

**Puerto Rico Electric Power Authority
Public-Private Partnerships Authority Title III Transformation White Paper**

February 1, 2019

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I. EXECUTIVE SUMMARY

This White Paper details the ongoing debt restructuring efforts of the Puerto Rico Electric Power Authority (“PREPA”) under Title III of the *Puerto Rico Oversight, Management, and Economic Stability Act* (“PROMESA”).¹ The purpose of this document is to provide a summary of the Title III process to parties participating in the request for proposals (“RFP”) process in order to prepare and submit proposals to maintain, rehabilitate, repair, refurbish, replace, improve, expand, as needed, and finance Puerto Rico’s electric power transmission and distribution system (the “T&D System”) pursuant to a long-term contract (the “Partnership Contract”). This White Paper is prepared for informational purposes only and does not purport to be all-inclusive or to contain all the information that a party may desire in investigating the potential transaction. The statements contained in this White Paper are made as of the date hereof, and there can be no assurance that the statements contained herein will be correct at any time after the date hereof.

II. TITLE III BACKGROUND

A. Significant Events Leading Up To PREPA’s Title III Filing.

PREPA was created in 1941 as a public corporation and governmental instrumentality of the Commonwealth of Puerto Rico (“Puerto Rico” or the “Government”) by Act No. 83 of the Legislative Assembly of Puerto Rico, approved May 2, 1941, as amended. PREPA generates, transmits, and distributes substantially all the electric power used in Puerto Rico. PREPA is one of the largest municipal utilities in the United States, ranking first in number of clients and revenues among public power utilities.

Prior to the Title III filing, PREPA faced historical challenges that resulted in degradation of its infrastructure and a dramatic deterioration of its financial and operating condition. The challenges included: (i) a prolonged recession leading to a significant drop in energy sales; (ii) legal requirements to provide power to certain customers at subsidized rates; (iii) relatively high levels of theft and other non-technical losses; (iv) inadequate capital investment leading to old, inefficient, and unreliable transmission, distribution, and generation facilities and outdated information and technology systems; (v) a high dependence on fuel oil and a non-diversified fuel mix; (vi) a lack of a strategic environmental compliance plan; (vii) a disorganized and ineffective customer service infrastructure; (viii) material operating liabilities; and (ix) a significant debt burden leading to a debt crisis.

PREPA’s obligations can be divided broadly into two categories: financial indebtedness and other material liabilities. PREPA’s financial obligations are composed of approximately \$8.3 billion in principal amount of power revenue bonds. Approximately \$2.25 billion in principal amount of PREPA’s bonds are insured by “monoline” bond insurers. PREPA’s financial obligations are also comprised of (i) approximately \$700 million in principal amount under two matured fuel

¹ PROMESA is codified at 48 U.S.C. §§ 2101-2241.

line loans; and (ii) approximately \$52.2 million notional amount under two interest rate swaps.² PREPA’s material non-financial liabilities fall into six primary categories: (i) accounts payable; (ii) obligations under collective bargaining agreements; (iii) pensions and other post-employment benefits; (iv) fuel, purchased power and obligations under renewable energy contracts; (v) environmental liabilities and litigation; and (vi) contingent or unliquidated litigation liabilities.

B. Title III Overview.

1. PROMESA.

Recognizing the delicate fiscal condition of Puerto Rico, the U.S. Congress enacted PROMESA, which was signed into law on June 30, 2016. PROMESA provides a series of mechanisms to achieve fiscal and budgetary balance and restore access to the capital markets to spur revitalization of the infrastructure in Puerto Rico.

PROMESA established the Financial Oversight and Management Board for Puerto Rico (the “FOMB”), which is tasked with working with the people of Puerto Rico and the Government to create the necessary foundation for economic growth. The FOMB consists of seven members appointed by the President of the United States and one *ex officio*, non-voting member designated by the Governor of Puerto Rico.

On January 18, 2017, the Puerto Rico Legislature adopted the *Enabling Act of the Puerto Rico Fiscal Agency and Financial Advisory Authority*, Act 2-2017, which created the Puerto Rico Fiscal Agency and Financial Advisory Authority (“AAFAF”) and gave AAFAF sole governmental responsibility for (i) working with the FOMB and (ii) restructuring public debt to present a “coordinated and global” response to Puerto Rico’s unprecedented fiscal crisis. Act 2-2017 § 2. Act 2-2017 established AAFAF as the “fiscal agent, financial advisor, and reporting agent of all entities of the Government of Puerto Rico” and designated AAFAF as the exclusive governmental entity responsible for “collaboration, communication, and cooperation” between the FOMB, see Act 2-2017 § 5(a), and Puerto Rico’s governmental entities.

2. Key Provisions of PROMESA.

a. Fiscal Plans and Budgets.

One of the cornerstones of PROMESA is the development, approval, and enforcement of fiscal plans and budgets for the Commonwealth and its covered instrumentalities.³ Such fiscal plans and budgets provide a framework for achieving fiscal responsibility and access to the capital markets. Fiscal plans are long-term planning tools, covering five or more fiscal years, while

² As of the date of PREPA’s Title III filing, PREPA had an additional financial obligation of approximately \$35 million in principal amount outstanding on a collateral line of credit from the Government Development Bank for Puerto Rico (“GDB”). On November 7, 2018, the United States District Court for the District of Puerto Rico approved a qualifying modification for GDB under Title VI of PROMESA. Pursuant to the qualifying modification, PREPA’s deposit claims against GDB were offset against this obligation resulting in the obligation’s full extinguishment.

³ See PROMESA §§ 201–204.

budgets cover at least one fiscal year.⁴ Annual budgets must be consistent with the fiscal plan then in effect.⁵

PROMESA contemplates that the FOMB and Puerto Rico's elected government will work together to adopt a fiscal plan.⁶ The process begins with the FOMB providing the Governor with a schedule for the development, submission, and approval of fiscal plans for the Commonwealth and any covered instrumentality.⁷ The Governor is then required to submit the proposed fiscal plan in accordance with such schedule.⁸ Following submission, the FOMB may certify the proposed fiscal plan if it determines that the fiscal plan meets 14 statutory requirements set forth in PROMESA, which are designed to "provide a method to achieve fiscal responsibility and access to the capital markets."⁹

b. **Adjustment of Debts.**

PROMESA provides the Government and its instrumentalities with two alternative methods to adjust unsustainable debt: (i) a voluntary debt modification process under Title VI of PROMESA, a largely out-of-court process through which modification of financial debt can be accepted by a supermajority of creditors; and (ii) a quasi-bankruptcy proceeding under Title III of PROMESA, an in-court debt restructuring process substantially based upon incorporated provisions of the Bankruptcy Code.

PROMESA requires a debtor to work with the FOMB in any debt restructuring and divides the debtor's authority by putting key restructuring tools in the hands of the FOMB, while preserving the elected government's operational control and voice in management and strategic decisions. PROMESA section 303 reserves the territory's political and governmental powers to the territory or "any territorial instrumentality thereof," subject only to Titles I and II.¹⁰ The structure established by Titles I and II, alongside the reservation of territorial power in section 303, requires the FOMB and the territorial government to work together to establish a fiscally responsible path forward that is acceptable to the FOMB. Additionally, PROMESA section 305 is modeled after Bankruptcy Code section 904 and prevents the Title III Court from interfering with the Government's exercise of its political or governmental powers and use of its property and revenues, subject to the FOMB's consent as the debtor's representative under Title III.¹¹

⁴ See PROMESA § 201.

⁵ See PROMESA § 202.

⁶ See PROMESA § 201(c).

⁷ See PROMESA § 201(a).

⁸ See PROMESA § 201(c)(2).

⁹ PROMESA § 201(b)(1).

¹⁰ See PROMESA § 303.

¹¹ See PROMESA § 305.

3. Commencement of the Commonwealth's Title III Case.

At a meeting on September 30, 2016, the FOMB designated the Commonwealth as an initial covered entity subject to oversight under PROMESA. On May 3, 2017, the FOMB filed a petition for relief for the Commonwealth pursuant to PROMESA section 304(a), thereby commencing a case under Title III of PROMESA in the United States District Court for the District of Puerto Rico (the "Title III Court").¹² Pursuant to PROMESA section 315 (48 U.S.C. § 2175), the FOMB serves as the Commonwealth's representative in its Title III case, Case No. 17 BK 3283-LTS (D.P.R. 2017).

Pursuant to PROMESA, the Chief Justice of the Supreme Court of the United States appointed District Court Judge Laura Taylor Swain from the Southern District of New York to preside over the Title III cases filed in the Title III Court. On June 1, 2017, the Title III Court entered an order granting the joint administration of the Title III cases that had been filed to date for procedural purposes only.¹³

C. Overview of PREPA's Title III Case.

1. Commencement of PREPA's Title III Case.

At a meeting on September 30, 2016, the FOMB designated PREPA as an initial covered entity subject to oversight under PROMESA. On July 2, 2017, the FOMB filed a petition for relief for PREPA pursuant to PROMESA section 304(a), thereby commencing a case under Title III of PROMESA in the Title III Court.¹⁴ Pursuant to PROMESA section 315 (48 U.S.C. § 2175), the FOMB serves as PREPA's representative in its Title III case, Case No. 17 BK 4780-LTS (D.P.R. 2017). On October 6, 2017, the Title III Court extended the joint administration order to cover PREPA's Title III case. Upon commencement of PREPA's Title III case, an automatic stay of litigation related to the financial indebtedness and other obligations of PREPA immediately went into effect, which affords PREPA and its officers protection while PREPA continues efforts to negotiate with its creditors to adjust its debts.

¹² All filings in the Commonwealth Title III case, and the related adversary proceedings, are available at: <https://cases.primeclerk.com/puertorico/>.

¹³ The debtors in the jointly-administered Title III cases, along with each debtor's respective Title III case number listed as a bankruptcy case number due to software limitations and the last four (4) digits of each debtor's federal tax identification number, as applicable, are: the (i) Commonwealth of Puerto Rico (Bankruptcy Case No. 17 BK 3283-LTS) (Last Four Digits of Federal Tax ID: 3481); (ii) Puerto Rico Sales Tax Financing Corporation ("COFINA") (Bankruptcy Case No. 17 BK 3284-LTS) (Last Four Digits of Federal Tax ID: 8474); (iii) Employees Retirement System of the Government of the Commonwealth of Puerto Rico ("ERS") (Bankruptcy Case No. 17 BK 3566-LTS) (Last Four Digits of Federal Tax ID: 9686); (iv) Puerto Rico Highways and Transportation Authority ("HTA") (Bankruptcy Case No. 17 BK 3567-LTS) (Last Four Digits of Federal Tax ID: 3808); and (v) Puerto Rico Electric Power Authority ("PREPA") (Bankruptcy Case No. 17 BK 4780-LTS) (Last Four Digits of Federal Tax ID: 3747) (collectively, the "Debtors").

¹⁴ All filings in the PREPA Title III case, and the related adversary proceedings, are available at: <https://cases.primeclerk.com/puertorico/>.

On August 1, 2018, the FOMB certified, pursuant to PROMESA section 201(e)(2), a revised version of the fiscal plan for PREPA as developed by the FOMB, pursuant to PROMESA section 201(d)(2). On September 30, 2018, the FOMB issued a compliance certification to the Governor that the fiscal year 2019 budget for PREPA, as developed by the FOMB pursuant to PROMESA section 202(c)(2), is a compliant budget.

2. **Bar Date.**

On February 15, 2018, the Title III Court entered an order establishing May 29, 2018 at 4:00 p.m. (AST) as the general bar date to file proofs of claim (as defined in Bankruptcy Code section 101(5)) against the Debtors on account of claims arising, or deemed to have arisen, prior to the respective commencement dates for their Title III cases, and otherwise setting forth rules and procedures relating to proofs of claim (the “Bar Date Order”). On May 25, 2018, the Title III Court entered an Order extending the claim bar date to June 28, 2018 at 4:00 p.m. (AST). As of June 28, 2018, 101 proofs of claim were filed in PREPA’s Title III case, with a total amount claimed of \$208,473,805.23.¹⁵

3. **Post-Petition Financing Agreement.**

On February 22, 2018, PREPA, as borrower, and the Commonwealth, as lender, entered into that certain Superpriority Post-Petition Revolving Credit Loan Agreement (the “Loan Agreement”), whereby the Commonwealth agreed to provide PREPA with revolving loans in an aggregate principal amount not to exceed \$300 million, bearing interest at 5% per annum (the “Post-Petition Financing”).

In connection with the Post-Petition Financing, the Commonwealth was granted an allowed, superpriority, administrative expense claim pursuant to Bankruptcy Code section 364(c)(1) in PREPA’s Title III case for all obligations arising under the Loan Agreement. “Eligible Uses” of the proceeds of the Post-Petition Financing are limited to “Current Expenses” under the Trust Agreement, dated as of January 1, 1974, as amended and supplemented, between PREPA and U.S. Bank National Association as successor Trustee (the “Trust Agreement”). As such, the order provides that PREPA’s repayment obligations to the Commonwealth for amounts borrowed under the facility are treated as “Current Expenses” under the Trust Agreement.¹⁶ Pursuant to the terms of the Loan Agreement and the legislation authorizing the financing, PREPA’s ability to borrow terminated as of June 30, 2018.

The Loan Agreement provides for a mandatory prepayment of the outstanding loan balance upon PREPA’s receipt of revenues in excess of amounts necessary to (i) pay budgeted

¹⁵ The filed proofs of claim do not include claims for bond debt, fuel line lender debt, or accrued retirement benefits, as those claims were exempted from the proof of claim requirement under the Bar Date Order.

¹⁶ See Order (A) Authorizing Debtor Puerto Rico Electric Power Authority to Obtain Postpetition Financing, (B) Providing Superpriority Administrative Expense Claims, and (C) Granting Related Relief, Case No. 17-BK-3283-LTS, Dkt. No. 2545 at 8.

expenses and (ii) maintain a maximum cash balance of up to \$300,000,000.00. As of the week ending January 18, 2019, \$146.8 million remained outstanding under the Post-Petition Financing.

4. **Preliminary Restructuring Support Agreement (the "Preliminary RSA").**

On July 30, 2018, the FOMB, AAFAF, and PREPA announced they had entered into a Preliminary RSA with an ad hoc group of PREPA bondholders (the "Ad Hoc PREPA Bondholder Group"). The Preliminary RSA contemplated an exchange of the outstanding PREPA bonds for refunding bonds issued by a special purpose vehicle ("SPV") through a PREPA plan of adjustment. Debt service payments on the refunding bonds by the SPV would be funded through a transition charge to be paid by power customers, collected by a servicer (likely the Partnership Contract counterparty), and paid to the SPV. Under the Preliminary RSA, the refunding bonds would be the obligation of the SPV only.¹⁷

At the time the Preliminary RSA was executed, the Ad Hoc PREPA Bondholder Group held approximately 57% of uninsured PREPA bonds representing 41% of the total bonds issued under the PREPA Trust Agreement. Certain additional parties have joined the Preliminary RSA. The monoline insurers and the fuel line lenders are not party to the Preliminary RSA. The outside date under the Preliminary RSA has been extended to February 12, 2019. The parties are continuing to negotiate a comprehensive Restructuring Support Agreement for the consensual restructuring of at least the uninsured bond debt under a Title III plan of adjustment (see below).

5. **Significant Litigation In Connection With PREPA's Title III Case.**

PREPA is, or was, a defendant, co-defendant, or respondent in various lawsuits brought as adversary proceedings or contested matters within its Title III case. The following lawsuits and contested motions do not comprise an exhaustive list of all pending litigation.

- a. *Motion of Ad Hoc Group of PREPA Bondholders, National Public Finance Guarantee Corporation, Assured Guaranty Corp., Assured Guaranty Municipal Corp., and Syncora Guarantee Inc. For Relief from the Automatic Stay to Allow Movants to Enforce their Statutory Right to Have a Receiver Appointed, Case No. 17-4780 (D.P.R. July 18, 2017)*

On July 18, 2017, a group of PREPA bondholders and bond insurers filed a request for relief from the automatic stay to commence an action in Puerto Rico court for the appointment of a receiver.¹⁸ The movants argued that the Title III Court should grant relief from the automatic stay for cause under Bankruptcy Code section 362(d)(1) to allow the movants to enforce certain

¹⁷ A similar charge is contemplated to be established to address PREPA's legacy pension obligations in an amount to be determined under the PREPA title III plan.

¹⁸ See Case No. 17-7480, ECF 74.

rights under Puerto Rico law and pursuant to the PREPA Trust Agreement to install a receiver for PREPA.

On September 14, 2017, the Title III Court entered an order denying the motion for relief from the automatic stay, which the movants appealed. Among other things, the Title III Court found that (i) PROMESA section 305 prohibits the Title III Court from transferring control of PREPA's management and property to a receiver without the FOMB's consent; and (ii) under PROMESA section 306, the Title III Court has exclusive jurisdiction over all the debtor's property, and a grant of relief from the stay to permit movants to seek the appointment of a receiver would require the Title III Court to cede that jurisdiction to another court.¹⁹

On August 8, 2018, the First Circuit reversed and remanded the issue back to the Title III Court for further proceedings consistent with its opinion.²⁰ The First Circuit held that PROMESA sections 305 and 306 alone do not preclude the Title III Court from, with appropriate findings, granting the movants' request for relief from the automatic stay to commence an action against PREPA to seek the appointment of a receiver. Although sharing the Title III Court's concerns regarding the impact of a robust receivership, the First Circuit reasoned that it might be possible to grant tailored relief for the petitioning creditors to seek a receivership in appropriate circumstances, provided that the receiver's role be limited to specific steps necessary to protect the creditor's collateral. Additionally, the First Circuit held that the exclusive jurisdiction provision of PROMESA section 306(b) keeps the bankruptcy process under the prerogative of the Title III Court, but allows the Title III Court to enlist or permit other courts to take action, which in turn enhances the control given to the Title III Court by PROMESA section 306. Importantly, the First Circuit advised that, on a renewed receiver motion, the Court must assess the prepetition value of the bondholders' collateral (if any security agreements exist).²¹ The First Circuit also ruled the Court must consider "whether the bondholders face a threat of uncompensated diminution in such value, whether the bondholders are seeking the protection of existing collateral or, instead, the creation of new collateral, and what, if any, adequate protection PREPA can offer short of a receiver being appointed to manage it if protection is warranted."²²

On October 3, 2018, National Public Finance Guarantee Corporation, Assured Guaranty Corp., Assured Guaranty Municipal Corp., and Syncora Guarantee Inc. filed a new motion for relief from the automatic stay (discussed below). As of the date hereof, the other movants have not filed a new motion or joined in the insurer's motion.

¹⁹ See Case No. 17-7480, ECF 299.

²⁰ See Appeal No. No. 17-2079, Document No. 00117323983. *In re Fin. Oversight & Mgmt. Bd.*, 899 F.3d 13(1st Cir. 2018)

²¹ *Id.* at 23.

²² *Id.*

- b. *Union de Trabajadores de la Industria Electrica y Riego (“UTIER”) v. Puerto Rico Electric Power Authority, et al., No. 17-00228 (D.P.R. Aug. 7, 2017).*

UTIER, a labor union that represents approximately 3,600 of PREPA’s 6,775 employees, has commenced two adversary proceedings against PREPA.²³ First, UTIER filed a complaint arguing that the appointment of FOMB’s members violated the Appointments Clause of the US Constitution, and, consequently, the FOMB’s acts are null and void, and the Title III cases must be dismissed.²⁴ UTIER alleges that the Appointment Clause, which requires the advice and consent of the Senate for Presidential nominees, conflicts with PROMESA’s procedure for the appointment of members of the FOMB. UTIER alleges that the members of the FOMB are officers of the United States and, therefore, must be appointed in a manner consistent with the Appointments Clause. UTIER further argues that the FOMB should be given particularly close scrutiny given its broad authority.

On August 15, 2018, the Title III Court entered an order upholding the FOMB appointments.²⁵ UTIER appealed to the First Circuit, which heard the appeal on December 3, 2018.²⁶ The First Circuit has not yet issued its decision.

- c. *Union de Trabajadores de la Industria Electrica y Riego (UTIER) v. Puerto Rico Electric Power Authority, et al., No. 17-00229 (D.P.R. Aug. 7, 2017).*

UTIER also filed a complaint against PREPA, the Commonwealth, the FOMB, the Governor of Puerto Rico, PREPA’s Executive Director, AAFAF’s Executive Director, the Secretary of the Treasury, the Director of the Commonwealth’s Office of Management and Budget, and the FOMB’s Executive Director disputing the constitutionality of four Commonwealth employment statutes and the 2017 PREPA fiscal plan and budgets for PREPA, arguing that they “alter, impair, take away without just compensation, or nullify” provisions of the collective bargaining agreement with PREPA related to the accrual and use of vacation and illness days, the mobility and transfer systems, and job classifications and are, therefore, invalid under the Contracts and Takings Clause of the US Constitution.²⁷

²³ See Case Nos. 17-228, 17-229.

²⁴ See Case No. 17-228, ECF 75. In addition to UTIER’s lawsuit, several other lawsuits, outside of PREPA’s Title III proceedings, have been filed similarly challenging the FOMB’s appointment under the Appointments Clause. See “Objection and Motion of Aurelius to Dismiss Title III Petition,” *In re: The Financial Oversight and Management Board for Puerto Rico, as Representative of The Commonwealth of Puerto Rico, et al.*, No. 17-BK-3283-LTS, Dkt. No. 913; *Assured Guaranty Corp.; Assured Guaranty Municipal Corp. v. FOMB, et al.*, No. 18-00087-LTS (D.P.R. July 23, 2018); *Hernandez-Montanez et al. v. Financial Oversight and Management Board for Puerto Rico et al.*, No. 18-00090-LTS (D.P.R. July 25, 2018).

²⁵ See Case No. 17-228, ECF 130.

²⁶ See Appeal No. 18-1787.

²⁷ See Case No. 17-229, ECF 38.

On December 17, 2018, defendants answered the amended complaint, denying its allegations and asserting the following affirmative defenses: (1) lack of subject-matter jurisdiction due to absence of injury; (2) lack of subject-matter jurisdiction due to mootness; (3) lack of subject-matter jurisdiction due to unripeness; (4) no substantial impairment of contract rights; (5) permissible exercise of police power as to alleged contract rights; (6) relief barred by law of the case; (7) failure to state a claim; (8) statute of limitations; (9) laches; (10) PROMESA section 106(e); and (11) PROMESA sections 303 and 305.²⁸ The Title III Court has not scheduled a hearing to consider the matter.

- d. *Puerto Rico Elec. Power Auth., et al. v. P.R. Energy Comm'n, No. 17-00256 (D.P.R. Sept. 5, 2017).*

On PREPA's behalf, AAFAP seeks Title III court review of provisions of the rate orders issued by PREC as *ultra vires*.²⁹ PREPA argues that the rate orders infringe upon the FOMB's authority over fiscal and budgetary matters related to PREPA under PROMESA sections 201-205, as well as infringe upon PREPA's board and management's authority to manage its business and operations, as protected by PROMESA section 303. PREPA also argues that the rate orders conflict with PREPA's obligation to comply with its fiscal plan.

On November 10, 2017, the Instituto de Competitividad y Sostenibilidad Economica de Puerto Rico ("ICSE"), a non-profit educational organization, filed a motion to remand the case to the Puerto Rico Appeals Court and PREC, and to lift stay to allow the rate case to continue in the appellate court and at PREC.³⁰ ICSE argues that, among other things, (i) PREC is the body that implements public energy policy and is the only body with the necessary expertise on rate review; (ii) PREC has committed no *ultra vires* acts; and (iii) the Puerto Rico Court of Appeals is the appropriate forum to adjudicate PREPA's arguments. On March 28, 2018, Judge Swain denied ICSE's motion, and referred the actions to Judge Dein for general pre-trial management.³¹ A joint status report regarding the management of this proceeding is due by February 20, 2019.

- e. *Urgent Motion for Entry of Order Confirming Appointment and Authority of Chief Transformation Officer, Case No. 17-BK-4780-LTS (D.P.R. Oct. 26, 2017).*

On October 26, 2017, the FOMB filed an urgent motion asking the Title III Court to confirm the appointment of a Chief Transformation Officer ("CTO") that would act as the chief executive officer of PREPA and report directly to the FOMB.³² The FOMB argued that it had authority to appoint a CTO as the sole "trustee" for PREPA under PROMESA section 301(c)(7). As "trustee," the FOMB contended that its powers include the power to manage the Debtors' operations when

²⁸ See Case No. 17-229, ECF 72-77.

²⁹ See Case No. 17-256, ECF 1.

³⁰ See Case No. 17-256, ECF 16.

³¹ See Case No. 17-256, ECF 46.

³² See Case No. 17-4780, ECF 361.

necessary to ensure the success of the restructuring process. The FOMB also argued that PROMESA section 315, which authorizes the FOMB to “take any action necessary on behalf of the debtor to prosecute the case of the debtor,” grants it the power to appoint a CTO. Finally, the FOMB argued that it had authority to appoint a CTO under PROMESA section 305 and Bankruptcy Code section 105 because it has consented to the Title III Court exercising its equitable powers with respect to PREPA’s governmental powers.

On November 16, 2017, after noting that the Oversight Board had not asserted that PREPA was non-compliant with a certified fiscal plan or budget, the Title III Court denied the FOMB’s motion, finding “no express provision within PROMESA and its incorporated Bankruptcy Code provisions, nor any inferential grant of power, that authorizes the FOMB to impose changes in structure or reporting lines within PREPA by appointing a CTO, or to exercise the authority of a chief executive officer, much less to delegate that authority to an agent of the FOMB.”³³ The Court noted, among other things, the structure of PROMESA “requires the FOMB and the territorial government to work together to establish a fiscally responsible path forward that is acceptable to the FOMB.”³⁴ The Title III Court also denied other various requests by Ad Hoc Group of PREPA Bondholders, AAFAF, U.S. Bank National Association, the PREPA Governing Board, Assured Guaranty Corp., and Syncora Guarantee Inc. to appoint other forms of emergency managers and co-managers. On November 28, 2017, the FOMB announced in a press release that it would not appeal this decision.

f. *Puerto Rico Elec. Power Auth., et al. v. Puerto Rico Energy Commission (“PREC”), No. 18-00024 (D.P.R. Mar. 13, 2018).*

On PREPA’s behalf, AAFAF seeks to remove to the Title III Court certain actions challenging and seeking review of provisions of the rate orders issued by PREC on November 17, 2017 and March 5, 2018 concerning PREPA’s 2018 fiscal plan.³⁵ The first order requires that PREPA submit to PREC’s authority and oversight regarding the contracting for restoration services, and the second requires PREPA to submit to PREC’s oversight and authority with respect to the 2018 fiscal plan. AAFAF contends that these orders invade the FOMB’s authority over PREPA under PROMESA and infringe on AAFAF’s authority as the exclusive representative of the Governor.

On April 30, 2018, PREC voluntarily dismissed, without prejudice, the cause of action to enforce the March 5, 2018 fiscal plan compliance order.³⁶ The restoration services contract order expired by its terms in May 2018; thus, the remainder of the complaint may be moot. Upon

³³ *Opinion and Order Denying Urgent Motion of FOMB to Confirm Appointment of a Chief Transformation Officer* (Docket Entry No. 361), Case No. 17-BK-4780-LTS, ECF 417 at 19.

³⁴ *Id.* at 19.

³⁵ See Case No. 18-024, ECF 1.

³⁶ See Case No. 18-024, ECF 20.

request by the parties to continue discussions regarding how to proceed with the dispute, the matter has been stayed until February 25, 2019 by order of the Title III Court.³⁷

- g. *Motion of National Public Finance Guarantee Corporation, Assured Guaranty Corp., Assured Guaranty Municipal Corp., and Syncora Guarantee Inc. for Relief from the Automatic Stay to Allow Movants to Enforce Their Statutory Right to Have a Receiver Appointed, Case No. 17-4780 (D.P.R. Oct. 10, 2018).*

On October 3, 2018, National Public Finance Guarantee Corporation, Assured Guaranty Corp., Assured Guaranty Municipal Corp., and Syncora Guarantee Inc. (the “Movants”), filed a new motion seeking relief from the automatic stay to in order to seek appointment of a receiver.³⁸ The movants argue that appointment of a receiver is necessary because, among other things: (i) PREPA’s management is highly politicized and incompetent, which contributed to its fiscal crisis; (ii) PREPA obstructs PREC, its independent regulator; (iii) PREPA has not adequately maintained its generation, transmission, and distribution assets; (iv) PREPA has poor billing and collection practices; and (v) PREPA incentivizes municipalities to consume (and waste) electricity through the Contribution in Lieu of Taxes program. The FOMB, PREPA, and AAFAF (together, “Respondents”) are defending against the motion.

Discovery regarding this motion is presently underway. Movants and Respondents are in discussions regarding the briefing and hearing schedule. We expect the hearing will not occur until April 2019 at the earliest.

III. IMPACT OF TITLE III ON P3 PROCESS

A. Lack of Incorporation of Bankruptcy Code 363 into PROMESA.

PROMESA did not incorporate Bankruptcy Code provisions that would limit a debtor’s ability to use of funds and assets outside of the ordinary course of business. As a result, PROMESA does not prevent PREPA from using its cash, including cash that is part of a secured lender’s collateral. Specifically, Bankruptcy Code section 363(b), which absent court approval restricts a debtor’s use, sale, or lease of property outside the ordinary course of business, does not apply in chapter 9 or under PROMESA. *Compare* 11 U.S.C. § 363(b) with § 901(a) and PROMESA § 301(a) (no incorporation of Bankruptcy Code section 363). Accordingly, PREPA is not required to seek Title III Court approval prior to entering into any contracts regarding any use, sale, or lease of its property.

Confirmation of a plan of adjustment in PREPA’s Title III case may be required, however, to release any valid liens against PREPA’s assets and may help ensure that both the T&D system and the Partnership Contract counterparty are free and clear of other legacy liabilities of PREPA. Bankruptcy Code section 363(f) is also not incorporated into PROMESA and, thus, there is no

³⁷ See Case No. 18-024, ECF 41.

³⁸ See Case No. 17-4780, ECF 975.

express mechanism to sell assets free and clear of liens outside of a plan. But in Title III, similar to Chapter 9, a debtor can sell assets free and clear of liens under a plan.³⁹ To be confirmed, a plan of adjustment must comply with PROMESA section 314 and the application provisions of Bankruptcy Code section 1129.

B. FOMB Contracting Policy.

As a covered governmental entity, PREPA is subject to the policies established by the FOMB. Pursuant to its authority under PROMESA section 204(b)(2), the FOMB has issued a policy regarding prior review of contracts (the “Contract Policy”).⁴⁰ The Contract Policy applies to “any contract that is proposed to be entered into by the [Government] . . . or any covered instrumentality.”⁴¹ Pursuant to the Contract Policy, all contracts with an aggregate expected value of \$10 million or more must be submitted to the FOMB for its approval before execution.

In addition to the mandatory submission of contracts, on a random basis or otherwise in its sole discretion, the FOMB will contact agencies or other governmental entities for review of contracts below the \$10 million threshold, to assure that they promote market competition and are not inconsistent with the relevant certified fiscal plan.

C. Assumption/Rejection of Executory Contracts and Unexpired Real Property Leases.

Bankruptcy Code section 365(a), as incorporated into PROMESA, provides that the FOMB, “subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.”⁴² Therefore, to the extent any of PREPA’s contracts are to be assumed by PREPA, and assigned to the private party to a Partnership Contract, it will need Title III Court approval upon request by the FOMB on behalf of PREPA. Upon the effective date of a plan of adjustment, unless an executory contract or unexpired lease has already been assumed or rejected pursuant to an order of the Title III Court, such executory contract or unexpired lease may be deemed either assumed (or assumed and assigned) or rejected pursuant to the terms of the plan of adjustment. If assumed by PREPA prior to transfer, the FOMB on behalf of PREPA must (a) cure, or provide adequate assurance that any outstanding defaults will be promptly cured; (b)

³⁹ See PROMESA § 301, which incorporates Bankruptcy Code section 1123(a)(5)(D).

⁴⁰ PROMESA section 204(b)(2) provides that “the Oversight Board may establish policies to require prior Oversight Board approval of certain contracts . . . to ensure such proposed contracts promote market competition and are not inconsistent with the approved Fiscal Plan.”

⁴¹ The Contract Policy applies to “all contracts or agreements in which the [Government] or any Covered Territorial Instrumentality is a counterparty, including those with the federal government, state governments, *private parties*, and nonprofit organizations” (emphasis added).

⁴² Bankruptcy Code § 365(a). Under PROMESA section 301, which incorporates, among other things, Bankruptcy Code § 365(c)(4)(A), any unexpired lease of nonresidential real property is deemed to have been rejected unless the FOMB assumes it within 120 days after the Title III proceedings commenced, subject to extension by Title III court order. FOMB’s time to assume or reject existing leases of nonresidential real property pursuant to the foregoing has been extended to January 31, 2019.

compensate any pecuniary loss as a result of the default, or provide adequate assurance that it will be promptly compensated; and (c) provide adequate assurance of future performance of the contract.