



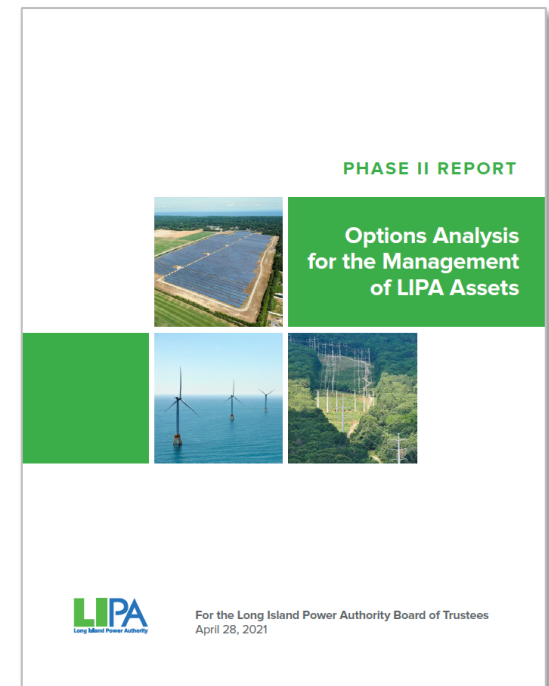
# **PHASE II REPORT: OPTIONS ANALYSIS FOR THE MANAGEMENT OF LIPA ASSETS**

*April 28, 2021*

# OVERVIEW

**This report is the second phase of an effort to present the Board and our stakeholders with an evaluation of the options to improve the future management of LIPA's assets**

- In November 2020, the Board and the Department of Public Service (DPS) asked LIPA staff to evaluate either (i) terminating LIPA's contract with PSEG Long Island; or (ii) renegotiating that contract to alter PSEG Long Island's management structure and incentives to improve operational performance
- In December 2020, LIPA staff issued an initial framing and analysis of the range of possible restructuring options to the Board and public in a Phase I report
- This Phase II report is a further refinement of the alternatives
- There is no perfect option, and there is no option without risk. For each option, the pros and cons have been carefully detailed to provide the Board of Trustees, elected officials, and stakeholders the facts to make an informed decision



# PSEG LONG ISLAND'S RESPONSE TO TROPICAL REVEALED SERIOUS MANAGEMENT DEFICIENCIES

## Fundamental Causes

- PSEG Long Island is not organized or incentivized to put Long Island customers first. LIPA contract represents only 4% of PSEG Enterprise profits
- Limited accountability and transparency to the LIPA Board of Trustees, LIPA staff, and DPS

## Proximate Causes

### PSEG Long Island management failed to:

- Maintain and stress test the telephone and outage systems per industry practices
- 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
- Tell LIPA before, during, or after the storm about the failing IT systems until a LIPA Task Force investigation uncovered the facts

## Visible problems during Tropical Storm Isaias



**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**

## Remedies

← **Contract reforms to  
improve  
management and  
oversight**

← **140 Board  
recommendations**

← **Improved LIPA and  
DPS oversight rights**

# CURRENT MANAGEMENT MODEL DOES NOT MEET CUSTOMER NEEDS

## PSEG's Promise: Top 25% Utility for Customer Satisfaction by 2018

2013

U.S. Rank #126 of 126

East Large #17 of 17

2020

U.S. Rank #124 of 143

East Large #13 of 17

2021  
YTD

U.S. Rank #143 of 144

East Large #17 of 17

**PSEG Long Island was provided with significant new resources to achieve improvements in customer service and reliability (\$4.2+ billion)**

PSEG does not provide the same level of management attention to Long Island operations as their New Jersey utility. Management issues can be found in, among other areas:

- Long-Term Planning
- Risk Management
- Asset Management
- Real Estate
- Budgets
- Information Technology
- Collections
- Inventory Management
- Workforce Management

# OVERVIEW OF FOUR OPTIONS

Ownership  
Model:

## Private Ownership

### Option 1 Sell LIPA's Assets to Private Investors

- Higher financing costs, greater tax burden
- Ineligibility for federal disaster relief under private ownership
- Requires an unrealistic \$450 to \$600 million of offsetting savings from operations to avoid higher costs to customers or cutting service

## Public-Private Arrangement

### Option 2 Reset the PSEG Long Island Relationship and Reform the Contract

- Strengthen PSEG Long Island management incentives and accountability to improve operations
- Strengthen LIPA oversight rights and ability to intervene to make course corrections – “trust but verify” the efforts of PSEG Long Island management

### Option 3 Seek a New Service Provider to Improve Operations

- Restart the relationship with a different partner that is better equipped to deliver
- Integrate lessons learned from the PSEG Long Island experience into new contractual framework

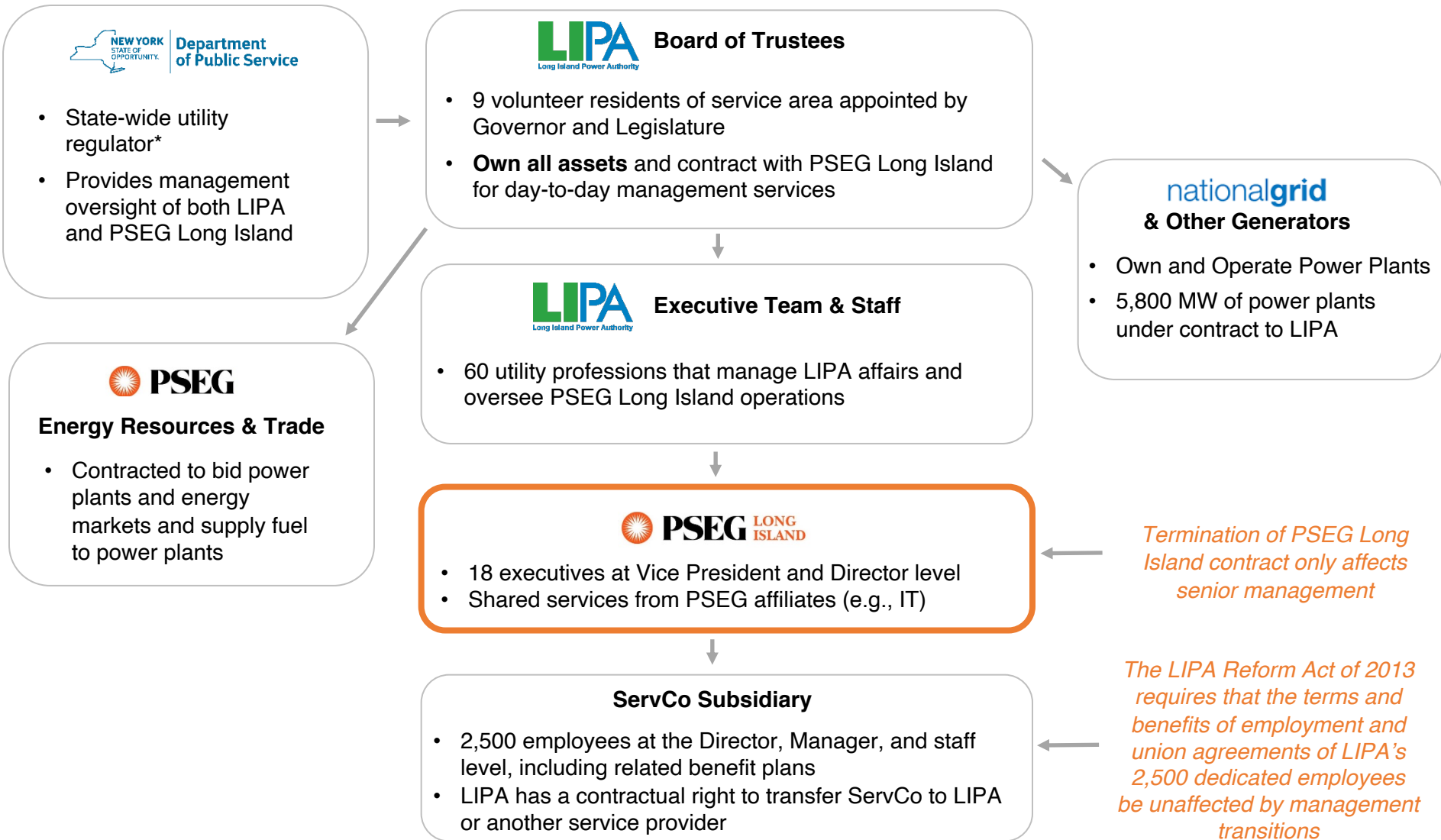
## LIPA Management

### Option 4 Bring Utility Operations Under LIPA Management

- LIPA is responsible for service delivery and directly accountable to the Long Island community
- ServCo subsidiary that employs the 2,500 customer-facing Long Island operations employees becomes a direct subsidiary of LIPA

Structural  
Options:

# UTILITY STRUCTURE



# OPTION 1: PRIVATIZATION COSTS TOO MUCH

**Privatization would significantly raise customer costs by an estimated \$32 per month for a typical residential customer**

- **Public ownership saves customers roughly \$447 million per year in financing costs**
  - LIPA's cost of capital is less than half that of comparable private utilities
  - Lack of dividend payments and corporate taxes is a significant cost savings
- **Federal disaster recovery and storm hardening grants are not available to privately owned utilities**
  - LIPA's FEMA grants have averaged \$160 million per year over the last decade
- **Privatization comes with significant transaction costs**
  - Estimated \$1.45 billion premium to early retire tax-exempt bonds and additional costs to issue equity
  - Inability to issue new tax-exempt bonds or refinance while privatization is being considered
- **Private sector synergies are insufficient to offset higher costs**
  - A private utility would need to generate \$450 to \$600 million of savings from an available expense pool of only \$641 million
  - Public utilities can access the scale and efficiency benefits of the private sector without a change in ownership structure

# OPTION 2: RESET PSEG LONG ISLAND RELATIONSHIP AND REFORM THE MANAGEMENT CONTRACT

**A reformed contract with PSEG Long Island needs to better align management incentives and accountability and strengthen transparency and oversight to improve operations**

## Strengthen Incentives and Accountability Mechanisms

1

Greater share of management compensation at risk based on performance

2

Expanded performance metrics with greater rigor covering all categories of service

3

Use of gating and default metrics to discourage singularly poor performance

4

Strengthen Long Island based management and accountability for Long Island operations

5

Require candor from service provider

+

## Strengthen Oversight

6

Require compliance with Board recommendations to address known deficiencies

7

Strengthen oversight in long-term planning, project prioritization, and budget development

8

Partition Long Island IT systems and facilitate independent verification and validation

## OPTION 2: THE CORE CONTRACT REFORMS

**The reform proposals are not “pendulum shifts” or overcorrections.** Rather, they are the minimum necessary conditions to address the management failures documented in the Isaias Task Force reports and the separate DPS investigation

- A high-trust agreement may have worked with the right partner. PSEG Long Island's actions and performance have jeopardized that trust

**The proposed reforms are a mutually reinforcing package,** much more effective collectively than individually

- As noted in the 2013 DPS Management and Operations Audit: *“Contractor control and performance cannot be fully relegated to metrics, premiums or penalties. It requires continuous guidance, diligent oversight, and meaningful intervention to ensure that things are done “right” and customer expectations are met.”*
- Similarly, strengthened LIPA and DPS **oversight is essential**, but is **not a substitute for contractual terms that incentivize empowered, engaged, accountable, local management**

## OPTION 2: CURRENT STATUS OF PSEG LONG ISLAND CONTRACT NEGOTIATIONS

### LIPA and PSEG Long Island have been unable to achieve the Board's objectives in negotiations

- PSEG Long Island's latest April 13 offer is modestly better than the current contract in some areas. However, it is worse in other areas. Overall, **the offer does not fundamentally address the weaknesses of the current contract**
- **LIPA remains open to offers that address the Board's concerns**
- Staff will keep the Board and public apprised if a proposal warranting consideration becomes available

## OPTION 3: REPLACE PSEG LONG ISLAND WITH A NEW SERVICE PROVIDER TO IMPROVE OPERATIONS

**Reset the expectations of our vendors to match the Board's vision for customers, while implementing the necessary cultural and contractual changes**

- **Identify through a rigorous and competitive bidding process a partner that more strongly aligns with the management orientation, capabilities, and partner mentality that LIPA seeks**
- **There is a market of potential vendors that can manage T&D operations, customer service, IT, and other functions**
  - Recent procurements from comparable utilities have seen substantial interest and qualified bids
- **LIPA need not partner with a single provider**
  - Unbundle services and award contracts to the most qualified individual providers
  - Gives flexibility to retain well-performing partners while replacing those that do not meet expectations
- **It could take up to two years to have new provider(s) in place**
  - 9 - 12 months bidding process plus 6 - 12 months transition period
- **The long-term benefits of a stronger management framework likely outweigh the short-term costs and risks**

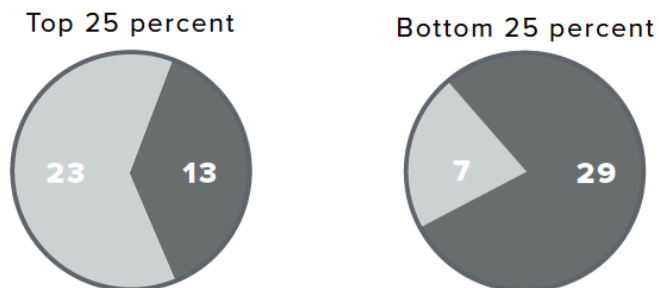
# OPTION 4: BRING OPERATIONS UNDER LIPA MANAGEMENT

## LIPA management offers several potential benefits:

- **Purity of mission** – Everyone from the Board of Trustees to the CEO, down to the line workers and customer-facing employees is accountable to customers and the community
- **Adaptability and responsiveness** – An independent service provider serves as a layer of separation between the Board's strategic vision and execution. A local utility would not have to maneuver around a third-party contract, providing greater flexibility
- **Transparency** – LIPA performance and contracts would be more transparent to customers and stakeholders than if key operations remain contracted out to a single entity that in turn subcontracts out large chunks of work
- **Resource efficiency** – A locally rooted utility management could be a strong steward of customer resources
- **Local governance and accountability** – The Board of Trustees – respected members of the Long Island community – would have the authority, information, and direct oversight necessary to hold management accountable

# OPTION 4: WHAT IS THE TRACK RECORD OF PUBLICLY-MANAGED UTILITIES?

## On Customer Satisfaction:



## On Reliability



Publicly Owned      Investor Owned

**Nationally, Public Utilities Perform Well on Measures of Customer Value Such as Customer Satisfaction and Reliability**

Sources:  
J.D. Power Electric Utility Residential Customer Satisfaction Survey, 2019

U.S. Department of Energy, Energy Information Administration

# OPTION 4: WHAT ARE THE FINANCIAL IMPLICATIONS OF LIPA MANAGEMENT?

	2022	2023	2024	2025	2022-2025 Total
<b>Estimated Change in Annual Revenue Requirements (\$M)</b>					
<b>Forego Management Fee and Hire New Management Team</b>					
Eliminate Management Fee (Operating Expense)	-\$24.2	-\$49.4	-\$50.4	-\$51.4	<b>-\$175.3</b>
Replace Management Positions	\$2.1	\$4.3	\$4.4	\$4.5	<b>\$15.3</b>
<b>Net Impact</b>	<b>-\$22.1</b>	<b>-\$45.0</b>	<b>-\$45.9</b>	<b>-\$46.9</b>	<b>-\$159.9</b>
<b>Forego Affiliate Charges and Replace Necessary Functions</b>					
Eliminate Affiliate Charges	-\$8.2	-\$16.8	-\$17.1	-\$17.5	<b>-\$59.7</b>
Replace Affiliate Functions	\$7.3	\$14.9	\$15.2	\$15.5	<b>\$52.8</b>
<b>Net Impact</b>	<b>-\$1.0</b>	<b>-\$1.9</b>	<b>-\$2.0</b>	<b>-\$2.0</b>	<b>-\$6.9</b>
Eliminate Carrying Costs on Capitalized Management Fee	-\$0.6	-\$1.2	-\$1.3	-\$1.3	<b>-\$4.4</b>
Contingent Cost Increases (e.g. Medical Benefits)	\$5.0	\$5.1	\$5.2	\$5.3	<b>\$20.6</b>
<b>Total Change in Annual Revenue Requirements</b>	<b>-\$18.6</b>	<b>-\$43.1</b>	<b>-\$44.0</b>	<b>-\$44.9</b>	<b>-\$150.7</b>
<b>Estimated Change in Annual Borrowing Requirements (\$M)</b>					
Eliminate Capitalized Management Fee	-\$15.8	-\$32.3	-\$32.9	-\$33.6	<b>-\$114.5</b>
<b>Total Estimated Savings</b>	<b>-\$34.5</b>	<b>-\$75.4</b>	<b>-\$76.9</b>	<b>-\$78.4</b>	<b>-\$265.2</b>
Estimated 2022-2025 Savings Net of Transition Costs					<b>-\$175.2</b>
Estimated 2022-2025 Savings Net of Transition Costs (excl. termination fee*)					<b>-\$236.2</b>

- Eliminating management fees and affiliate expenses saves approx. \$100 million annually, more than offsetting the \$25 million in new labor and sourcing costs estimated under LIPA management
- LIPA customers could save **\$175 to \$236 million, net of transition costs, through the 2025**. Total savings between **2022 and 2033 could be in the range of \$860 to \$920 million**
- The savings generated through public management could be used to reduce future rate adjustments or reinvested in new strategic initiatives driven by customer needs and priorities

\*The OSA specifies a contract termination fee of approximately \$61 million. The termination fee is not owed to PSEG Long Island if it breached material obligations in the OSA, as we believe they have, so we expect actual transition costs to be closer to \$30 million rather than \$90 million.

# OPTION 4: WHAT ARE THE KEY RISKS OF LIPA MANAGEMENT?

## Management Quality

- The management team must be up to the task. **The utility should be managed by seasoned professionals** whose own **careers and compensation are explicitly linked to their actual performance** – with verifiable and transparent metrics
- LIPA anticipates needing to add top talent in **12 new senior positions** to fill out the management structure. The ability to offer **competitive, market-based salaries** is a critical success factor
- It may be challenging to replicate a private entity's ability to incentivize efficient operation and service through compensation

## Customer and Stakeholder Support

- Between 1998 and 2013, utility service was provided using a public-private partnership structure under the LIPA brand. Customer dissatisfaction was the primary motivation for the LIPA Reform Act
- Customers may perceive a move to LIPA management as a return to a previously failed management model that they would not support
- The **change in business model** towards LIPA management would require the **full support of our state's elected officials, regulators, stakeholders, and most importantly customers**

## OPTION 4: WHAT ARE THE KEY RISKS OF LIPA MANAGEMENT?

### Board Governance and Management Accountability

- The Board must understand its role, with the assistance of DPS, in **holding management accountable** and ensuring that management creates a culture of continuous improvement that delivers on evolving industry standards and best practices

### Private Sector Role

- The public power utility will need to selectively and **flexibly assemble best-in-class expertise** from the private sector

### Transition Risks

- Shift to LIPA management introduces short-term **business continuity risks and costs** associated with hiring a new management team, shifting 2,500 employees to a new organization, and migrating certain IT systems that must be adequately managed
- LIPA management would need to put forth **a transition plan that adequately mitigates the risks**

# NEXT STEPS

## Options Analysis

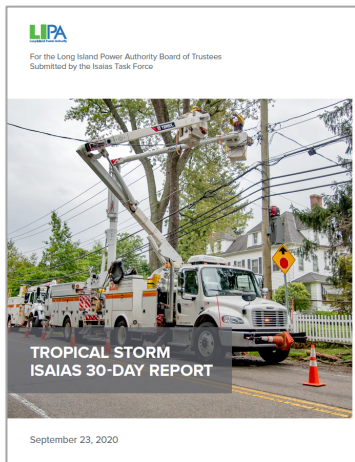
- **Option 2 (Reform PSEG Long Island Contract):** Continue to engage with PSEG Long Island management and remain open to offers that credibly address the Board's concerns
- **Option 3 (New Service Provider):** Issue a Request for Information accompanied by an aggressive outreach effort to new potential service providers
- **Option 4 (LIPA Management):** Continue our diligence efforts

## Public Comment

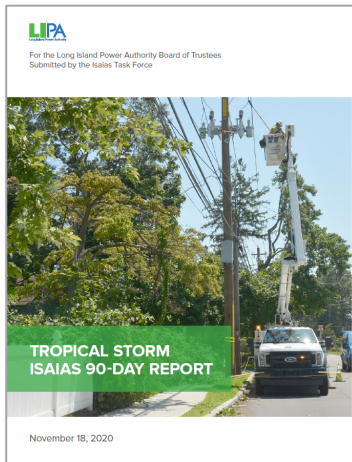
**The LIPA Board of Trustees welcomes hearing from our elected officials, stakeholders, and most importantly customers on the future management of LIPA's assets**

- LIPA Board of Trustees will accept public comments on the Options Analysis at 11 a.m. during its **Wednesday, May 19 Board meeting**
- Virtual public comment hearings starting at 6 p.m. on **Tuesday, May 25 and Thursday, May 27**. Sign up [here](#) to speak.
- Written comments may also be submitted **electronically** through the [LIPA website](#). All comments submitted will be available for public review.

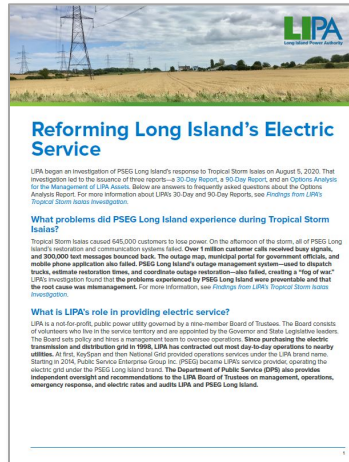
# FOR MORE INFORMATION



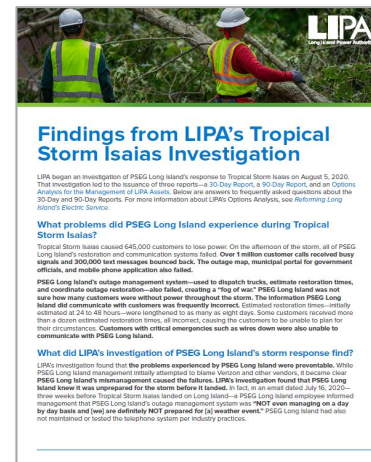
[30-Day Report](#)



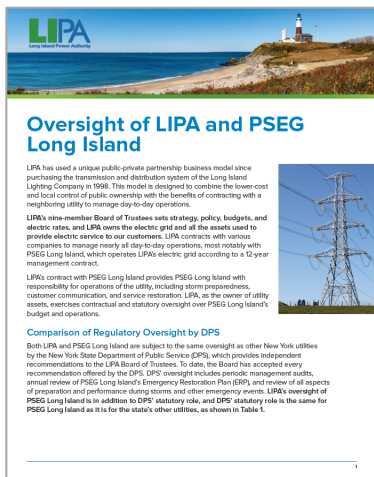
[90-Day Report](#)



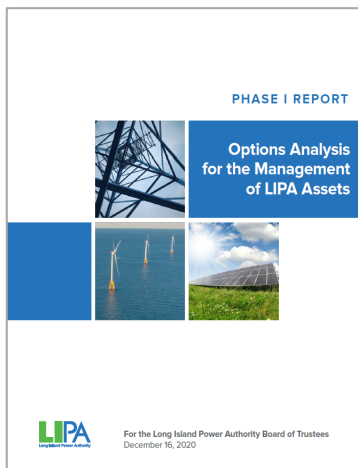
[Fact Sheet](#)



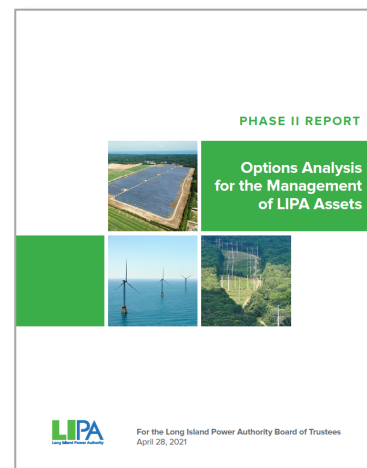
[Fact Sheet](#)



[Fact Sheet](#)



[Phase I Options Analysis](#)



[Phase II Options Analysis](#)

## Options Analysis – Phase II