



Dominic J. Frederico
President & Chief Executive Officer

August 16, 2017

Gerardo J. Portela Franco
Executive Director
Fiscal Agency & Financial Advisory Authority
PO Box 42001
San Juan, PR 00940-2001

Dear Mr. Portela:

I write in response to your letter dated August 4, 2017, which responded to my July 21 letter explaining the need for a rate increase at PREPA. It is encouraging to see, from your August 4 letter, that you agree an operational transformation of PREPA is necessary. We look forward to PREPA, the Administration of Governor Rosselló, and the PROMESA Financial Management and Oversight Board (“Oversight Board”) commencing much anticipated concrete plans for that transformation, and a focus on the greater than 80% of PREPA’s cost structure unrelated to its debt service obligations (which themselves had already been set for material reduction under the Restructuring Support Agreement (“RSA”). Aside from this acknowledgement, however, we feel compelled to disagree with a number of other points in your August 4 letter.

1) You assert: ***“PREPA does not set its own rates.”*** In fact, almost all PREPA debt was incurred when PREPA not only had the unfettered right to set its own rates, but the obligation to set them at a level sufficient to cover all its costs. PREC, which was established in 2014, is obligated under Puerto Rico Law to approve rates sufficient to pay PREPA’s debt service, as well as PREPA’s other costs (see Act 57-2014 and Act 4-2016). PREPA, in turn, is obligated to submit rate requests to PREC that would provide sufficient revenue to pay PREPA debt service and its other costs. PREC previously approved a transition charge that would have provided sufficient funds to pay restructured debt service. PREPA and the Administration of Governor Rosselló have an obligation to respect PREPA’s covenants and the law. Not only has the administration of Governor Rosselló not shown an inclination thus far to do so, but in fact one of its first acts with regard to PREPA was to request and receive a delay, to October 2017, for a rate increase already approved by PREC.

2) You state: ***“PREPA is operating under a certified Fiscal Plan... That is inconsistent with the rate increase you request...”*** Contrary to your statement, the certified Fiscal Plan is not inconsistent with our requests. In fact the approved Fiscal Plan explicitly uses the projections and capital structure of the RSA as the foundation of its financial forecasts. The Oversight Board, after certifying the Fiscal Plan, inappropriately and illegally rejected the RSA (which had already been “deemed” approved by PROMESA), but did not reject the transition charge approved by PREC and included in the certified Fiscal Plan. We urge the administration of Governor Rosselló to show

leadership in demanding that the Oversight Board overturn its improper RSA rejection and, irrespective of the success of that effort, move forward with a rate increase in line with PREPA's covenants, contracts and Puerto Rico law.

3) You state: ***“PREPA was not created to act like an independent corporation. Pursuant to its enabling legislation, PREPA was charged with the conservation, development, and utilization of the energy resources of Puerto Rico to promote the general welfare of Puerto Rico’s inhabitants and to increase commerce and prosperity. PREPA’s rate structure must thus support the economic recovery of Puerto Rico as set forth in the Commonwealth Fiscal Plan.”*** These statements are at best misleading. Contrary to the assertion that PREPA “was not created to act like an independent corporation,” PREPA’s enabling act specifically creates PREPA as “a body corporate and politic **constituting a public corporation.**” 22 L.P.R.A. § 193(a). The purpose of a public corporation is to be independent, in credit and operation, from the related host government that established the public corporation. Indeed, the enabling act states that PREPA is **“a corporation having legal existence and personality separate and apart from that of the Government.”** 22 L.P.R.A. § 193(b).

You suggest that PREPA’s corporate obligations to its creditors and other stakeholders can be abrogated on the basis of a general statement of purpose appearing in Section 6 of the enabling act. 22 L.P.R.A. § 196. However, the kind of general, precatory language you cite from the statement of purpose does not override the specific requirements imposed upon PREPA under its enabling act, including, the power and obligation to fix rates that **“shall be sufficient . . . for the payment of the principal and interest on its bonds, and for fulfilling the terms and provisions of such covenants made with or for the benefit of the purchasers or holders of any bonds of [PREPA]”** 22 L.P.R.A. § 196(l).

Moreover, as part of the collateral package securing PREPA’s bonds, PREPA entered into a binding commitment, set forth in a trust agreement and supported by the provisions of the enabling act cited above, to “fix, charge and collect reasonable rates and charges” and “adjust such rates and charges so that Revenues will at all times be sufficient” to pay the “Current Expenses of the System” and cover 120% of “the aggregate Principal and Interest Requirements for the next fiscal year” on account of the bonds. The invocation of the need “to promote the general welfare of Puerto Rico’s inhabitants” or to “support the economic recovery of Puerto Rico” does not negate these specific, binding and enforceable obligations. Indeed, it is an indication that the Puerto Rico legislature determined that the best means of promoting the general welfare and supporting economic prosperity was to create an entity independent of the Commonwealth’s credit, legal obligations, and political interference in order to operate in a business-like manner. PREPA can only pursue its general corporate mission subject to, and in compliance with, its express obligations under the enabling act and its binding commitments under the trust agreement and the bonds.

More generally, we sincerely call upon AAFAF, PREPA, the Administration of Governor Rosselló, and the Oversight Board to heed the situation in Venezuela today. PROMESA calls for Puerto Rico to regain access to the capital markets and achieve fiscal responsibility (these are the only two objectives stated in the “Purpose” of the Financial Oversight and Management Board - Title I Sec. 101 (a)). Unfortunately, the Commonwealth’s and Oversight Board’s attempt to ignore PREPA’s standing as a public corporation with explicit legal obligations, and instead use it as a tool to provide below cost electricity to subsidize the general welfare and prosperity of island special interests is misguided and

a direct precursor to further financial isolation. Such an approach will undermine the prospects for any privatization partnerships PREPA may seek in the future. Rather than present a path to Statehood, prosperity, or achieving PROMESA's goals of fiscal responsibility and access to capital markets, we see a path of increasing isolation, crisis and instability if more prudent and responsible measures are not promptly taken.

As we have expressed in the past, Assured Guaranty stands ready to support PREPA's ongoing transformation to enable it to lower the cost of power generation and transmission. However, it is difficult to foresee reasonable settlements occurring, and PREPA will not be able to honor its obligations to its stakeholders — including customers, who deserve efficient and reliable electricity services at a fair market rate — and restore capital market access unless and until PREPA, the Administration of Governor Rosselló and the Oversight Board respect contracts and the rule of law, and act in a fiscally responsibility manner.

Very truly yours,



Dominic J. Frederico,
President & Chief Executive
Officer

CC:
Hon. Ricardo Rosselló Nevares
Financial Management and Oversight Board Members