

June 4, 2018

Re: The Potential Transformation of the Puerto Rico Electric Sector

## **I. INTRODUCTION**

In January 2018, the Government of Puerto Rico announced its intent to transform and modernize the electric system through private ownership or operation of the assets of the Puerto Rico Electric Power Authority (“PREPA”). The transformation could take a variety of forms including a concession or management agreement for the transmission and distribution (“T&D”) system, a sale, lease or concession of certain PREPA-owned generation assets or other similar structures and could entail a single or a series of transaction(s). PREPA is currently a vertically-integrated utility serving approximately 1.5 million customers across Puerto Rico. The Government of Puerto Rico, the Financial Oversight and Management Board (“Oversight Board”) and PREPA have identified certain key objectives that will be considered as part of this transformation process including, without limitation, delivering low-cost electricity to ratepayers of Puerto Rico, increasing energy resiliency and reliability, deploying new technologies, investment and financial strength and exercising industry best-practices and operational excellence.

Citigroup Global Markets Inc. (“Citi”) and Rothschild & Co. (“Rothschild”) have been retained as financial advisors in connection with any potential transaction(s). Citi and Rothschild are pleased to announce the solicitation of market feedback from parties interested in participating in any potential transaction(s). This letter (“Letter”) outlines the questions and protocols that will be followed for this stage of the transformation process.

## **II. AVAILABLE INFORMATION**

Enclosed with this Letter is a high-level overview of the PREPA opportunity and proposal process. In addition to these materials, interested participants may also refer to the PREPA Fiscal Plan and to Chapter 10 of the New Fiscal Plan for Puerto Rico, in each case as certified by the Oversight Board in April 2018, for certain additional information relevant to the transaction(s). Copies of these documents can be found at <https://juntasupervision.pr.gov/index.php/en/fiscalplan/>.

## **III. INTERESTED PARTY FEEDBACK**

Citi and Rothschild are seeking written responses from parties that are interested in participating in potential transaction(s). In addition to responses to questions set forth herein, respondents should communicate clearly any / all preferences with respect to business lines (generation vs. T&D, etc.), transaction structure, regulation, etc.

### ***General Questions***

- Please describe your initial view on the opportunity to participate in a transaction(s) with PREPA.
- Please describe your view of how the electric sector in Puerto Rico can best be transformed.
- Does the proposed approach of a T&D concession and a sale of generation represent the best way to transform the electric sector in Puerto Rico or should we consider other options? And, if not, what other options would you put forth for consideration as a potential best path forward?
- What do you find appealing / unappealing about the transaction structure set forth in the “base case” above?

### Regulatory Structure Questions

- Please present your views regarding the structure and authority of the Puerto Rico Energy Commission (“PREC”). Please be as specific as possible including naming the features you consider important.
- Should the concession / operator agreement (including rates for compensation and recovery of capital investments between the T&D concessionaire / operator and the Government of Puerto Rico) be approved by PREC?
  - What key items should be included in that concession / operator agreement?
- What, in addition to standard items (see below), should the regulator have authority to approve? Please provide an explanation for your answer
  - IRP, capital structure, allowed return, budgets, major capital projects, performance metrics, incentives / penalties, RPS compliance
- Do you have a view on when rates and the IRP should be filed and reviewed (e.g., every 3 years)?
- What sort of rate “tools” should be available to the regulator (e.g., formula rates)?
- What sort of public policies should the regulator adopt regarding renewable power, distributed energy resources and energy efficiency?
- Should the pass through of generation costs be subject to a prudence standard and only allowed if the costs are deemed prudent?
- Should there be performance metrics including incentives and penalties for generation functions and, if so, who should design and enforce those metrics? For example, should these metrics be negotiated with the generator or set out through a rulemaking?
- What role should PREC have in terms of new generation projects? Should the regulator approve new generation projects and, if so, under what review standard?
- Should the regulator have the authority to approve the sale or disposition of generators and, if so, under what review standard?

### T&D Questions

- Please describe your initial view on the opportunity to participate in a concession or other arrangement for PREPA’s T&D system.
- Please describe your interest in participating in a concession or similar arrangement for PREPA, where you would provide the T&D and customer care functions (e.g. billing, collection and information services) of the electric utility in Puerto Rico subject to a long-term concession or similar contract.
  - Would a structure where you are able to earn a regulated return on capital expenditures be the preferred compensation structure? If not, please describe the preferred method of compensation that would be received for your role as concessionaire / operator. Please include details around your desired compensation structure (e.g. authorized return on equity, authorized capital structure, mechanisms for incentive payments, etc.)
  - What contract term length / renewal policy would you be comfortable with in the context of such an arrangement?
  - Are there specific reasons a long-term concession / management structure may not work for you?
- Please describe your views on the post-transaction structure of PREPA.
  - Do you have a view on a potential sale or lease of the PREPA-owned generation assets to an unaffiliated third-party, including the identity of a potential buyer(s), length of offtake agreement(s), which assets are retired vs. sold and willingness to retain assets by T&D owner / operator slated for reliability reserve margins or potential retirement?
  - Do you have a view on whether the T&D owner and concessionaire / operator should or should not be legally excluded from owing generation assets?
  - Do you have a view on the integration into the utility system of existing and new distributed energy resources as well as microgrids?

- Please describe your appetite for grid modernization capital investment (in an approximate annual dollar amount) as well as the associated financing plan.
  - To what extent, if any, will the provision (or lack thereof) of federal restoration funds to PREPA affect your investment appetite?
- Please provide your thoughts on strategies for how you think legacy obligations should be managed, including debt service, pensions, collective bargaining agreements and environmental.
  - Please provide your preliminary views of the treatment of the current collective bargaining agreements / employees in a transaction(s).
  - Please provide your preliminary views of the treatment of pensions in a transaction(s).
  - Please provide your preliminary views of the treatment of any environmental liabilities in a transaction(s).
- Please describe the key due diligence items that would be necessary in order to be in a position to make a binding proposal. Are there any items that uniquely apply to this process?
- Please describe your initial views on the optimal generation fuel mix for Puerto Rico.
- Are there timing considerations that would influence your ability to participate in such a transaction(s)?
- Would you envision seeking a partner(s) for such a transaction(s)?

### Power Generation Questions

- Please describe your initial view on the opportunity to participate in a transaction(s) to acquire (by sale, lease, concession or otherwise) all or a portion of PREPA's generation fleet.
  - Would you be interested acquiring all or only a subset of the existing generation assets?
  - To the extent that it is deemed optimal to divest all PREPA-owned generation assets to a single party, would this negatively affect your view of the opportunity?
  - To what extent does your view of the transaction(s) related to generation depend on the ultimate concessionaire chosen as part of the T&D transformation process and / or the terms of the concession agreement?
- The eventual owner(s) of the generation assets would be expected to enter into long-term power purchase and operating agreements. Please describe the ideal structure for such contracts, including desired tenor, compensation structure, counterparty (PREPA vs. Concessionaire), etc.
- Please describe your initial views on the optimal generation fuel mix for Puerto Rico and to what extent, if any, these views will be dictated by the ongoing Integrated Resource Plan ("IRP") as opposed to internal due diligence.
- Please describe your appetite for investing in new generating facilities and / or other ongoing investments
  - Would you be willing to compete in generation request for proposals in alignment with a publicly stated IRP?
  - What generation fuel type would you be interested in investing in?
- Please describe the key due diligence items that would be necessary in order to be in a position to make a binding proposal to acquire existing generation. Are there any items that uniquely apply to this process?
- Are there timing considerations that would influence your ability to participate in such a transaction(s)?
- Please describe how you would approach any potential environmental liabilities / decommissioning responsibilities at the facilities.
- Please provide your preliminary views of the treatment of the collective bargaining agreement / employees in a transaction(s).

#### **IV. PARTICIPANT RESPONSE PROTOCOL**

Citi and Rothschild request that parties wishing to participate in the solicitation of feedback concerning the potential transformation of the electric sector submit written responses no later than June 18, 2018 at 12:00pm ET. Any submissions received after that date may be considered but also may not be reviewed at our discretion. Written submissions will only be accepted via email and should be submitted on a confidential basis to both [prepa.opportunity.feedback@citi.com](mailto:prepa.opportunity.feedback@citi.com) and [prepa.opportunity.feedback@rothschild.com](mailto:prepa.opportunity.feedback@rothschild.com). Under no circumstances should PREPA, the local Puerto Rican or Federal Government, the Oversight Board or any of their affiliates be contacted directly, nor should any responses to this Letter be posted publicly.

In addition to the written answers, please let us know if you would like to have the opportunity to further discuss your feedback directly with Citi and Rothschild. Citi and Rothschild intend to consider all feedback received in this process, whether or not such feedback is supplemented by a further meeting or discussion.

Please note that the solicitation of feedback in no way constitutes an offer to take part in a transaction(s) or in the transformation of the electric sector. The ultimate transformation process will be run in accordance with the relevant legislation passed by the Legislative Assembly of Puerto Rico and the pending PREPA Title III case. Any and all attempts to circumvent the processes established herein, or those processes that may be established as part of the ongoing legislative and judicial proceedings, may result in the disqualification of the transgressing party from continued participation in the transformation of the Puerto Rico electric sector. This market sounding exercise does not commit the Government of Puerto Rico, PREPA or the Oversight Board to enter into a contract with any interested market participant or proceed with a transformation process as described herein. Participants in this feedback solicitation will not be given any preference in future phases on this transformation process.

#### **V. PRELIMINARY TRANSFORMATION PROCESS TIMELINE**

Citi and Rothschild, in consultation with key process stakeholders, have developed a preliminary timeline for the completion of the transformation process. This timeline is only indicative and may be subject to change. This timeline, as well as a brief summary of the key components of each phase of the process, is as follows:

- i. Market Sounding (Q2 2018)
  - Invite market participants to provide feedback on the proposed privatization process
  - Receive written feedback, which will be considered and potentially incorporated into the transaction process
- ii. Request for Qualifications (“RFQ”) Process (Q3 2018)
  - RFQ materials, requirements and procedures published publicly
  - RFQ responses received and evaluated according to defined / commonly accepted standards
  - Qualified parties notified and admitted into the next phase (RFP phase)
- iii. Request for Proposals (“RFP”) Process (Q3 2018 – Q2 / Q3 2019)
  - RFP process materials are published to participating parties
  - Detailed due diligence inclusive of Q&A, site visits and access to relevant subject matter experts
  - Distribution of definitive documentation (e.g. Concession Agreement, etc.)
  - Evaluation of RFP responses and negotiation of definitive documentation
  - Selection of winning RFP and, to the extent applicable, approvals obtained from the various authorities
- iv. Closing Period (Q3 / Q4 2019)
  - Completion of all relevant closing procedures

Citi and Rothschild reserve the right to make adjustments to the preliminary timeline based on responses provided as part of this solicitation of feedback, or for any other reason deemed prudent to the successful completion of the transformation process.

## **VI. CONCLUSION**

Citi and Rothschild look forward to receiving market feedback related to the potential transformation of PREPA. On behalf of the Government of Puerto Rico, the Oversight Board, PREPA and all other stakeholders, we would like to thank you for your interest in this opportunity and look forward to your response.

This letter (the "Letter") and associated presentation (the "Presentation," and collectively with the Letter, the "Materials") are being posted publically, but intended for a limited number of parties who, it is believed, may be interested in participating in the transformation of the Puerto Rico electric sector (the "Transaction") through private ownership or operation of the assets of the Puerto Rico Electric Power Authority ("PREPA" or the "Company"). These Materials are furnished solely for the purpose of evaluating the transaction described hereby.

Citigroup Global Markets Inc. ("Citi") as the financial advisor to the Financial Oversight and Management Board (the "Oversight Board") and Rothschild Inc. ("Rothschild" and together with Citi, the "Advisors") as financial advisor to the Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF" and together with the Oversight Board, the "Clients") are acting as Advisors in connection with the potential Transaction.

The Materials has been prepared based on information provided by the Company. The Advisors have not conducted any investigation with respect to such information, and each of the Advisors, the Clients and the Company expressly disclaim any and all liability for representations, expressed or implied, contained in, or for omissions from, these Materials or any other written or oral communication transmitted to any interested party in the course of its evaluation of the Transaction. Only those particular representations and warranties that may be made by the Company in a definitive written agreement, when and if one is executed, and subject to such limitations and restrictions as may be specified in such agreement, shall have any legal effect.

In addition, these Materials may include certain statements provided by the Company with respect to the Company's historical and anticipated performance. Estimates of future performance reflect various assumptions made by the Company that may or may not prove accurate, as well as the exercise of a substantial degree of judgment by management as to the scope and presentation of such information. No representations or warranties are made as to the accuracy of such statements or estimates of anticipated performance. Actual results achieved during projection periods may differ substantially from those projected.

These Materials shall remain the property of the Company.

These Materials does not constitute an offer or invitation for the sale or purchase of the securities, assets or business described herein and shall not form the basis of any contract.