



**Department of
Public Service**

Rory M. Christian
Chair and
Chief Executive Officer

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November 23, 2021

Via E-mail and U.S. Mail

Honorable Mark Fischl, Vice Chairman
Board of Trustees
Long Island Power Authority
333 Earle Ovington Blvd.
Uniondale, New York 11553
boardoftrustees@lipower.org

Re: Reformed Operation Services Agreement between the Long Island Power Authority and PSEG Long Island LLC

Dear Vice-Chairman Fischl:

I am pleased to provide the recommendation of the New York State Department of Public Service (DPS or the Department) regarding the Reformed Operation Services Agreement (Reformed OSA) between the Long Island Power Authority (LIPA) and PSEG Long Island LLC (PSEG LI). The Reformed OSA represents a quantum surge in oversight by the Department, enhances the terms and conditions of the current Amended and Restated Operations Service Agreement (A&R OSA) between LIPA and PSEG LI to the benefit of customers, and includes new or improved mechanisms to ensure accountability by PSEG LI. The Reformed OSA includes both the lessons learned and remedial actions from Tropical Storm Isaias (TS Isaias or the Storm), as well as lessons learned since 2014. The Reformed OSA ensures that PSEG Long Island customers receive the protections that they so strongly need and is a sound resolution to the enforcement actions recommended by the Department following our investigation into PSEG Long Island's response to Tropical Storm Isaias. PSEG Long Island will pay \$30 million for ratepayer benefits to offset the harm caused, and the new contract terms are transformative improvements that will significantly decrease the likelihood of these types of failures in the future. The Department will ensure PSEG LI meets all the new rigorous requirements, and we will diligently ensure PSEG Long Island is held accountable to meet this new regulatory standard. To that end, the Department recommends that the Reformed OSA be adopted by the LIPA Board of Trustees (LIPA Board).

As you well know, on August 4, 2020, TS Isaias made landfall on the east coast, where it made its way north and passed through eastern New York State. The storm caused severe and extensive damage throughout the Mid-Hudson, New York City, and

Long Island Regions. The LIPA Service territory, operated by PSEG LI, experienced the highest winds, which included recorded gusts between 70-78 mph. That same afternoon, all of PSEG Long Island's restoration and communications systems failed, leaving over 500,000 customers unable to communicate with their electric utility and hampering restoration efforts. Over 1 million customer calls received busy signals, 300,000 text messages bounced back, and web services and mobile phone applications failed. Customers were unable to report critical emergencies, and those that could get through received inaccurate restoration times. PSEG LI ultimately experienced peak outages of 380,000 with total customer impacts at approximately 645,000.

On August 5, 2020, Governor Cuomo directed the Department to investigate New York State's major electric utilities' (utilities) following the slow and inadequate response of certain electric utilities to Tropical Storm Isaias, including PSEG LI. On August 19, 2020 in the wake of TS Isaias the Department issued a Notice of Apparent Violations and Direction of Prompt Interim Remedial Action.¹

As stated in the NOAV, the Department's initial investigation further revealed that PSEG LI failed to follow its Department-recommended and LIPA-adopted Emergency Response Plan's (ERP) requirements relating to PSEG LI's: (1) damage assessment responsibilities; (2) responsibility to maintain a functional Outage Management System (OMS); (3) responsibility to publish accurate Estimated Time of Restoration (ETR) notices; and (4) responsibility for timely and effective communication and coordination with its customers, local municipal governments, and state agencies.

The NOAV also directed PSEG LI to take prompt remedial actions which included testing PSEG LI Outage Management System, developing plans to secure outside crewing resources beyond NAMAG and private contractor resources, testing the capabilities of all command and data centers, call centers, and back-up command centers, refining coordination plans with municipalities, and updating Life Support Equipment and Critical Infrastructure lists. In addition, the NOAV directed PSEG LI to establish a program to provide financial compensation to LIPA customers who lost refrigerated food and medicine and noted PSEG LI's public statements that it would waive any claim for its 2020 incentive compensation payments under the A&R OSA.

Between August and November 2020, DPS Staff identified evidence relating to more than 70 potential violations of PSEG LI's ERP.² As further discussed in the DPS Preliminary Storm Report, PSEG LI violated various aspects of its ERP. Staff's investigation included review of PSEG LI's Scorecard report filed on September 13, 2020 its Part 105 Report filed on October 15, 2020 and extensive document review, issuance of interrogatories, and interviews and depositions of PSEG LI and Public

¹ Matter 20-01633, Investigation into the Utilities' Preparation for and Response to August 2020 Tropical Storm Isaias and Resulting Electric Power Outages, Notice of Apparent Violations Related to Tropical Storm Isaias and Direction of Prompt Interim Remedial Action (issued August 19, 2020) (NOAV). See also, Matter 20-01764, DPS Investigation into PSEG Long Island's Preparation and Response to Tropical Storm Isaias.

² Matter 20-01764, supra, DPS Letter to LIPA (dated November 13, 2020) pp. 2-3. (November 13 Letter).

Service Enterprise Group (PSEG) personnel conducted by DPS and the Department of Financial Services.³ The investigations by both DPS and LIPA determined management was aware that critical information technology systems were not working before the storm, had inadequate business continuity plans, and had not maintained or rigorously stress tested systems, in addition to other technical violations which materially lengthened PSEG LI's emergency response.

In the November 13 Letter to the LIPA Board, DPS recommended multiple options be considered to address PSEG LI's failures. The Department recommended that the LIPA Board consider termination, litigation, renegotiation, declaration of a failure to meet storm performance metrics, declaration of no renewal of the A&R OSA beyond 2025, an audit of costs imprudently incurred by PSEG LI, and referral of the investigation findings to the New Jersey Board of Public Utilities. DPS recommendations made clear to PSEG LI that the company must do better, it must provide the level and quality of service expected, and that it faces serious consequences should it fail to meet these expectations and obligations and would compel PSEG LI to improve its performance for the remainder of its existing contract with LIPA or levy the appropriate consequences for the company's failures.

On December 16, 2020 in response to DPS' recommendations, LIPA issued its Options Analysis for the Management of LIPA Assets Phase 1 Report.⁴ The Phase 1 Report presented three options. Option 1 considered transferring LIPA's assets to a private utility; Option 2 considered reforming or resetting the single-partner municipal model (i.e., change the OSA with PSEG LI to deliver better results for LIPA's customers and greater assurance that PSEG LI is focused on Long Island or forge a new contract with a new service provider); and Option 3 considered transforming operations under a municipal management model.

In furtherance of Option 2, LIPA and PSEG LI began confidential settlement negotiations with the assistance of DPS to consider how the A&R OSA could be improved to the betterment of LIPA's customers. During this time LIPA also considered the other options identified in the Phase 1 Report, including pursuit of a civil litigation lawsuit against PSEG LI in Nassau County.⁵

After six months of meaningful negotiation, on June 28, 2021, LIPA announced it had reached an agreement with PSEG LI on a set of contract reforms that puts customers first and provides LIPA and the DPS greater oversight authority. On November 9, 2021, PSEG LI and LIPA, announced their agreement on the specific terms of the Reformed OSA which was issued for public review and comment.

The Reformed OSA puts a majority of PSEG Long Island compensation at risk. The Reformed OSA increases the amount of PSEG Long Island's annual compensation

³ Matter 20-01633, *supra*, Isaias Storm Report (issued November 19, 2020).

⁴ LIPA Phase 1 Options Analysis, <https://www.flipsnack.com/LIPower/lipa-phase-i-options-analysis/full-view.html> (accessed July 28, 2021). (Phase 1 Report)

⁵ Long Island Power Authority v. PSEG Long Island LLC, 614228/2020, Nassau Supreme Court.

at risk from \$10 million to \$40 million, including automatic reductions for failures to meet minimum emergency response, customer satisfaction, and reliability standards and a new DPS investigative process to reduce compensation for failures to provide safe, adequate, and reliable service to customers.

PSEG LI's annual compensation in the current A&R OSA and in the Reformed OSA is \$78 million, however, the Reformed OSA increases the variable components of PSEG LI's compensation to \$40 million, more than half of PSEG LI's total annual compensation. The \$40 million has two components. The first component is \$20 million variable compensation pool awarded based on PSEG LI's performance of annual incentive compensation metrics. The second component is \$20 million which is compensation subject to reduction because of DPS investigation. In addition to increasing the amount at risk to incent PSEG LI's performance, the number of metrics, process for selecting those metrics, and the criteria for establishing metrics has all been improved as part of the Reformed OSA which will be discussed below.

Yet, of critical importance is the new component which establishes a new DPS led process by which PSEG LI will be held accountable for potential failures. The \$20 million of compensation subject to reduction comes attached to its contractual obligations subjecting PSEG LI to investigation by the Department for failures to comply with its LIPA Board adopted Emergency Response Plan, and failures to provide safe, adequate, and reliable service to customers. These obligations include PSEG LI's participation in the same administrative and investigative processes applied to New York's other Investor Owned Utilities (IOUs). This includes an expansive discovery and hearing process, e.g., deposition of relevant personnel, and fully litigated evidentiary hearings. This new process will enable DPS and LIPA to reduce PSEG LI's compensation for its failures and acts as a strong safeguard against future harms, and a powerful tool to redress customer harms perpetrated by PSEG LI, consistent with the processes employed against IOUs under the Public Service Commission's jurisdiction.

As discussed above, the Reformed OSA amends the total amount of incentive compensation while also amending the number of metrics, process for selecting those metrics, and the criteria for establishing metrics. The Reformed OSA allows for the imposition of up to 110 metrics across 5 new scope areas with over 50 scope specific sub-functions. The substantial increase in metrics will ensure that the numerous aspects of PSEG LI's operations services are scrutinized and that performance in all scope areas is either improved or maintained appropriately. The Reformed OSA also includes new gating and default metrics, specifically Emergency Preparedness and Response, and Cybersecurity which automatically reduces PSEG LI's compensation for failure to achieve adequate performance. For 2022, the increase to 96 total incentive compensation metrics creates an extensive set of criteria to assess and incent PSEG LI's performance

Further, these rigorous annual performance goals will be set annually by the LIPA Board and DPS to ensure the company meets industry best practices across all the services provided to LIPA and its customers. The Reformed OSA dissolves the

process under the A&R OSA by which LIPA and PSEG LI determine the annual metrics. Under the Reformed OSA, LIPA will develop proposed metrics, upon which PSEG LI may review and provide comment. LIPA's proposal and PSEG LI's comments will then be subject to DPS review and recommendation. DPS' recommendations, which may include its own proposed metrics will then be submitted to the LIPA Board for their consideration and adoption. This new process appropriately situates LIPA and the LIPA Board as the entity which determines the overall trajectory of the organization through goal setting and policy-making, however, this process also strengthens DPS' role by providing for their direct involvement in reviewing and recommending the annual incentive compensation metrics. This process is replicated for other recommendations and proposal proffered by LIPA to ensure compliance by PSEG LI.

A key finding of DPS and LIPA's investigations was the lack of focus by PSEG LI's management team. The Reformed OSA provides enhanced contractual requirements which ensure that PSEG LI is fielding a truly Long Island-based management team. The Reformed OSA specifically provides that the President and Chief Operating Officer (COO) of PSEG LI will have full and final operational decision-making authority. This enhancement of PSEG LI's President and COO authority under the A&R OSA makes clear that their decisions put Long Island customers first and that the operations of PSEG LI are their preeminent focus. The Reformed OSA also restricts the President and COO from holding other positions or having professional responsibilities with PSEG LI affiliate PSEG in New Jersey to ensure the President and COO has no conflicting responsibilities or priorities.

In addition, the local senior management team will be strengthened with new executive positions for information technology, cybersecurity, emergency response, business services, and human resources. The Reformed OSA continues to implement the focus on Long Island operations and customers by requiring that all Long Island employees report to PSEG LI on Long Island, e.g., straight-line reporting. Additionally, the compensation for all PSEG LI management employees will be linked to the performance of Long Island operations.

Further, the Reformed OSA also includes new requirements for long-term planning, budget development, and cost management. These new standards require greater long-term planning, transparency, and accountability for delivering projects and services on time and within budget to meet the customer needs and deliver maximum value for customers. For instance, the Reformed OSA creates specific criteria to report budgetary transfers of Operation and Maintenance (O&M) funding which improves oversight of PSEG LI's spending. In addition, the Reformed OSA contains various reporting requirements for reporting on pass-through expenditures, financial and regulatory compliance, asset and fleet management, the compliment of personnel, and the status of various contracts and agreements PSEG LI enters on behalf of LIPA. These enhancements strengthen oversight by DPS and LIPA providing more timely and consistent reporting on PSEG LI's operations.

The Reformed OSA also creates new requirements to fix known operational issues in a timely manner. Another key finding of DPS and LIPA's investigations was PSEG LI's inability to address the known failures of its OMS. The Reformed OSA requires PSEG LI to disclose issues like the failure of the OMS and provide LIPA and DPS plans to redress these issues. This requirement expands to cybersecurity incidents as well. These requirements will ensure that when issues are discovered they are ameliorated timely and effectively to avoid customer harm.

In conjunction with the various requirements discussed above, the Reformed OSA requires timely and accurate disclosure of significant operational issues. The Reformed OSA requires timely, affirmative disclosure to LIPA and DPS of issues that significantly impair PSEG LI's ability to provide reliable service, emergency response, cybersecurity, financial impairment, noncompliance with laws, or circumstances that may endanger public health, safety, and welfare. PSEG LI must fully and accurately disclose to LIPA and DPS these issues. Disclosure, in advance of or as early as possible, will avoid or significantly mitigate the potential harm to customers. This new requirement not only redresses the failure of PSEG LI to disclose issues regarding its OMS in advance of TS Isaias but will also foster a more proactive and cooperative approach to leverage the expertise and support of LIPA and DPS in addressing the most serious impairments to PSEG LI's ability to serve customers.

The Reformed OSA also institutes a new process to provide for the periodic cost and quality review of PSEG LI's affiliate services. This requirement increases the transparency around PSEG LI's decisions to hire PSEG affiliates to provide particular services to LIPA. This periodic review process provides LIPA and DPS greater oversight to ensure PSEG LI and its affiliates perform services with better quality and at lower costs than competing vendors and will hold PSEG LI accountable for the operational efficiencies it claims to derive from retaining these affiliates.

The Reformed OSA also creates requirements for Independent Verification and Validation (IV&V) of information technology systems. The agreement provides new rights to LIPA, in consultation with DPS, to independently test and validate the performance of mission-critical information technology systems, such as those that failed during TS Isaias. This new process will allow LIPA and DPS to develop the appropriate criteria to test PSEG LI's systems. This process also reflects the inclusion of additional OMS stress testing requirements in PSEG LI's 2021 ERP, as recently recommended by DPS and adopted by the LIPA Board.⁶ The Reformed OSA also reflects the requirements of the ERP to provide Business Continuity Plans in the event of failure of critical information technology systems and the additional levels of practice/drilling for emergencies contained in the ERP.

Further, the Reformed OSA acknowledges the need to separate certain information technology systems from PSEG in New Jersey. The Reformed OSA provides for the development of an information technology separateness plan which will

⁶ Matter 20-02608, PSEG LI Emergency Response Plan (2021 Plan) Review, DPS Recommendations (issued August 3, 2021).

assess the process and cost of implementing separate information technology platforms from New Jersey-based systems to ensure better accountability and oversight. The plan will be provided to the DPS for its review and recommendation. DPS will review the plan to ensure it is appropriate and to protect customers from unjust or unreasonable costs. DPS' recommendations will be provided to the LIPA Board for its consideration.

In addition to the various new mechanisms and process enhancements, the Reformed OSA eliminates automatic renewal of the contract, allowing the parties to mutually agree to an extension. As discussed above, DPS recommended in its November 13 Letter that LIPA affirmatively declare it would not renew the A&R OSA for the period after 2025. While LIPA did not elect to do so, the Reformed OSA reflects that an automatic renewal of the contract may not be in the best interest of customers. To that end, the Reformed OSA allows LIPA and PSEG LI to consider renewal, as their relationship may persist under the terms of the Reformed OSA until 2025.

The Reformed OSA also restricts the criteria and fee for which PSEG LI may terminate the Reformed OSA, at its option, for Changes in Regulatory Law. This amendment to the contract reduces the impact to LIPA and its customers should PSEG LI argue that legislative changes negatively impact PSEG LI's economic position, exposure, or revenues. This amendment mitigates potential impacts to customers.

Finally, PSEG LI has agreed to forfeit \$30 Million for its failures during TS Isaias. PSEG LI's forfeiture is comprised of \$6.6 million to reimburse customers without power for more than 72 hours for food and medicine spoilage; \$19.5 million in payments and credits to LIPA towards the cost of upgrading the information technology and communication systems that failed during the storm, and \$3.9 million in contributions to Long Island-based charities. The \$30 million forfeiture and settlement via adoption of the Reformed OSA will resolve the pending litigation related to PSEG LI's failures to meet contract standards during TS Isaias. PSEG LI's forfeiture represents a significant portion of its annual compensation and will provide direct benefits to LIPA's customers. Moreover, the amount is consistent with penalties levied against New York's other IOUs equivalent with those penalties on an operating revenue basis.⁷

In addition, in the November 13 Letter to the LIPA Board, DPS identified numerous potential violations and stated the Department's investigation was continuing, however, as recommended in the same November 13 Letter, LIPA has pursued renegotiation of the A&R OSA.⁸ The Reformed OSA delivers on stricter controls, metrics, reporting, and dynamic compensation mechanisms to compel improved performance and to protect ratepayers. The Reformed OSA is a sound resolution to the enforcement actions recommended by the Department following our investigation into PSEG Long Island's response to Tropical Storm Isaias and the Department anticipates

⁷ See Cases 20-E-0586, *et al.*, *Tropical Storm Isaias Investigation*, Order Granting Motion and Adopting Joint Outage and regulatory Settlement Agreement (issued July 15, 2021).

⁸ November 13 Letter, p. 5.

the formal conclusion of its investigation commensurate with the effective date of the Reformed OSA.

The Reformed OSA greatly enhances the requirements which dictate the level and quality of service, and it is undeniable that the consequences PSEG LI faces should it fail are also greatly increased. The Department of Public Service will ensure PSEG Long Island meets all of the new rigorous requirements, and we will diligently ensure PSEG Long Island is held accountable to meet this new regulatory standard.

As such, I strongly recommend that the LIPA Board adopt the Reformed OSA.

Respectfully submitted,



Rory M. Christian
Chief Executive Officer

CC: Thomas Falcone, LIPA Chief Executive Officer
Anna Chacko, LIPA General Counsel
Bobbi O'Connor, LIPA Secretary to the Board of Trustees
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