

**TERM SHEET FOR AMENDMENTS TO  
THE OPERATIONS SERVICES AGREEMENT**

This Term Sheet is intended to describe the material, substantive terms of the proposed amendments to the Operations Services Agreement (as amended by Amendments No. 1 and No. 2 thereto, the “OSA”) between the Long Island Lighting Company d/b/a LIPA (“LIPA”) and PSEG Long Island LLC, dated December 28, 2011. This Term Sheet is not intended to be legally binding. The Parties’ execution of definitive, legally binding agreements will be contingent upon receipt of all necessary corporate, regulatory and third party approvals (which are acceptable to each Party in its sole discretion). The effectiveness of the amended OSA will be subject to certain conditions described below. The Article and Section references in the Term Sheet are to Articles and Sections in the OSA unless otherwise indicated. Capitalized terms have the meanings assigned to them in the OSA unless otherwise defined.

The OSA will remain in full force and effect except as amended to reflect the substance of the following proposed amendments:

**Realignment of  
Authority/Responsibility**

The rights and responsibilities of the Service Provider and LIPA will be realigned so that the Service Provider has, to the extent legally permissible and subject to the terms of LIPA’s bond and other financing agreement covenants, autonomy and responsibility to operate and maintain LIPA’s transmission and distribution system (“T&D System”) in LIPA’s Service Area (“Operations Services”) and set the related plans, policies, procedures and programs. Accordingly, LIPA’s oversight authority over the Service Provider with respect to the Operations Services will be minimized. As part of this realignment, the Joint Operating Committee, along with its rights and responsibilities will be eliminated. While remaining the owner of the T&D System with ultimate rate making authority, LIPA’s role and functions would be reduced to managing its financial, debt, PILOTs, tax and legal obligations, providing support to the LIPA Board’s functions and responsibilities and managing LIPA’s contractual obligations with a concomitant reduction in the number of LIPA employees and Board positions. As part of this realignment, it is expected that review authority over LIPA and the Service Provider will be created in the Department of Public Service (“DPS”) pursuant to new legislation (as described below).

The Parties acknowledge that amendments to Articles 3 and 4, related defined terms and other sections of the OSA will be required to reflect the realignment and expansion of the Service Provider’s responsibilities as well as the objectives and other terms in this Term Sheet.

The scope of rights and responsibilities of the Service Provider specifically will be expanded to include (i) management of the T&D System and associated functions, (ii) responsibility for management and implementation, subject to applicable regulatory and tariff requirements, of energy efficiency programs, and (iii) the responsibility to participate as a party in rate cases before the DPS (as described below) and other New York State regulatory processes. Additionally, the Service Provider or its Affiliate will have the right to provide other services relating to power supply, fuel procurement and other related services commencing on January 1, 2015 and ending on December 31, 2025 on terms, conditions and performance criteria to be agreed upon (including minimum revenues) as set forth in the amended OSA. If the Service Provider enters into contracts with its Affiliates for provision of the services described in the

previous sentence, the Service Provider's costs, including arm's-length compensation for the Affiliates, will be treated as Pass-Through Expenditures.

For purposes of clarity, subject to cost substantiation, all expenditures (including reasonable attorneys' fees) of the Service Provider in relation to the DPS process authority established under the new legislation (as described below) or other regulatory proceedings, or to satisfy any regulatory/legal standards or requirements imposed by DPS or other Governmental Bodies will be treated as Pass-Through Expenditures. Both the Service Provider's demonstrated transition costs incurred to achieve efficiency savings as well as the costs of providing services related thereto on an ongoing basis under the amended OSA for the benefit of LIPA's customers, will be treated as Pass-Through Expenditures. The Parties shall bear their own transaction and related third party costs incurred in connection with their entering into the amended OSA.

The Service Provider will have the opportunity to propose certain investments in discrete programs or projects that will be set out in the amended OSA, possibly including transmission lines, energy efficiency programs, and renewable and distributed generation under a "Utility 2.0" program described below, which investments are expected to result in a meaningful reduction in energy usage and overall cost of energy across the T&D System; provided, however, that no such investments will be made which would jeopardize the tax exempt status of LIPA's bonds or violate bond covenants, and that such investments are consistent with local franchise agreements. If the Service Provider makes any such capital investment, it will have the opportunity to earn a reasonable rate of return thereon consistent with standards for New York transmission and distribution electric utilities. Such return and the structure of any capital investment by the Service Provider or its Affiliate will be agreed upon by the Parties at the time of the investment.

### **Naming/Branding**

Consistent with the realignment of rights and responsibilities of the Service Provider and LIPA as provided in this Term Sheet, PSEG Long Island and its management shall become the face of the T&D service in the Service Area for the Term of the amended OSA. To that end, PSEG Long Island shall have full authority to determine policies and procedures with respect to the use of its name and service mark and PSEG Long Island's name and service mark will replace LIPA's name and logo, including on all signage, customer bills, vehicles, equipment, uniforms, letterhead, and on utility-related communications, advertisements, public announcements, websites and similar areas for the Term of the amended OSA. Upon expiration or earlier termination of the amended OSA, PSEG Long Island shall no longer be the face of the T&D service in the Service Area, PSEG Long Island's name and service mark shall have been removed from the aforementioned areas, and all rights to such name or service mark granted to LIPA (or to any entity other than the Service Provider and its Affiliates) under the amended OSA, including any licenses or sublicenses, will terminate, in each case unless otherwise agreed to by the Service Provider.

It is the Parties' intention that to enable the Service Provider to effectively

communicate with the customers and government officials regarding Service Area T&D matters, PSEG Long Island shall have direct responsibility for media and other public communications on all utility-related matters, including communications with the public officials and local municipalities and counties regarding storm preparation, management and response, customer communications, programs and complaints and the like. Accordingly, PSEG Long Island and the Service Provider shall have full authority to determine all communications policies and procedures relating to its provision of T&D Service under the amended OSA. Other than as provided herein, any costs that the Service Provider incurs to generally promote or advertise the PSEG Long Island name or brand in the Service Area (other than to satisfy a requirement of a Governmental Body as agreed to by the Service Provider) shall not be reimbursable as a Pass-Through Expenditure unless approved in writing by LIPA.

## **Utility 2.0**

Not later than July 1, 2014, and annually thereafter, the Service Provider shall submit to the DPS and the LIPA Board for their review a proposed long range capital and operating plan to improve the T&D System's long run flexibility, service and value to customers and move the electric system toward a customer-centric model, by among other things:

- Providing greater (a) customer flexibility for distributed energy resources and management, (b) system-wide benefits in energy affordability and improved service and (c) system resiliency and reliability;
- Incorporating, where cost effective, programs to reduce or defer significant capital expenditures associated with the traditional T&D System and smooth peak demand, including programs related to energy efficiency, demand response, distributed generation, energy storage, micro-grid systems and vehicle recharging;
- Incorporating, where cost effective, advanced power controls for transmission and distribution facilities, technology-based energy efficiency and load management programs, real-time power monitoring equipment and integrated communications systems; and
- Identifying those portions of the T&D System for which unregulated, value-added services could be offered to customers by alternative energy providers, including the Service Provider's Affiliates.

To ensure a level competitive field, the Parties agree to provide a public participation and comment process, and to hold at least one technical conference, related to the initial plan.

## **2013-2015 Rate Freeze**

A long-term objective of the Parties is to provide for customer rate stability. To that end, the Parties acknowledge and confirm their commitment to seek a freeze of rates as reflected in the total bill to customers, in the aggregate (exclusive of the power supply charges) for the 2013-2015 period. In order to reach this objective, the Parties will strive to achieve sufficient efficiency and other operating and financial cost savings within their respective budget portions to achieve that goal, recognizing

that implementation will require certain legislative and other governmental and third party actions.

The Parties also recognize the long-term objective of achieving significant improvements in customer satisfaction, electric reliability, storm response, and overall service quality. As such, the Parties agree that specific Budget components related to T&D operations will be increased for 2014 and 2015 to levels sufficient to achieve targeted improvement objectives.

Based on the above, LIPA executive management, as part of the normal budget approval process, will recommend to the LIPA Board for action at the Board's December 2013 meeting no increase in customer rates (exclusive of power supply charges) for 2014.

### **Process for 2014-15 Budgets**

In 2013, the Service Provider will prepare and submit for LIPA's review and approval the Operating Budget (the definition of which term will be amended to subsume the Energy Efficiency Budget) and the Capital Budget (collectively, the "Budgets") for each of the years 2014 and 2015. LIPA will prepare its portion of the consolidated LIPA operating budget that is not covered by the Budgets, including provisions for its debt service, depreciation and amortization expenses and taxes (such portion prepared by LIPA, "LIPA's Budget Portion" and, together with the Budgets, the "Consolidated LIPA Budget").

The 2014 and 2015 Consolidated LIPA Budget will not be subject to the DPS review process described below. The effectiveness of the amended OSA will be conditioned on agreement between the Service Provider and LIPA with respect to the 2014 and 2015 Budgets.

### **Process for Subsequent Budgets**

In 2015, the Service Provider will prepare the proposed Budgets for each of the years 2016, 2017 and 2018. In preparing the proposed Budgets, the Service Provider will consult, but not be required to obtain agreement from, LIPA. LIPA will prepare, and be solely responsible for, LIPA's Budget Portion for each of the years 2016, 2017 and 2018. Subsequently, the same process will be carried out every three years for the duration of the amended OSA. The Work Plans will be eliminated for all budgets during the Term of the amended OSA.

The Consolidated LIPA Budget prepared in 2015 will be included in the rate plan filed as part of the DPS review process described below.

### **Effect of Budgets**

#### *Flexibility to Reallocate*

The Service Provider will have complete flexibility, subject to compliance with the Contract Standards and prior consultation with, but not subject to approval by, LIPA, to (i) reallocate or postpone expenditures within the approved Operating Budget, (ii) reallocate or postpone expenditures within the approved Capital Budget and (iii) reallocate between the approved Operating Budget and the approved Capital Budget in order to address changed operational or commercial circumstances or new legal or regulatory requirements. Such reallocated amounts will be treated as if initially budgeted in the relevant Budget in all respects, including with respect to the Performance Metric associated with the Cost Management

Category set forth in Appendix 8 to the OSA (the “Cost Management Performance Metric”).

*Flexibility to Overrun*

Any Excess Expenditures (which, as in the current OSA, are limited to 2% of the Budgets) will be treated as if initially budgeted in all respects, including with respect to the Cost Management Performance Metric.

*Emergencies*

If an event or condition that is beyond the reasonable control of the Service Provider other than a Storm Event, for example, due to a major equipment failure or fire (a “Non-Storm Emergency Event”), occurs and the Service Provider determines that certain non-budgeted expenditures are required in order for it to provide Operations Services in accordance with the Contract Standards, the Service Provider will have the right to make the expenditures and elect, in its sole discretion, to treat the expenditures as (i) reallocations between different Budget items, (ii) Excess Expenditures or (iii) “Non-Storm Emergency Expenditures” as described below.

If the Service Provider elects to treat the expenditures as Non-Storm Emergency Expenditures, the Service Provider will submit a request to LIPA to approve the Non-Storm Emergency Expenditures and approve an amendment (under Section 5.2(B)(ii)) to the then-current approved Budget to provide for such expenditures.

If LIPA agrees that the expenditures were required in order for the Service Provider to provide Operations Services in accordance with the Contract Standards, the expenditures will qualify as “Non-Storm Emergency Expenditures”, and LIPA must either approve the requested Budget amendment or permit Service Provider to include in the relevant Budgets for subsequent periods a separate account in an amount sufficient to allow the Service Provider to provide for the Non-Storm Emergency Expenditures over the remaining duration of the Term (including early termination). Expenditures that are determined to meet the above standard will be treated as if initially budgeted in all respects, including with respect to the Cost Management Performance Metric.

*Liability For Disallowed Costs*

In the event (i) that all or a portion of certain costs incurred by the Service Provider in connection with a Major Storm Event (defined below) (such costs, “Major Storm Costs”) or Non-Storm Emergency Expenditures were incurred unreasonably and imprudently, applying the same scope of review and standards as those applied by the DPS to investor owned utilities and/or (ii) FEMA denies reimbursement of all or a portion of certain Major Storm Costs or Non-Storm Emergency Expenditures incurred by the Service Provider on grounds that actions taken by the Service Provider were in violation of FEMA standards for reimbursement and such denial becomes final, the Service Provider’s liability (in amounts not treated as Pass-Through Expenditures) will be up to (x) \$5 million in each of Contract Year 2014 and 2015 and (y) \$10 million in each Contract Year after 2015, in each case in the aggregate for Major Storm Costs and Non-

Storm Emergency Expenditures; provided that the Service Provider will have no such liability for the relevant Contract Year in the event LIPA exercises its termination right set forth in clause (i)(B) under the caption “LIPA’s Termination Right” below. A “Major Storm Event” shall mean a storm event of significant magnitude such that costs incurred related thereto would have been subject to DPS review had LIPA been an investor owned utility.

*Default Budget*

If a Budget has not been approved by the beginning of a Contract Year, the approved Budget for the preceding Contract Year (as amended) as adjusted for inflation will remain in effect until such time as a Budget for that Contract Year is approved (such Budget, a “Default Budget”). Expenditures made in accordance with a Default Budget, and any related Excess Expenditures, will be treated the same way as any expenditures made in accordance with an approved annual Budget.

*DPS Filing Not Required*

The Service Provider’s exercise of any flexibility regarding Budgets and expenditures set forth in each item under the caption “Effect of Budgets” will not require a filing with the DPS except as the DPS may otherwise require in connection with its review of Major Storm Costs or Non-Storm Emergency Expenditures.

*No Obligation to Pay Unbudgeted or Unfunded Amounts*

The amended OSA will provide that notwithstanding the flexibility regarding Budgets and expenditures and provisions regarding storm costs and Non-Storm Emergency Expenditures set forth in each item under the caption “Effect of Budgets”, the Service Provider shall have no obligation or responsibility to pay any costs or expenditures (including Pass-Through Expenditures) to the extent the amounts are not budgeted or are not available for withdrawal from the Operating Account or Storm Reserve, as applicable. Matters set forth under the caption “Effect of Budgets” will be deemed to be with respect to a Budget.

**DPS Review**

The OSA and relevant statutes will be amended to provide for review of Consolidated LIPA Budgets and related rate plans, and certain amendments thereto, by the DPS and recommendations by the DPS to the LIPA Board with respect to reviewed items.

The adoption of New York State legislation that is in substantially the form of Program Bill #6 proposed by the Governor on May 13, 2013 and is ultimately mutually satisfactory to the Parties will be a condition precedent to the effectiveness of the amended OSA.

**Compensation**

The realignment of the relationship between the Service Provider and LIPA will result in the Service Provider assuming a greater role and responsibility to operate, maintain and manage the T&D System than now provided in the OSA. In addition, the Service Provider will be providing the use of its name and brand which have important reputational value,

assuming greater operational (and potential financial) risks than currently envisioned, and providing further value to customers through efficiency and other expected cost savings, all of which are expected to result in considerable value to LIPA and its customers. Accordingly, the Parties agree that it is appropriate to equitably adjust the Service Provider's existing compensation arrangements under the OSA as described below.

The Management Services Fee will continue to consist of the fixed fee component and the incentive compensation component.

For Contract Years 2014 and 2015 as operating efficiencies are achieved and phased in, the Service Provider's compensation will remain the same as currently provided in the OSA.

Beginning for the 2016 Contract Year, the annual fixed compensation component will be increased to \$58 million (from \$36.3 million), and the annual Incentive Compensation Pool, from which the Incentive Compensation will be paid, will be increased to \$8.7 million (from \$5.44 million), which amounts will be in 2011 Dollars escalated by CPI as currently provided in the OSA.

As under the current OSA, the Service Provider will be eligible to earn Incentive Compensation each year from the Incentive Compensation pool based on the Service Provider's favorable performance relative to Performance Metrics set forth in the OSA. The Performance Metrics will be streamlined to include fewer metrics, but will continue to include the core principles of budget compliance, reliability and customer satisfaction.

## **Termination/Expiration**

### *LIPA's Termination Rights*

LIPA will have the right to terminate the amended OSA (i) if the Service Provider, for two Contract Years of a consecutive three year Contract Year period, fails to meet minimally acceptable performance levels for providing electric service consistent with sound fiscal and operating practices with respect to (A) Cost Management, Service Reliability and Customer Satisfaction, or (B) Major Storm Performance metrics related to storm monitoring and preparation, execution of damage assessment procedures, outage response and restoration time, and communication with critical life support customers, the general public and other emergency responders, or (ii) as currently provided in the OSA, in the event of a Change of Control, Municipalization or Privatization. LIPA's sole remedy in the case of the events under clause (i) above shall be such termination rights.

### *Service Provider's Termination Rights*

The Service Provider will have the right to terminate the amended OSA in the event of (a) Privatization (except if the Service Provider or its Affiliate is the counterparty to the Privatization or enters into a replacement agreement with the successor owner to operate the T&D System or LIPA), or (b) Municipalization, subject in each case to a reasonable period for Back-End Transition Services (which period will be set forth in the amended OSA), or (c) a Change in Regulatory Law.

In the amended OSA, a "Change in Regulatory Law" shall mean a change,

amendment or modification (collectively, a “change”) to the Public Service Law, adoption of or a change to any other New York state (or federal, in the case of clause (iv) below) law or any adoption of, or change to, any interpretation (having the force of law) of or regulation or regulatory action under the foregoing, in each case that occurs on or after the date of execution of the amended OSA and that (i) alters the scope, nature or level of the DPS statutory oversight and review authority over the Service Provider or LIPA in a manner which materially and adversely affects the Service Provider’s ability to perform its obligations under the amended OSA, (ii) renders unenforceable or invalid, in whole or in part, any material provision of the amended OSA, (iii) subjects ServCo or PSEG Long Island LLC (or any of their Affiliates that provides services pursuant to the amended OSA) to rate or other substantive regulation by the DPS or other state utility commission or (iv) leads to or results in the Federal Energy Regulatory Commission (“FERC”) asserting jurisdiction (A) with respect to the amended OSA or any rate schedule related thereto or (B) over ServCo or PSEG Long Island LLC (or any of their Affiliates that provides services pursuant to the amended OSA) by reason of its use, management or operation of transmission or generation assets of LIPA.

If the Service Provider exercises a Change in Regulatory Law termination right under clause (i), (ii) or (iv) above, during the Service Provider Termination Notice Period (as defined below) the Service Provider shall be deemed to have satisfied any Performance Metrics affected by the Change in Regulatory Law and any costs of the Service Provider relating to such Change in Regulatory Law shall be treated as Pass-Through Expenditures (subject to cost substantiation). Prior to the commencement of the Service Provider Termination Notice Period for termination under clause (ii) above, the Parties will, for a reasonable cure period to be set forth in the amended OSA, negotiate in good faith to restructure the OSA in a manner that would keep the Service Provider in the same position as it would have been in without regard to the relevant Change in Regulatory Law. The Service Provider Termination Notice Period will commence at the expiration of such reasonable cure period unless otherwise agreed upon by the Parties.

If the Service Provider exercises a Change in Regulatory Law termination right under clause (iii) above, the amended OSA will automatically terminate and the Termination Date will be one day prior to the effectiveness of such Change in Regulatory Law unless such termination is waived in writing by the Service Provider.

Each Party shall be required to notify the other Party upon becoming aware of a prospective adoption of or change to law, regulation or regulatory action that, if effected, is reasonably likely to result in any Change in Regulatory Law.

#### *Service Provider’s Termination Fee*

The Service Provider will be entitled to a termination fee (the “Termination Fee”) payable by LIPA upon early termination of the amended OSA (i) by LIPA due to a Privatization or Municipalization or (ii) by the Service Provider for an Event of Default by LIPA, Privatization or Municipalization, or a Change in Regulatory Law (other than for the reason

set forth above in clause (iv) under the caption “Service Provider’s Termination Rights”).

The amount of the Termination Fee (whether payable before, in, or after the Contract Year 2016) shall be equal to the maximum amount of Management Services Fee (including the fixed and Incentive Compensation components) payable for Contract Year 2016 (in 2011 Dollars escalated by CPI). Commencing in the Contract Year 2021, the Termination Fee will be subject to a reduction of 10% for each Contract Year after 2020 so that by Contract Year 2025 the Termination Fee amount will be equal to 50% of the amount otherwise payable. The Termination Fee will be in addition to the amounts otherwise payable by LIPA under Section 7.4(C)(1).

*Termination Notice Periods*

The amended OSA shall provide that the Termination Notice Period shall be no longer than 12 months. The period from the date a termination notice is issued by the Service Provider (for any reason other than for a Change in Regulatory Law described in clause (iii) under the caption “Service Provider’s Termination Rights”) until the Termination Date (the “Service Provider Termination Notice Period”) shall be subject to a reasonable period for Back-End Transition Services, which period will be set forth in the amended OSA. Upon the commencement of the Termination Notice Period or the Service Provider Termination Notice Period, LIPA shall promptly initiate efforts to find a successor service provider as promptly as practicable.

**Term; Option to Extend**

The Term of the amended OSA will be extended by two years and shall therefore expire on December 31, 2025. Moreover, if the Service Provider has achieved an agreed upon high levels of performance with respect to customer satisfaction, operating efficiencies and other agreed metrics during the contract period, the Parties will commit to negotiate in good faith to extend the Term of the amended OSA on substantially similar terms and conditions for an additional 8 years.

**Letter Agreement**

The terms and conditions set forth in the letter agreement dated as of June 22, 2012, between LIPA and PSEG Long Island LLC, will be reflected in the amended OSA as the Parties agree to be appropriate.

**Conditions to Effectiveness**

The effectiveness of the amended OSA will be further contingent upon (a) satisfactory completion and resolution, in the Service Provider’s sole discretion, of the Service Provider’s regulatory analysis in jurisdictions outside New York, including a disclaimer of jurisdiction from the FERC over ServCo, PSEG Long Island LLC and any Affiliate of the Service Provider providing management or operation services associated with LIPA’s electric transmission system under the amended OSA and (b) LIPA obtaining a favorable private letter ruling from the Internal Revenue Service satisfactory to LIPA in its sole discretion, to the effect that the amended OSA is a “Qualified Management Contract” or will not cause the portion of the facilities and property financed by LIPA’s tax exempt bonds to be used for private business purposes under Section 141(b) of the Internal Revenue Code.