

**PowerAdvocate Message to PSEG  
re: Definitive O&M Agreement**

Dear PSEG –

The Puerto Rico Public-Private Partnerships Authority (the “Authority”) would like to thank you for your continued participation in the process for the transformation of the Puerto Rico Transmission and Distribution System (the “T&D Transformation”). In particular, the Authority thanks you for the comments you submitted to the updated draft of the O&M Agreement, the call to discuss your views on the biggest issues raised by the updated draft, and your participation in the most recent meetings to review your comments in more detail (the “Contract Meetings”). As with prior meetings to engage on topics related to the T&D Transformation, the Contract Meetings were very helpful in terms of both providing an opportunity for the parties to hear each other out and allowing the Authority and its advisors to better understand PSEG’s remaining concerns.

The Authority and its advisors have carefully considered the feedback received from all Qualified Respondents. Taking into account this feedback and the goals of the Authority in pursuing the T&D Transformation, the Authority and its advisors have prepared, and the Partnership Committee has approved, a definitive version of the O&M Agreement, which is being shared with Qualified Respondents together with this memo. The Authority firmly believes that this definitive version, which has evolved significantly from the initial draft of the O&M Agreement shared in May, reflects an appropriate sharing of risk between the parties but addresses the large majority of the concerns raised by Qualified Respondents throughout the process. In addition, the Authority will be sharing Addendum No. 6 to the RFP for the T&D Transformation – which will include the definitive proposal requirements and evaluation criteria – with Qualified Respondents in the coming days.

To assist you and your advisors in reviewing the definitive O&M Agreement, we have summarized below a number of key changes to the O&M Agreement and, where relevant, included the Authority’s rationale for the changes. Capitalized terms used but not defined in the summary below generally have the same meaning as in the definitive O&M Agreement.

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1. Risk Allocation

- a. *Customer Claims and Consequential Damages* – To provide additional comfort with respect to claims from third parties (in addition to the indemnification protections already contemplated under §18.2), the definitive O&M Agreement includes a condition precedent to the Service Commencement Date that a Liability Waiver, insurance coverage or another mutually acceptable alternative shall have been implemented to provide adequate protection to claims from customers with respect to the T&D System (*see* §4.5(o)). More specifically, the

Liability Waiver, insurance or other mutually acceptable alternative would protect or otherwise provide coverage for Owner's, ManagementCo's and ServCo's liability for (i) any Losses arising in any way out of the operation of the T&D System (including for ordinary negligence, but excluding gross negligence and willful misconduct) and (ii) any loss of profits, special damages and or other consequential damages howsoever arising.

- b. *Force Majeure Events* – The definitive O&M Agreement expands what constitutes a Force Majeure Event by including (i) instances where the geographic area is declared a “disaster zone” or similar pronouncements and (ii) strikes and other labor disputes involving ServCo's own employees if they occur in the first 18 months after the Service Commencement Date. Consistent with the discussion during the Contract Meetings, strikes and labor disputes of ServCo's employees was included in the definition for a period of time to acknowledge that Operator may need some time to stabilize its workforce. However, with respect to union or labor work rules that increase the number of employees or the cost of performing, etc., the Authority does not believe that these conditions should be Force Majeure Events given that the costs of any such condition would be treated as T&D Pass-Through Expenditures. Similarly, the failure of a Governmental Body to issue an approval on a timely basis should not, by itself, constitute a Force Majeure Event as there may be valid reasons for this action.
- c. *Operator's Indemnification Obligations* – The definitive O&M Agreement provides that Operator will not be liable to Owner Indemnitees if it has acted or refrained from acting in accordance with the terms of the O&M Agreement, as determined by a final, non-appealable judgment (*see* §18.3(a)(iv)). It also includes additional exceptions to Operator's indemnification obligations for Force Majeure Events, for any matter for which Owner expressly indemnifies Operator and for events or circumstances arising prior to the Service Commencement Date (*see* §18.1). As discussed during the Contract Meetings, the Authority believes that limiting Operator's indemnification obligations to only cover claims brought by third parties is not appropriate.
- d. *Limitation on Operator's Liability* – The definitive O&M Agreement includes a mechanism whereby Operator is not liable to Owner Indemnitees until the following damage thresholds are reached (and then only for damages above such threshold): (i) \$5 million per Contract Year until the end of the second Contract Year; and (ii) \$2.5 million per Contract Year from the beginning of the third Contract Year through the end of the Term. Similar to the approach taken in the definitive O&M Agreement with respect to strikes under Force Majeure Events, this mechanism helps mitigate the risk of liability early in the Term and take into account the transition that will be involved. This approach tracks PSEG's proposal for an initial “amnesty” period and minimum monetary thresholds below which Operator would not be liable. The definitive O&M Agreement also clarifies that the caps on Operator's liability include Disallowed Costs, consistent with your feedback (*see* §18.3(a)(i)). However, the Authority does not believe that the caps on Operator's liability to Owner Indemnitees should be broadened to

also cover Delay Liquidated Damages and the Owner Termination Fee, as these are stand-alone concepts that will be bid on separately by Qualified Respondents.

## 2. Funding Protection and Certainty

- a. *Contingency Reserve Account* – To provide Operator with additional assurances that funds will be available to make the required payments to Operator (including any non-recurring or unbudgeted payments), the definitive O&M Agreement includes the concept of a Contingency Reserve Account (*see* §7.5(f)). The Contingency Reserve Account – which would be gradually pre-funded and topped up to an amount equal to one and a half months of the initial Operating Budget – would be available to Operator to cover any unforeseen events and funding shortfalls.
- b. *Interim Rate Increases* – As previewed in the prior version of the O&M Agreement, the definitive O&M Agreement provides for a rate order to be approved by PREB that would authorize Operator to implement interim rate adjustments within a certain range without PREB’s prior approval but which would require PREB’s *subsequent* approval for the rate adjustments to continue in effect (*see* §4.5(q)). Obtaining such a rate order will be a condition precedent to the Service Commencement Date.
- c. *Indemnity-related Payments* – The definitive O&M Agreement also addresses concerns relating to the ability to meet non-recurring or unbudgeted payments by providing that any indemnification obligation that remains unpaid by Owner for more than 60 days will be treated as a T&D Pass-Through Expenditure and may therefore be withdrawn by Operator from the Service Accounts (*see* §18.2).
- d. *Service Accounts* – The definitive O&M Agreement includes certain revisions related to the Service Accounts that are intended to provide additional assurances that the requisite funding will be available. These revisions include:
  - (i) broadening the scope of what was previously referred to as the “Storm Reserve Account” so that funds deposited in that account are available to cover any Outage Event (whether or not caused by a storm) (*see* §7.5(d)); and
  - (ii) adding Generation Expenditures Accounts, including a Purchase Power Account that would be pre-funded and topped up so that it includes two months of the relevant Generation Budget (*see* §7.5(e)). These changes are in line with changes that PSEG proposed to help mitigate against the risk that the necessary funds will not be available to Operator. Given these protections and the added Contingency Reserve Account, the Authority does not believe it is appropriate or necessary to further increase the pre-funding levels beyond four and a half months, to prepay Operator’s Fixed Fee or to pre-fund the Back-End Transition Service Fee.
- e. *Initial Budgets and Rate Order* – The definitive O&M Agreement includes, as a condition precedent to the Service Commencement Date, a requirement that PREB shall have issued a rate order sufficient to fund the Initial Budgets (*see* §4.5(g)). In response to your feedback, initial Budgets will cover the initial

Contract Year and include the projected budgets for the following two Contract Years.

- f. *Owner Credit Rating* – The definitive O&M Agreement includes a mechanism providing that, for so long as Owner effectively achieves an Investment Grade Rating or a securitization vehicle achieves a AA credit rating, then the levels of pre-funding required for the relevant Service Accounts will be reduced from four and a half months to three months and the Contingency Reserve Account would no longer need to be pre-funded (*see* §7.8). Any funds that are released from any Service Account as a result of achieving such credit ratings will be used for the repayment of existing debt of Owner, refunds to T&D Customers or other similar purposes. The Authority believes that this mechanism is appropriate given that concerns regarding Owner’s financial situation should be mitigated once it achieves the relevant rating, and therefore the corresponding protections should be adjusted accordingly.

### 3. Federal Funding

- a. *Planning Team* – The Authority understands the need to have Operator provide input with respect to Federal Funding and the Integrated Resource Plan during the Front-End Transition Period. Consistent with your suggestion, the definitive O&M Agreement provides that, promptly following the Effective Date, the Parties will establish a planning team (together with COR3) to review the current status of Federal Funding, the Integrated Resource Plan and related workstreams, and develop plans and recommendations with respect thereto (*see* §4.3(j)).
- b. *Minimum Amount of Federal Funding* –The Authority has confirmed that it will not be possible to identify, as of the signing of the O&M Agreement, the specified minimum amount of Federal Funding that will be obligated as of the Service Commencement Date. As discussed during the Contract Meetings, the Authority does not agree with providing Operator with a termination right in the event specified minimum amounts of Federal Funding have not been obligated by certain milestones given that Operator will be expected to play a significant role in obtaining such funding. The Authority believes that Qualified Respondents should have sufficient comfort with respect to the availability of Federal Funding based on: (i) recent meetings with representatives of FEMA and COR3; (ii) the role Operator will play in this context during the Front-End Transition Period, as described above; and (iii) the definitive O&M Agreement providing that either (x) the Capital Account – Federally Funded will be pre-funded based on Obligated and scheduled Federally Funded Capital Improvements or (y) a credit facility reasonably acceptable to Operator will be available to fund Federally Funded Capital Improvements (*see* §7.5(b)(iii)).
- c. *Procurement Manuals* – The definitive O&M Agreement provides that the Federal Funding Procurement Manual will be reviewed and approved by COR3 and will be submitted for review by FEMA and DHS OIG (*see* §4.5(i)). In addition and as you suggested, the definitive O&M Agreement also contemplates

the preparation of a Non-Federal Funding Procurement Manual during the Front-End Transition Period, which is intended to facilitate the procurement for Non-Federally Funded Capital Improvements (*see* §4.1(f)).

#### 4. Regulatory Oversight

- a. *Role of PREB* – The definitive O&M Agreement further clarifies the role that PREB is expected to play as independent regulator, including by: (i) specifying the time periods within which PREB should review and respond to Operator’s requests, such as with respect to the System Remediation Plan (*see* §4.1(d)); (ii) expressly indicating that PREB is deemed to have acknowledged its rights, duties and obligations under the O&M Agreement by delivering the Energy Compliance Certificate (*see* §3.9(c)); and (iii) acknowledging Operator’s right to request that PREB’s decisions be reviewed by the courts in accordance with Puerto Rico law (*see* §15.1). The Authority believes that these clarifications, together with the expansion of the definition of Change in Regulatory Law, should provide appropriate comfort to Qualified Respondents with respect to the role of PREB.
- b. *Change in Regulatory Law* – The definitive O&M Agreement expands the definition of a “Change in Regulatory Law” to include regulatory changes that (i) invalidate Operator’s selection under the RFP, (ii) cap rates charged to T&D Customers (other than a temporary cap on rates to address an Outage Event) or (iii) rescind or amend the Liability Waiver (if in effect) in a materially adverse manner. In addition, the definitive O&M Agreement also provides that Operator would be entitled to a Termination Fee in the event of termination due to certain Changes in Regulatory Law (as discussed in greater detail below).
- c. *Oversight vs. Audit* – To help address a concern you raised, the definitive O&M Agreement includes a defined term for “Oversight,” distinct from an “Audit,” and incorporates this term where relevant.

#### 5. Performance Metrics and Incentive Fee

- a. *Operator Event of Default for Failure to Achieve Performance Metrics* – This Operator Event of Default was adjusted such that it applies to a failure to meet the Minimum Performance Threshold for any three Key Performance Metrics (which is defined as a subset of the Performance Metrics) – rather than *any* of the Performance Metrics as in the previous draft – for three consecutive years (*see* §14.1(k)). In addition, the definitive O&M Agreement now makes clear that this Operator Event of Default does not apply to failures to meet Key Performance Metrics as a result of a Force Majeure Event, an Outage Event or Owner Fault.
- b. *Key Performance Metrics and Major Outage Performance Metrics* – In response to feedback from Qualified Respondents, the definitive O&M Agreement now contemplates a mechanism whereby Operator would still have an opportunity to earn the Incentive Fee during a Major Outage Event or a Force Majeure Event. If

a Major Outage Event prevents Operator from achieving Performance Metrics, Operator would be entitled to earn the Incentive Fee to the extent it achieves the Major Outage Event Performance Metrics (*see* §7.1(c)(vi)). Similarly, if a Force Majeure Event (other than a Force Majeure Event that is a Major Outage Event) prevents Operator from achieving Performance Metrics, Operator would be entitled to earn the Incentive Fee to the extent it achieves the Key Performance Metrics (*see* §7.1(c)(vii)).

## 6. Events of Default, Termination and Remedies

- a. *Operator Termination Fee* – In response to your feedback, the circumstances under which a Termination Fee would be payable to Operator were expanded to include (i) a sale of the T&D System and (ii) a Change in Regulatory Law that (x) renders unenforceable any right or privilege of Operator under the O&M Agreement, (y) subjects Operator to rate or other substantive regulation by PREB that materially and adversely affects Operator’s ability to perform or (z) caps or has the effect of capping rates (other than a temporary cap to address an Outage Event) (*see* §14.6(c)(i)).
- b. *Remedies for Early Termination Due to Owner Fault* – The definitive O&M Agreement continues to include a cap on the additional damages that Operator may recover for a termination due to Owner fault (other than in those specific circumstances where Owner is required to pay the Operator Termination Fee) (*see* §14.6(d)). However, the cap was reformulated as follows: (i) it expresses the Fixed Fee as the lesser of (A) the Fixed Fee earned in the Contract Year prior to termination and (B) the net present value of the Fixed Fee over the remaining Term discounted at a rate of six percent; and (ii) it is increased to include the Incentive Fee earned in the Contract Year prior to termination. The cap is intended to reflect the fact that – unlike in a concession arrangement where the concessionaire makes significant upfront and/or periodic payments to the owner – the damages in a “fee for service” contract are limited as there is no capital investment being made and Operator has the ability to redeploy its management team to another project upon an early termination of the contract. Moreover, having the amount of damages Operator is entitled to due to an early termination be correlated with the service fee it receives is consistent with the approach taken under the LIPA O&M contract.
- c. *Termination for Failure to Agree on Budgets* – The termination right for failure to agree on Budgets was revised such that it will also be available if the Parties fail to agree on the Operating Budget, and such failures result in Budget Disputes, for three or more consecutive Contract Years (*see* §14.5(d)).

## 7. Front-End Transition

- a. *Compensation* – The definitive O&M Agreement includes the concept of Operator receiving an additional profit margin on the Front-End Transition Service Fee to compensate it for its efforts during the Front-End Transition

Period (*see* §4.6(b)). Operator would also receive a similar profit margin in connection with the Back-End Transition Service Fee (*see* §16.4(b)). Qualified Respondents will be asked to bid their proposed profit margins as part of their submissions. As a corollary to this profit margin, the definitive O&M Agreement maintains the concept of Delay Liquidated Damages payable to Owner in the event that Operator does not timely achieve the Service Commencement Date by the date that is three months following the Target Service Commencement Date.

- b. *Workstreams for Front-End Transition Period* – In response to feedback from Qualified Respondents, the definitive O&M Agreement now provides that the Performance Metrics and the GenCo Shared Services Agreement will be further developed during the Front-End Transition Period (*see* §4.2(f) and §4.2(l)). The definitive O&M Agreement also provides that the negotiation of the Servicing Contract, the development of the Data Security and Vegetation Management Plans, the demarcation of the T&D System and the determination of the insurance specifications will also take place during the Front-End Transition Period (*see* §4.2(f), §4.2(h) and §4.5(l)).
- c. *Title III Approvals* – The definitive O&M Agreement provides additional clarity with respect to the Title III approvals that will be sought during the Front-End Transition Period. §4.1(c) provides that (i) within 10 Business Days following the Effective Date, Owner will be required to file a motion with the Title III Court seeking administrative expense treatment for any accrued and unpaid amounts required to be paid by Owner under the O&M Agreement and (ii) Operator may terminate if (A) such motion has not been approved within 90 days (subject to possible extension periods) and (B) Operator gives Administrator at least 30 days’ prior written notice of its intent to terminate (with copy to PREB). The definitive O&M Agreement also includes a condition precedent to the Service Commencement Date requiring receipt by Owner of Title III Approvals from the Title III Court reasonably acceptable to Operator (*see* §4.5(n)).

## 8. Other Updates

- a. *Environmental Matters* – The O&M Agreement has been updated to provide that: (i) Operator’s environmental management obligations generally do not apply to pre-Existing Environmental Conditions; (ii) Operator’s liability with respect to exacerbation of disclosed Pre-Existing Environmental Conditions is limited to the extent the exacerbation is attributable to Operator’s gross negligence or willful misconduct; and (iii) if Operator certifies that to its best knowledge an alleged Pre-Existing Environmental Condition did not arise after the Service Commencement Date, then Owner will bear the burden of proof by a preponderance of the evidence to demonstrate that such condition is not a Pre-Existing Environmental Condition (*see* §5.10). In addition, the O&M Agreement now provides an Owner representation with respect to Pre-Existing Environmental Conditions (*see* §5.10).

- b. *Subcontractors and Contractors* – The definitive O&M Agreement clarifies that Operator’s payment obligations under any Subcontract will be T&D Pass-Through Expenditures, *except* to the extent Operator elects to subcontract any service to be provided by ManagementCo, in which case such payment obligation shall be paid by ManagementCo from the Fixed Fee (*see* §11.1(a)). It also provides additional details regarding the conditions applicable to the engagement of “Contractors” (as defined in 2 CFR 200.23) which is intended to address your feedback on the O&M Agreement (*see* §11.1(b)).
- c. *Essential Public Service* – The provision relating to Operator providing an essential public service has been updated to clarify that this acknowledgement does not impose any additional obligation on the Parties (*see* §3.7).
- d. *Acceptable Operator Security* – The Authority believes that it is appropriate for the Guarantee to cover Operator’s payment *and* performance obligations (*see* Exhibit D).
- e. *Performance Extension Option* – As discussed during the Contract Meetings, limitations under the “qualified management agreement” requirements prevent including a concept whereby Operator has the right to extend the Term if it has satisfied certain Performance Metrics.
- f. *Dispute Resolution* – Consistent with your feedback, the categories of disputes that will be subject to resolution as Technical Disputes have been expanded to also include disputes with respect to the Front-End Transition and Back-End Transition Service Fees, as well as those related to Force Majeure Events (*see* §15.3). The Authority believes that the scope of disputes that will be subject to technical dispute resolution is appropriate; consistent with the policy of the Puerto Rico Government for PPP transactions, any other disputes will be subject to resolution before the Commonwealth Court of First Instance.



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We hope that this summary of the key changes to the O&M Agreement, the vast majority of which are in response to specific comments of Qualified Respondents, and PSEG in particular, will be helpful to you and your advisors in reviewing the definitive O&M Agreement. We also hope that the changes will demonstrate that the Authority is committed to making the T&D Transformation process fair and equitable for all parties while protecting the interest of rate payers.

If you have any questions on the above items or any other elements of the definitive O&M Agreement, please let the Authority know by replying to this message via the PowerAdvocate platform.

**\*This communication is subject to confidentiality undertakings and all other terms of the RFP\***

Thank you.

The Puerto Rico Public-Private Partnerships Authority