BY ELECTRONIC MAIL

February 5, 2018

The Honorable Ricardo A. Rosselló Nevares
Governor of Puerto Rico
La Fortaleza
P.O. Box 9020082
San Juan, PR 00902-0082

Dear Governor Rosselló Nevares:

The Board is in receipt of PREPA’s proposed fiscal plan, dated January 24, 2018 (the “Proposed Plan”), and recognizes the substantial revisions that PREPA has made to the existing fiscal plan, certified by the Board on April 28, 2017 (the “Current Plan”), to adjust for the post-Hurricane Maria reality and to account for a contemplated transformational transaction. Nonetheless, the Board has determined that the Proposed Plan requires certain revisions before the Board can certify it as compliant with the requirements of the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”). This letter will serve as the notice of violation provided for in Section 201(c)(3)(B)(i) of PROMESA. The Board looks forward to continuing to discuss the Proposed Plan, and the violations detailed herein, with you in the coming weeks.

Specifically, the Proposed Plan needs to provide a five-year plan for a financially sustainable utility, which is required as a baseline regardless of future transformation plans. The Proposed Plan must also further define realistic measures to reduce costs so that PREPA can continue delivering electric services to the people of Puerto Rico at more affordable rates. The Proposed Plan must also support a transaction by providing a set of targets for a potential bidder to meet or exceed during the bidding process, in line with the Governor’s announced plan to privatize generation and enter into a long-term concession agreement for transmission and distribution.

PROMESA provides the Government with a powerful tool to restore economic growth and opportunity to the people of Puerto Rico. The Board urges the Government to use this tool to provide for a sustainable fiscal future for PREPA and the Island’s energy sector and to create the conditions that provide for more affordable electricity, more reliable electricity, cleaner electricity, and a more resilient power infrastructure.
Baseline

The Board requires two changes to baseline projections:

- **Financial projections**: The Proposed Plan must include financial projections for the entire length of the fiscal plan which demonstrate a sustainable financial and operating plan.

- **Federal funding**: The Proposed Plan must include a realistic estimate of federal funding. This assumption regarding federal funding provides the basis for prioritization of outstanding projects and the potential for third party investment.

Measures

The Board requires three changes to revenue and expense measures:

- **Capital planning and IRP**: The Proposed Plan must further define a path toward a new IRP with clear target dates for completion. The Proposed Plan must provide guidance for the IRP by defining a set of goals and targets to be confirmed in a comprehensive IRP, focusing on least cost compliant generation and a capital delivery plan. These goals should include generation portfolio targets, with the goal of decreasing fuel and purchased power costs by at least 5 cents per kWh. Generation should be a significant near-term focus as it presents the largest opportunity for cost savings and for immediate investment by third-parties, and represents the largest shift from the prior IRP due to changes in demand outlook and technology pricing.

- **Cash management**: The Proposed Plan must further detail the means to improve fiscal governance, accountability, and controls for cash management. The Plan should provide a section addressing specific cash management initiatives and targets intended to reduce short-term liquidity concerns and begin conversations targeting long-term cost savings. This chapter should further address increasing collections, managing fuel and purchased power costs, and efficiently allocating labor.

- **Operational savings**: The Proposed Plan must include a more defined section on operational savings, including analyses based on the new forecast demand environment, milestones, and plans for implementation. Operational initiatives are expected to produce savings of at least 1.5 cents per kWh through a number of different operational measures. The Plan should address savings initiatives at a directorate level, addressing specific levers to create savings, and paths to execute these actions.

Other

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1 Section 201(b)(2)  
2 Section 201(b)(1)(A), (B), (J), (L)  
3 Section 201(b)(1)(D), (F), (G), (J)  
4 Section 201(b)(1)(D), (F), (G)  
5 Section 201(b)(1)(D), (G)
The Board requires the following other changes to the Proposed Plan:

- **Industry structure**: The Board applauds the announcement of the plan to privatize generation and enter into a long-term concession for transmission and distribution. To build on the announcement and materials published to-date, the Proposed Plan must contain much greater detail, including specificity regarding ownership models and a timeline towards supporting the proposed transformational transaction. In addition, the Proposed Plan must address steps to improve governance leading up to a transition and describe a strategy for effective governance in a concession or similar arrangement.

- **Debt sustainability analysis**: The Proposed Plan must include a more specific analysis of PREPA’s 30-year debt sustainability projections, including specific assumptions related to macroeconomic projections and the projected costs of pension liabilities. Rather than include a range of potential debt service, the plan should outline specific debt capacity year-on-year.

- **Time horizon**: Upon further reflection, the Board has determined that the Proposed Plan must extend through FY23.

- **Included entities**: The Proposed Plan must include each component unit and subsidiary of PREPA.

**Conclusion**

The Board recognizes the difficulties implicit in these policy decisions, as well as the long path to return PREPA to fiscal stability. Reaching this goal will take time, enormous effort and the full commitment of PREPA’s and the Government’s leadership, but done properly and in a sustained manner it will put PREPA on the path to a better future. The Board specifies 6:00pm AST on February 12, 2018 as the deadline for submitting a revised, proposed fiscal plan, including all financial models.

Sincerely,

José B. Carrión III  
Chair

Andrew G. Biggs  
Carlos M. García  
Arthur J. González  
José R. González  
Ana J. Matosantos  
David A. Skeel, Jr.

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6 Section 201(b)(1)(B), (J)  
7 Section 201(b)(1)(I)  
8 Section 201(b)(2)  
9 Section 201(b)(1)(A), (F), (L)