

September 25, 2018

Puerto Rico Electric Power Authority  
Supplier Registry Office  
Attn: Natalia Martinez Lugo  
Procurement Representatives for RFP  
PO Box 3670151  
San Juan, Puerto Rico 00936

Subject: Request for Proposals for Fuel Supply in the North and  
Conversion of San Juan Units 5 and 6, RFP 81412

Dear Ms. Martínez:

Arctas Capital Group, LP (“Arctas”) in response to the Puerto Rico Electric Power Authority (“PREPA”) July 30, 2018 Request for Proposals for Fuel Supply in the North and Conversion of San Juan Units 5 and 6, RFP 81412 (“RFP”) submits this informative letter in lieu of a proposal.

Arctas has extensive expertise in developing, acquiring, structuring, financing, optimizing and managing a broad range of complex energy infrastructure assets and energy businesses. Since its inception in 2002, Arctas’ business focus has been primarily in the Americas and Caribbean energy markets. Arctas is a successful developer of energy projects, including wind farms in Texas and Central America, natural gas pipeline in Colombia, and also acquired one of the largest non-institutional positions in Mirant equity following their bankruptcy filing (and subsequently teamed with a boutique restructuring firm to advise \$1.2B bondholders on US portfolio of Mirant power assets in bankruptcy).

The individuals at and working with Arctas on its Puerto Rico effort have deep knowledge and experience in Puerto Rico. Arctas executives, then employees of a unit of Enron that was the 50% lead partner in the EcoEléctrica LNG terminal and 540 MW power plant (“EcoEléctrica”), had key executive responsibilities in EcoEléctrica development, financing, and construction and commercial operation. Arctas founder and managing director David Haug was the lead executive for this effort from 1993 until power production began. I myself, Rick Sierra, an Arctas Vice President, had executive management responsibilities from 1995-2003 in the development of the EPC agreement, construction management, and oversight of commercial operations.

Arctas, together with consultants, over the last two years, has been actively assessing and monitoring developments in Puerto Rico relevant to the generation, transmission, pricing and financing of electric power in Puerto Rico. During that time we have participated in governmental, regulatory, and PREPA initiatives and have expressed interest in participating in Puerto Rico energy projects, including projects that increase natural gas fired generation. Arctas was an Intervenor in the Puerto Rico Energy Commission proceeding on the Aguirre Site Economic Analysis, Case No. CEPR-AP-2017-0001, having submitted filings, testimony, and briefs. More recently we participated in initial PREPA 2018 IRP Stakeholder Meeting to provide feedback on PREPA’s initial plans to develop a 2018 Integrated Resource Plan.

After the RFP was issued on July 30, 2018, Arctas requested and was granted access to the RFP materials on August 2, 2018. We subsequently attended the RFP Kick-off Meeting on August 9,

2018 and the Visit to the Job Site on August 10, 2018. We have also submitted questions to PREPA on August 28, 2018, some of which PREPA provided responses on September 10, 2018.

After review of the RFP materials and bidder questions and PREPA responses, including PREPA responses to a portion of the questions Arctas submitted to PREPA for response, we are not in position to submit a credible proposal generally consistent with the RFP requirements for the following reasons:

**1. The RFP timeline did not allow sufficient time to develop proposal details so as to demonstrate to PREPA that any particular fuel delivery concept is viable.**

The following supplier question and PREPA response regarding insufficient time to submit a proposal and asking if extending the deadline is being considered was provided to the bidders on September 15, 2018:

*Supplier question: According to RFP timeline, the submission deadline is on September 11, 2018, however, due to the complexity of this project, the technical and feasibility studies to be conducted, the information required to be included in the proposal, scope of work and permitting assessment and permitting plan, letter of support from Puerto Rico Port Authority, plan for financing, pricing, among others, we consider that this period of time is too short even for a RFP. Is PREPA considering to extend this term according to the requested information?*

*PREPA response: The deadline for proposals' submission is September 25, 2018.*

Although no alternate fuels are explicitly excluded, the RFP principally seeks LNG fuel supply proposals for San Juan 5 and 6 as stated in the first paragraph of RFP Section 1.0 Purpose and Intent. There is currently no existing infrastructure that could be used to deliver LNG/natural gas or to San Juan 5 and 6, so any proponent's proposal would have to be based on the construction of new infrastructure. The less than 7 weeks between the kick-off meeting and the deadline to submit a proposal is simply nowhere near enough time to develop and complete necessary work product to establish the infrastructure cost and execution plan, permitting feasibility, and fuel supply contracting structures that would demonstrate to PREPA that any given concept for new LNG/natural gas infrastructure is viable. Sufficient time in the RFP schedule is necessary to allow those bidders interested in proposing LNG fuel supply to compete with those offering alternatives such as LPG, where there already exists some of the LPG infrastructure necessary to meet the RFP requirements.

**2. The need to supply the natural gas volumes stated in the RFP are unsupported and problematic given that PREPA does not make any commitments to purchase a minimum amount of natural gas during the 5 year fuel supply agreement.**

The following supplier question and PREPA response regarding investment recovery was provided to the bidders on September 10, 2018:

*Supplier question: Under what scheme will PREPA remunerate the total of the investment required to guarantee the minimum storage, and the maximum regasification send out to attend units 5 and 6? Taking into account that there will be no take or pay provision allowed by the contract.*

*PREPA response: PREPA is seeking proposals for fuel supply and acknowledges that pricing will be determined by the supplier considering many factors including but not limited infrastructure development, capital cost of the fuel supply facilities, fuel source, transportation cost and logistics, cost of capital, operating costs. The proposals shall include whatever pricing is necessary for the proposing company to meet their specific needs. Proposers shall include detailed descriptions of their pricing proposal including any fixed and variable costs they require to complete the project. The cost of the conversion of the existing PREPA facilities shall be included in the pricing proposals with the expectation that the recovery of all of these costs will be identified and only included in the initial 5 year term of the agreement in the form of a fixed capacity payment. The fuel cost payment is not intended to be on a take or pay basis requiring minimum annual fuel delivery. However, reasonable alternatives to these payment structures will be considered to meet the project objectives.*

Without adding to the RFP a minimum natural gas take or other condition that provides for capital cost recovery of new fuel supply infrastructure, the proposer has no assurance that it will recover its investment cost. As such, PREPA should at least demonstrate that the RFP fuel storage and supply requirements, which are based on San Juan units 5 and 6 operating at 85% capacity factor (which are far greater than historical capacity factors), are based on its overall generation plans and projections for the future, including its planned privatization of generation assets, generation mix targets, and grid transformation (which may include mini grids with certain amounts of generation required to be within each mini grid). This would allow bidders to better evaluate the risk that PREPA would purchase dramatically lower fuel quantities, or even no quantities, instead of the amounts assumed in the RFP. Without an understanding of the likely amounts of natural gas consumption at San Juan 5 and 6 units, LNG supply concepts that require significant infrastructure, which may be optimal for PREPA, may not be identified, evaluated, and proposed.

**3. Certain commercial terms in the RFP and the draft Fuel Sale and Purchase Agreement (“FSPA”) are undefined or inconsistent with typical fuel supply agreements, resulting in unevaluated risks that should otherwise be assessed so as to be able to offer credible fuel supply pricing.**

In addition to the above concerns regarding minimum natural gas take, the following aspects of the RFP and FSPA do not allow for the development of firm fuel supply pricing (Note – Items a and d below are issues in which we submitted related questions to PREPA but did not receive a response):

a. The FSPA does not appear to have any fixed date or any penalties tied to achieving the start of the Firm Supply Period. Firm dates and penalties are typical for infrastructure construction and supply delivery agreements to ensure that proposal completion and supply dates are not artificially low in order to increase selection prospects.

b. FSPA section 40 under Bonds, Seller is to provide both a Performance Bond and Payment Bond, but there is no mention of what should Seller assume regarding PREPA financial condition and/or credit support for PREPA’s obligations. The following supplier question and PREPA response regarding PREPA credit was provided to the bidders on September 15, 2018:

*Supplier question: What credit support will be provided by PREPA to the winning bidder?*

*PREPA response: This RFP contemplates a bilateral credit support structure to be negotiated between the parties. Any credit support structure incorporated into the agreement will require approval by the Financial Oversight and Management Board as part of the statutory review process.*

Since it is uncertain as to whether or not any PREPA credit support will ultimately be provided the credit risk cannot be properly evaluated.

c. The following supplier question and PREPA response regarding termination of contracts was provided to the bidders on September 10, 2018:

*Supplier question: RFP section 10, item S states “The office of the Chief of Staff shall have the authority to terminate this Contract at any time.” Please describe the conditions in which such termination can be made and amounts payable to the Seller for costs or commitments incurred before such termination.*

*PREPA Response: Addendum 8, Attachment 1, Item 35: This clause is a requirement of the Memorandum No. 2017-001, Circular Letter 141-17 of the Office of the Chief of Staff of the Governor of Puerto Rico and the Office of Management and Budget in all governmental contracts. The memorandum doesn’t establish any condition, right or limitations in case of termination. Notwithstanding, in case of termination by the Office of the Chief of Staff the contractor has the same rights that in the case of termination for convenience by PREPA, that is the compensation for services rendered under the agreement until the termination date.*

Termination of the FSPA for convenience at any time puts any investment made prior to delivery of services (i.e. fuel deliveries) at risk. We don’t foresee that LNG infrastructure would be built with this termination possibility.

d. The RFP does not make clear how the planned generation privatization may impact the fuel supply agreement. The following supplier question and PREPA response regarding planned generation privatization was provided to the bidders on September 15, 2018:

*Supplier question: How does this process and the investment in the San Juan power plant, align with the goals of privatization of PREPA’s assets? What risk would reside with the Contractor in the event the San Juan site/power plant is sold to a 3rd party as part of privatization?*

*PREPA response: This RFP is being pursued independent of the privatization efforts, though fundamentally the objectives of this procurement support PREPA’s vision for an electric system that is Customer Centric, Reliable, and Sustainable, while promoting financial viability and economic growth. This RFP is likely to economically advantage the San Juan site/power plant versus its current position related to other power supply options on the island. Any potential or future transaction involving the San Juan site or facility would be governed by the laws of Puerto Rico, and potentially subject to Title III proceedings under PROMESA. As with any transaction, it is the*

*responsibility of the counterparties to evaluate and understand the risks associated with the terms and conditions of the agreement. PREPA recommends potential counterparties seek the advice of counsel to identify and evaluate the risk specific to their own situation.*

It is very possible that the timelines for the privatization of PREPA generation assets and this RFP process will overlap, creating uncertainty for each process. Additionally, a possible outcome could result in a new owner and plan for San Juan 5 and 6 that would negatively affect the fuel supply agreement.

Although bidders are free to submit proposals with terms that are vastly different than what is stated in the RFP, we believe the RFP should have certain elements that must be met so that bidders have greater certainty as to what is most beneficial to PREPA and what must absolutely be included in a proposal. This would allow bidders to focus their proposal efforts on concepts that most closely meet PREPA's needs.

Furthermore, this kind of RFP process with the above unresolved key issues is likely to generate responses only from a very limited number of bidders that are not concerned about the about the key issues, believing that they can submit a proposal around a concept that they already have prepared, then be selected to participate in the subsequent evaluation rounds, and later radically change their proposal after PREPA addresses the key issues. In addition, the unresolved key issues are also certain to discourage some bidders who take RFPs seriously from participating because meeting the conditions of the RFP is not feasible.

Either way, it is unlikely that PREPA will receive a favorable proposal for LNG fuel supply that will be approved, financed, and completed so as to achieve PREPA's goal of reducing fuel oil fired generation and lowering its cost of generation. In addition, both of the above concerns make it unlikely that a loosely drawn RFP process will result in the best lowest cost, quickest, and most efficient solution for Puerto Rico and for PREPA customers. Perhaps could consider revising or revising the process; in such an event we would be interested in further participating in the process.

Sincerely,

Rick Sierra  
Arctas Capital Group LP