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PRIVILEGED AND CONFIDENTIAL

P3 Responses to PSEG Clarification Questions re: T&D O&M Agreement

#	Title	PSEG Question	P3 Response
1.	**Funding**	Our primary concern which we have clearly stated throughout this entire process is ensuring that we have sufficient funding to properly operate the system and bring it to industry standards from its present position. **a. FEMA** - A CP for commencement of operations services that a specified and substantial amount of FEMA funding (obligation) has been removed in the most recent draft. Our meeting with FEMA, while positive, is no substitute for contractual protection. We require a CP (and ongoing level) of sufficient Federal funding. **b. Initial Budgets** –In your latest draft it appears that mutual agreement by the parties as to the initial budget is no longer a CP, rather, PREB must ultimately approve the initial budget and if we disagree with PREB's decision, we would be in a dispute process where PREB, as an administrative agency, will be afforded deference by the Puerto Rico courts-- a very unbalanced position for us. As further noted below, we want mutual agreement with respect to budgets with referral to an impartial technical expert if there is a dispute. If a budget requires a rate increase we recognize that PREB approval will be required, and it should be generally consistent with the budget policy provision we proposed for the parties to reach agreement.	**a.** The revised O&M Agreement continues to include contractual protections with respect to the availability and sufficiency of Federal Funding (including pre-funding the Capital Account – Federally Funded with 4.5 months of Obligated Federally Funded Capital Improvements), which we are happy to discuss further to help address any remaining concerns. **b.** This does not represent a change from the prior draft of the O&M Agreement, which provided that the Initial Budgets would be approved by PREB. The revised O&M Agreement seeks to provide greater certainty to Operator by stating that if PREB does not respond within a specified time after receiving the proposed Initial Budgets, Operator may proceed as if PREB had approved them. The revised O&M Agreement also provides as a CP that PREB will have issued a Rate Order sufficient to fund the Initial Budgets (which Initial Budgets now also include, in response to PSEG's prior feedback, the projected budgets for the following two Contract Years).

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2.	**Termination and 'put'**	Section 16.3 -your latest draft states that in a termination or expiration event, the ability of us to 'put' (i.e., automatic transfer) ServCo to the Owner is at Administrator's option. If a termination or expiration event occurs, we need a pre-planned exit path and require this put.	We will consider adjusting the O&M Agreement to provide that, following termination or expiration of the O&M Agreement, Owner or another appropriate successor will assume any liabilities associated with ServCo's employees (including severance costs, if any) that are reflected in the Budgets or otherwise agreed by Owner. Please note that the Back-End Transition Plan is intended to provide Operator with a clear pre-planned exit path.
3.	**Guarantee**	The guarantee should be for Management Company's potential payment obligations, not performance. The guarantor will be a wholly-owned investment grade entity that is incorporated in the US (or an LC) and will specify a maximum liability amount consistent with the defined term Operator Security Amount which appears in the draft but is not used in the form guaranty.	In the event that the entity that qualified during the RFQ process is not the same entity that enters into the O&M Agreement, the Authority should be in the same position it would have been in had that pre-qualified entity entered into the O&M Agreement. In addition, as previously noted, the Authority does not expect Operator to engage in gross negligence or willful misconduct and therefore does not believe (i) that this is an appropriate standard for performance under the O&M Agreement or (ii) that liability for gross negligence or willful misconduct should be capped. As a result, we have provided that the Guarantee should (x) be a guarantee of payment as well as performance and (y) not be subject to a cap. Given that the only acceptable operator security contemplated under the O&M Agreement is the Guarantee, the term Operator Security Amount will be removed from the O&M Agreement.
4.	**PREB**	We have concerns about PREB's broad oversight and our potentially relatively weak position in disputes regarding budgets, rates, performance metrics and other matters. As it stands, you get 'two bites at the apple', by us having to agree with Administrator (subject to technical dispute process), then obtaining PREB approval, where any disputes would go to Puerto Rico courts and PREB, as an administrative agency, would be afforded deference. Our prior suggestions to try to level the playing field in the dispute process and to expedite that process so that it does not negatively impact operations were rejected. The Technical Dispute process should include PREB so it is more balanced and efficient.	As the independent regulator, PREB should have oversight over the key elements that may impact rates, such as budgets, rates and performance metrics. That said, the revised O&M Agreement streamlines this oversight function by specifying the time periods within which PREB will review and respond to Operator's requests, including with respect to the Initial Budgets, the Performance Metrics and the System Remediation Plan. In addition, the O&M Agreement deliberately avoids requiring duplicative approvals from both Administrator and PREB. Budgets following the Service Commencement Date are only Approved by Administrator and not PREB. Conversely, only PREB is tasked with approving rates. The limited areas in which both Administrator and PREB are involved are those in which Administrator will support Operator in its submissions to PREB during the Front-End Transition Period. These include the Performance Metrics, the Initial Budgets and the System Remediation Plan. Administrator's function in this context is only to make recommendations. With respect to disputes, as discussed during the meetings in New York, it would not be appropriate to contractually require that an independent regulator such as PREB give deference to the views and decisions of third parties. We are not aware of any jurisdiction where a regulator would be bound in such a way.

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5.	**Transition duration and Review time by parties**	The Initial Budgets, System Remediation Plan (SRP) and Performance Metrics each require a 60-day review by Administrator, followed by a 120-day review by PREB. That is six months of review. If we actually started transition on January 1, 2020 (i.e., you have all PR approvals prior to that so we can start transition) and if it somehow only took us an equal amount of time to actually prepare these budgets, plans and metrics as you require to review it (six months), then the earliest mathematically possible date to go live would be January 1, 2021. We recommend narrowing the scope of the SRP and metrics to a Phase 1 covering the first 2-3 years, which will enable a shorter review period for Administrator and PREB (30 days each), which will enable the possibility of an earlier transition. We would update the SRP and metrics for the long term in the subsequent budget cycle.	The O&M Agreement will shorten the 60-day review by Administrator of the Initial Budgets, SRP and Performance Metrics to 30 days. In addition, we will also assess the feasibility of reducing the 120-day review by PREB in the O&M Agreement. The O&M Agreement allows the definitive Performance Metrics that are developed and approved during the Front-End Transition Period to have scope covering the first two to three years. Accordingly, the Performance Metrics currently included in Annex VIII, including the five-year scope described therein, are indicative and subject to revision during the transition. The SRP developed during the Front-End Transition Period is intended to provide a comprehensive plan forward to stabilize the T&D System as soon as reasonably possible. As a result, the expectation is for the complete SRP to be implemented in a relatively short amount of time. Creating multiple SRPs each with a limited scope could undermine this effort by unnecessarily prolonging the implementation.

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6.	**Prefunded accounts**	a. **Investment grade rating** enabling step-down of funds. Insert symmetrical provision that if investment grade rating were subsequently lost that you will immediately replenish back to the 4.5 months and the contingency reserve fund. b. **Contingency reserve account – 7.5(f) –** change the funding replenishment to 'within ten days' not 'as soon as Owner has sufficient funds to do so'. c. **Control** –You have repeatedly advised that the Servicing Agreement will give us comfort as to control of accounts. We have not seen it, please send the draft. If a draft is not available at this point in time then insert the requirement for a control agreement. d. **Unfunded amounts (7**.7) – reinsert our clause that provides "all parties acknowledge Operator/ManagementCo has no obligation or responsibility to incur or pay any costs or make expenditures in providing O&M services…." Otherwise it could be read that Operator/ManagementCo could be required to fund certain costs when the accounts are not funded, which will not be the case.	**a.** The O&M Agreement will provide for Owner's obligation to pre-fund the Service Accounts, including the Contingency Reserve Account, to be reinstated if the investment grade rating is lost or downgraded. This will be clarified in an updated version of the O&M Agreement distributed via an addendum to the RFP. In particular, immediately upon a rating downgrade, the level of prefunding required will be increased from 3 months to 4.5 months and the obligation to deposit funds into the Contingency Reserve Account will be reinstated; provided that if Owner does not have sufficient funds to fund the Front-End Transition Account, the Service Accounts or the Back-End Transition Account in the required amount, this failure will not constitute a default so long as the Front-End Transition Account, the Service Accounts and the Back-End Transition Account are topped up to the level at which it should be at any given point as soon as Owner has sufficient funds to do so and in any event within 6 months of the Rating Downgrade Date. **b.** The Contingency Reserve Account was added to the revised O&M Agreement to grant additional credit support and is intended to provide Operator with a buffer as additional protection in the event that funds in the Service Accounts are insufficient to perform the O&M Services. Accordingly, the provision was drafted to be funded over time via excess cash in the system and we do not think requiring replenishment within 10 days is appropriate. **c.** As with the Service Accounts, the Servicing Contract becomes relevant at the Service Commencement Date, once Operator begins managing the T&D System revenues. As mentioned during the meetings in New York and as reflected in the revised O&M Agreement, Operator will have an opportunity to fully negotiate the terms of the definitive Servicing Contract during the Front-End Transition Period, and the Servicing Contract must ultimately be acceptable to it. **d.** To avoid ambiguity on this point, the relevant language will be reinserted in the O&M Agreement. Operator will still have the obligation to try to address Budget shortfalls in the manner provided in Sections 7.4 and 7.7.

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7.	**Pass-through costs**	a. **Affiliates** – we intend to leverage our Service Company in NJ for certain matters – i.e, install a new ERP, outage management system, dispatch system, etc. We expect those costs (no margin) to be pass-through costs. Section 4.2(l) and 5.2 prohibits that. This is an important tool for us to leverage our expertise and bring that value to PREPA, at no profit. (fyi – same as LIPA). b. **Employees for FEMA** – You have informed us that this agreement is not FEMA compliant. We would like to find a way to have our Puerto Rico employees work on FEMA projects and have costs reimbursed by FEMA. It will be more cost-efficient and a better workforce development path. Let's discuss.	**a.** The language in Section 5.2(d)(ii) (*System Contracts*) requiring that replacements for existing System Contracts comply with the Federal Funding Requirements (including the Federal Funding Procurement Manual) is intended to apply only to System Contracts that involve Federal Funding. This will be clarified in an update to the O&M Agreement. We could not identify any language in Section 4.2(l) (*Shared Services Agreement*) of the revised O&M Agreement that would prevent PSEG from leveraging its service company, but welcome any clarifications. **b.** From the beginning of the process, we have indicated that the O&M Agreement will not be FEMA compliant. We remain open to considering any proposed solutions to address the concerns identified.
8.	**Environmental – pre-existing conditions**	Change language back to the broader definition, include Operator in assessment process, change responsibility of addressing those to Operator, who will keep Administrator informed.	The definition of Pre-Existing Environmental Conditions has not changed – it is the same as what was included in the prior draft of the O&M Agreement. Section 5.10 in the revised O&M Agreement was modified to accommodate Operator by providing that Operator will not be responsible for any Pre-Existing Condition that is exacerbated as a result of the environmental health and safety activities that Operator is responsible for performing (except to the extent Operator exacerbates a Pre-Existing Environmental Condition and such exacerbation is attributable to Operator's GN/WM). However, this modification does not preclude Operator from participating in the process for assessing or addressing any such conditions.
9.	**Termination rights**	Change in Law appears to have been erroneously removed.	There was no termination right for a Change in Law in the prior draft of the O&M Agreement. This is consistent with LIPA, which does not appear to include a termination right for a Change in Law. There was and continues to be a termination right for a Change in Regulatory Law, which has been expanded given the expansion of the definition of what constitutes a Change in Regulatory Law. In addition, Operator is protected from Changes in Law as Force Majeure Events, entitling Operator to seek relief via changes to the Budgets, Performance Metrics, etc.

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10.	**Insurance**	We should be a named insured on the policy, the cost of which will be a T&D pass-through expenditure. (fyi – same as LIPA)	Section 10.3 of the O&M Agreement provides that Operator will be included as an additional named insured where commercially applicable and pertinent to the coverage. The definitive Insurance Specifications that will be jointly prepared by the Parties during the Front-End Transition Period will specify the appropriate policies under which Operator will be included as an additional named insured.
11.	**Genco**	We want to reconfirm the general scope you envision, specifically, that the scope is for IRP, entering into generating contracts as agent, dispatch and, for up to three years, providing administrative support services to the generation fleet that PREPA will operate, i.e., we will not run the generating stations, nor procure fuel supply for Genco, rather PREPA will retain employees to run and oversee that part of the legacy business itself.	Confirmed. The scope of the Operator's generation-related responsibilities can be largely summarized as follows: • Operator, as agent for Owner, will be responsible for preparing the IRP, which will be subject to review and approval by PREB. • Operator will be responsible for monitoring and maintaining Resource Adequacy. These functions may require the Operator to identify and recommend generation projects for which procurement processes will need to be carried out. The Operator will be responsible for providing technical back-up and support related to these procurements, as laid out in Section 5.13(d) of the O&M Agreement, but the Owner will be the entity that executes and becomes the legal counterparty to these projects. • Operator, as agent of the Owner, will be responsible for the dispatch, scheduling and coordination of power and electricity from available generation assets. • The Operator will only provide administrative support services to GenCo for up to three-years (unless extended by mutual consent). The actual operation and management of these generation units will be continued by the PREPA employees that currently operate and manage this portion of PREPA's operations until this portion of PREPA's business is outsourced to a private entity or their useful life expires. • Fuel procurement and supply functions for the Legacy Generation Assets will be conducted through PREPA's fuel procurement and supply office, as assumed by GenCo, not the Operator. Should new power purchase and operating agreements with IPPs be tolling agreements, GenCo will also provide fuel to such IPPs.

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12.	**Section 9.9**	This addition in this draft expressly requires compliance with Act 120. We believe this Act cited the $0.20/kWh customer rate target. We know that rates are currently in excess of this target and will continue to increase to address the RSA, pension underfunding and investments needed for the system. Reinsert the sentence that we proposed regarding this target to address the apparent conflict.	This is not an addition – the language is the same as appeared in the prior draft of the O&M Agreement, and is expressly required under Act 120 (as highlighted in the footnote to Section 9.9). The law that references the $0.20/kWh customer rate target is Act 17-2019, and such law provides that the target is aspirational.
13.	**Conditions to execution**	This draft requires that the conditions to execution be reasonably acceptable. We do not want to be in a position where approvals contain modifications from the Puerto Rico agencies which could be adverse to us that we find unacceptable and then potentially be in a dispute as to whether we have acted reasonably with $30 million in bid security at risk.	The revised O&M Agreement includes "*in form and substance reasonably acceptable to … ManagementCo*" only to the conditions to execution that relate to the formal approvals provided by the boards of Owner and Administrator (via board resolutions), the Governor and the FOMB. Operator should not have the ability to walk away from executing the O&M Agreement because it unreasonably disagrees with the form or content of a board resolution or similar approval document. In this regard, we also note that the representations contained in the O&M Agreement will provide Operator will full protection as to the due authorization and validity of the contract.