board, among other things, seek to **either terminate or renegotiate LIPA’s contract with PSEG Long Island**

OPTION 1: REFORM PSEG LONG ISLAND'S CONTRACT

PSEG Long Island continues to file implementation plans for the nearly 100 recommendations

PSEG Long Island Status of Recommendations	
Completed and Pending Review	15
Project Plans Accepted and In Progress	18
Project Plans Rejected 1x	5
Project Plans Rejected 3x	15
Project Plans due in February	28

38% of plans rejected for non-responsiveness

LIPA has crafted and presented a term sheet to PSEG Long Island detailing **contract reforms to improve alignment and accountability**

INTEGRITY & TRANSPARENCY REFORMS

Problem	Solution
PSEG Long Island management is not candid with LIPA or DPS about problems. For example, PSEG Long Island management actively hid the failure of the outage management system that was evident and unresolved for weeks before Tropical Storm Isaias	• PSEG Long Island would have an explicit duty of candor to act in LIPA's interest and be honest and forthright in disclosing information to LIPA • LIPA would have the right to independently verify and validate the design and testing of all critical information technology systems
PSEG Long Island is slow to provide information or data to LIPA for independent oversight	• PSEG Long Island would be required to use IT systems that are separate from its New Jersey parent and to provide LIPA with real time access and dashboards to facilitate oversight • LIPA's direct access to information systems and records would allow Authority staff to "trust but verify"

MANAGEMENT STRUCTURE REFORMS

Problem	Solution
PSEG Long Island's Chief Operating Officer (COO) has limited discretion and authority to make decisions. 53 Long Island managers report to superiors in Newark, NJ, who are distant and unaccountable to Long Island operations or LIPA	• All PSEG Long Island management would be based on Long Island and reports directly or in a direct line to PSEG Long Island's COO • PSEG Long Island management's compensation would be transparent and tied to Long Island operations • PSEG Long Island management could be removed for inadequate or unresponsive performance
PSEG Long Island management is not dedicated full time to LIPA operations	• All PSEG Long Island management would be dedicated to LIPA operations, without responsibilities to other PSEG affiliates

ACCOUNTABILITY & INCENTIVE REFORMS

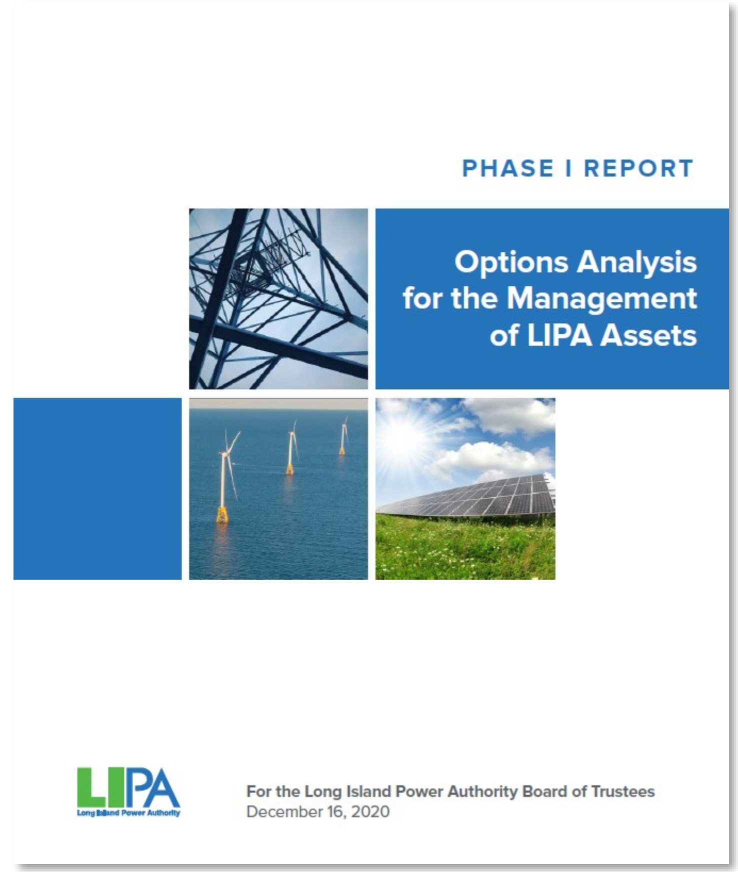
Problem	Solution
PSEG Long Island does not act in accordance with LIPA or DPS recommendations. PSEG Long Island takes risks as a contractor that LIPA would not take as the asset owner	• PSEG Long Island would be obligated to implement the policies and recommendations adopted by the LIPA Board, who serve as the trustees of the assets
Balanced Scorecard (incentive) metrics are too limited to represent the quality of services	• Contract would include service level agreements with industry-standard metrics and qualitative measures for each major scope of service
Balanced Scorecard metrics can only be amended by mutual consent by LIPA and PSEG Long Island	• LIPA may specify revised metrics that are relevant to today's operating environment provided they are reasonably attainable
More than 80 percent of PSEG Long Island's compensation is fixed. Less than 0.4 percent of total compensation has been at risk	• Fixed management fee would cover the costs of providing management services while most compensation would be "pay for performance"
PSEG Long Island faces limited financial consequences even when it obviously violates contract standards. LIPA has to sue PSEG Long Island for damages	• Contract prescribes reductions in compensation for failure to meet minimum standards • PSEG Long Island retains greater responsibility for damages caused by its own actions

QUALITY & COST OF SERVICES REFORMS

Problem	Solution
PSEG Long Island has been hired by LIPA to perform dozens of services. In some areas, PSEG Long Island provides substandard services (e.g., IT). LIPA must hire or fire the whole company as a package	• LIPA can require PSEG Long Island to sub-contract services to another qualified provider, while transitioning existing employees to the subcontractor's management
PSEG Long Island may hire affiliates to provide services to LIPA (currently approx. $20 million per year). These services are priced at "average cost" rather than "marginal cost." Better quality services may be available at lower cost from other providers	• PSEG Long Island must pre-submit business justification to LIPA for hiring an affiliate rather than Long Island staff or another provider
PSEG Long Island lacks long term planning to improve customer satisfaction or meet other customer goals	• PSEG Long Island would submit long-range plans to LIPA tied to annual work plans and budgets
PSEG Long Island passes through all costs to LIPA and has limited incentive to operate efficiently	• PSEG Long Island must file budgets tied to historic costs and annual work plans. Significant reallocations must be pre-reviewed by LIPA

OPTION 2: REPLACE PSEG LONG ISLAND MANAGEMENT

- The LIPA Board has asked staff to present the **best reformed contract terms** offered by PSEG Long Island alongside the **best alternative plan** no later than **March 31, 2021**
- **LIPA owns all the electric grid assets** and has the right to transition the 2,500 PSEG Long Island employees to **another management company** or to LIPA subsidiary under **LIPA management**



Click here to view the report

OPTION 2: REPLACE PSEG LONG ISLAND MANAGEMENT

LIPA management option:

- Hire approximately **12 managers** to supplement existing LIPA team
- Transition **2,500 ServCo employees** to **LIPA subsidiary in 2022**
- Estimated **$85 to $105 million** of one-time transition costs
- Annual savings of **$65 to $75 million per year** (**up to $815 million through 2032**), which could be used to reduce customer bills or reinvested in customer satisfaction, reliability and clean energy

Hire another management company:

- Cost and terms would not be known until after bid process is complete

TRANSITION PLANNING: DUE DILIGENCE

LIPA has formed **due diligence teams to review 18 functional areas** and report back to the Board on findings no later than **March 31, 2021**

Due Diligence Teams		
Executive	Business Services	Legal
Transmission & Distribution	Support Services	Procurement
Projects & Construction	Corporate Comm. & Public Affairs	Facilities
T&D Operations	Finance	Records Management
T&D Emergency Planning	Human Resources	Security
Customer Service	Information Technology	Materials Management

TIMELINE

Due Diligence

PSEG OSA Renegotiation

January · February · March · Board Decision · April · 2022

Execute Transition

Handoff to New Management

Implement nearly 100 PSEG Long Island reforms. PSEG Long Island management operates under new contract with greater accountability and transparency

WHAT COULD LIPA HAVE DONE TO PREVENT THIS?

LIPA missed PSEG Long Island's inadequate design and testing of the information technology and communication systems that failed during Isaias

- **LIPA relied too much on PSEG Long Island's representations.** For example, PSEG Long Island told LIPA that the outage management system was stress-tested to perform in Superstorm Sandy-like conditions. LIPA did not independently validate the testing
- **PSEG Long Island actively hid problems from LIPA.** For example, PSEG Long Island never told LIPA about the significant performance issues experienced with the outage management system in June and July before Isaias. LIPA only learned of these pre-storm problems as a result of its investigation
- **LIPA missed what in hindsight were warning signs about the declining quality of services PSEG Long Island was providing to LIPA operations.** Things like high turnover, frequently changing priorities, and delayed projects. We now understand the degree to which these were caused by mismanagement rather than normal business shifts

LIPA is reviewing its oversight practices to ensure PSEG Long Island is meeting its contractual obligations. But we also need contractual changes. Oversight is not a substitute for engaged and accountable management

PSEG LONG ISLAND WORK FORCE

What does this mean for the 2,500 PSEG Long Island ServCo employees?

No change to jobs, salaries, or benefits. LIPA made, and kept, the same promise when it transitioned from National Grid to PSEG Long Island management in 2014. The dedicated workforce is integral to LIPA's success under any management structure

CONCLUSION

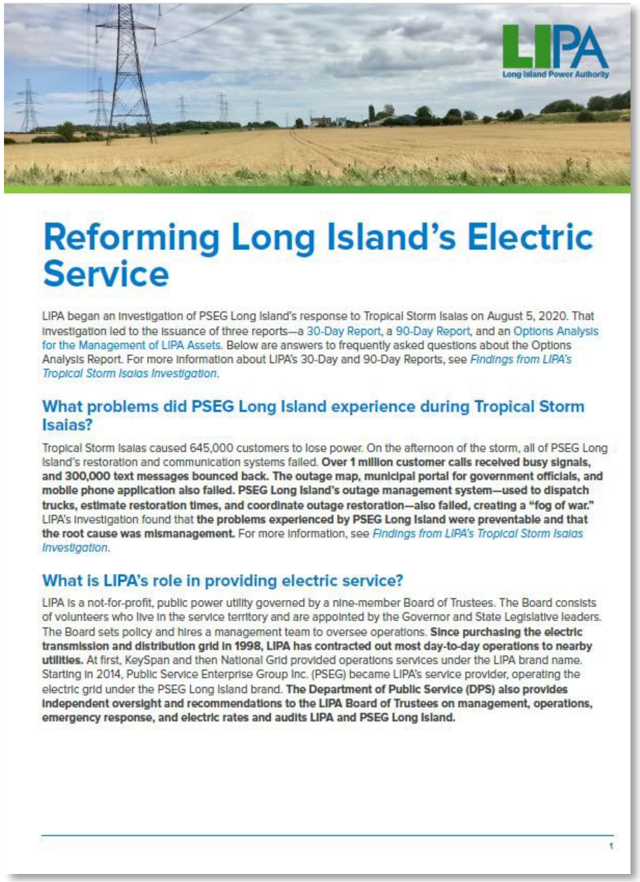
Why does LIPA find itself here? A PSEG Long Island management failure that is simply too big to ignore. PSEG Long Island management knew it was unprepared for Tropical Storm Isaias and failed to act. PSEG Long Island management actively hid information from LIPA for a period of months – before, during, and after the storm

The next challenge won't be the same as the last one. Oversight is not a substitute for engaged and accountable management

The contract with PSEG Long Island was well intentioned. But it hasn't worked as planned. And PSEG Long Island has not achieved what they were hired to do – to provide a leading utility for Long Island

It's time for a course correction

FOR MORE INFORMATION



Reforming Long Island's Electric Service

LIPA began an investigation of PSEG Long Island's response to Tropical Storm Isaias on August 5, 2020. That investigation led to the issuance of three reports—a 30-Day Report, a 90-Day Report, and an Options Analysis for the Management of LIPA Assets. Below are answers to frequently asked questions about the Options Analysis Report. For more information about LIPA's 30-Day and 90-Day Reports, see *Findings from LIPA's Tropical Storm Isaias Investigation*.

What problems did PSEG Long Island experience during Tropical Storm Isaias?

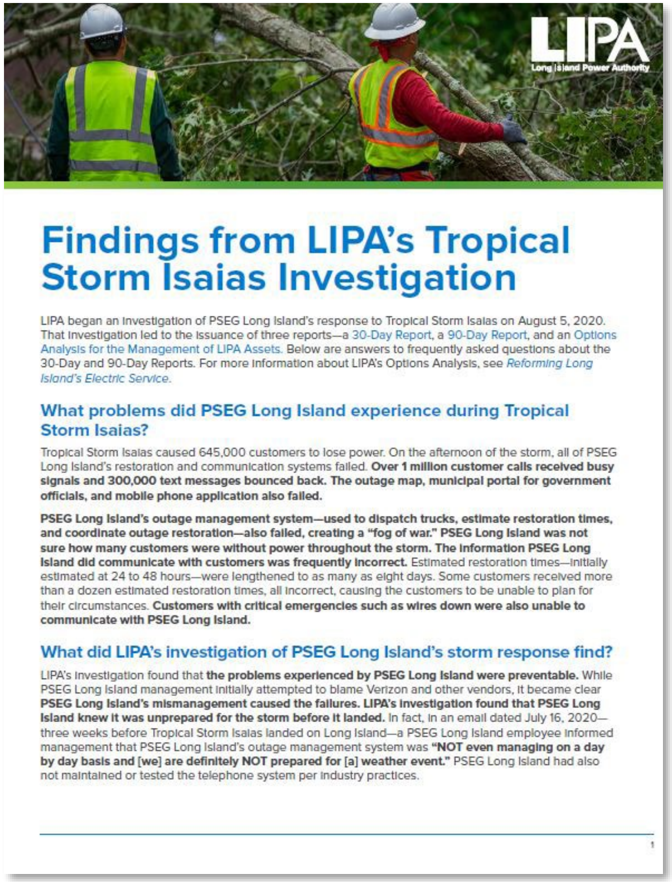
Tropical Storm Isaias caused 645,000 customers to lose power. On the afternoon of the storm, all of PSEG Long Island's restoration and communication systems failed. **Over 1 million customer calls received busy signals, and 300,000 text messages bounced back. The outage map, municipal portal for government officials, and mobile phone application also failed. PSEG Long Island's outage management system—used to dispatch trucks, estimate restoration times, and coordinate outage restoration—also failed, creating a "fog of war."** LIPA's investigation found that **the problems experienced by PSEG Long Island were preventable and that the root cause was mismanagement.** For more information, see *Findings from LIPA's Tropical Storm Isaias Investigation*.

What is LIPA's role in providing electric service?

LIPA is a not-for-profit, public power utility governed by a nine-member Board of Trustees. The Board consists of volunteers who live in the service territory and are appointed by the Governor and State Legislative leaders. The Board sets policy and hires a management team to oversee operations. **Since purchasing the electric transmission and distribution grid in 1998, LIPA has contracted out most day-to-day operations to nearby utilities.** At first, KeySpan and then National Grid provided operations services under the LIPA brand name. Starting in 2014, Public Service Enterprise Group Inc. (PSEG) became LIPA's service provider, operating the electric grid under the PSEG Long Island brand. **The Department of Public Service (DPS) also provides independent oversight and recommendations to the LIPA Board of Trustees on management, operations, emergency response, and electric rates and audits LIPA and PSEG Long Island.**

1

Click here to view the fact sheet



Findings from LIPA's Tropical Storm Isaias Investigation

LIPA began an investigation of PSEG Long Island's response to Tropical Storm Isaias on August 5, 2020. That investigation led to the issuance of three reports—a 30-Day Report, a 90-Day Report, and an Options Analysis for the Management of LIPA Assets. Below are answers to frequently asked questions about the 30-Day and 90-Day Reports. For more information about LIPA's Options Analysis, see *Reforming Long Island's Electric Service*.

What problems did PSEG Long Island experience during Tropical Storm Isaias?

Tropical Storm Isaias caused 645,000 customers to lose power. On the afternoon of the storm, all of PSEG Long Island's restoration and communication systems failed. **Over 1 million customer calls received busy signals and 300,000 text messages bounced back. The outage map, municipal portal for government officials, and mobile phone application also failed.**

PSEG Long Island's outage management system—used to dispatch trucks, estimate restoration times, and coordinate outage restoration—also failed, creating a "fog of war." PSEG Long Island was not sure how many customers were without power throughout the storm. The information PSEG Long Island did communicate with customers was frequently incorrect. Estimated restoration times—initially estimated at 24 to 48 hours—were lengthened to as many as eight days. Some customers received more than a dozen estimated restoration times, all incorrect, causing the customers to be unable to plan for their circumstances. **Customers with critical emergencies such as wires down were also unable to communicate with PSEG Long Island.**

What did LIPA's investigation of PSEG Long Island's storm response find?

LIPA's investigation found that **the problems experienced by PSEG Long Island were preventable.** While PSEG Long Island management initially attempted to blame Verizon and other vendors, it became clear **PSEG Long Island's mismanagement caused the failures. LIPA's investigation found that PSEG Long Island knew it was unprepared for the storm before it landed.** In fact, in an email dated July 16, 2020—three weeks before Tropical Storm Isaias landed on Long Island—a PSEG Long Island employee informed management that PSEG Long Island's outage management system was **"NOT even managing on a day by day basis and [we] are definitely NOT prepared for [a] weather event."** PSEG Long Island had also not maintained or tested the telephone system per industry practices.

1

Click here to view the fact sheet