

**GOVERNMENT OF PUERTO RICO
PUBLIC SERVICE REGULATORY BOARD
PUERTO RICO ENERGY BUREAU**

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IN RE: REVIEW OF THE PUERTO RICO
ELECTRIC POWER AUTHORITY
INTEGRATED RESEOURCE PLAN

CASE NUM.: CEPR-AP-2018-0001

SUBJECT: ARCTAS CAPITAL GROUP, LP FINAL
SUBSTANTIVE AND LEGAL BRIEF

ARCTAS FINAL SUBSTANTIVE AND LEGAL BRIEF

TO THE HONORABLE PUERTO RICO ENERGY BUREAU:

NOW COMES Arctas Capital Group, LP (“Arctas”), through its legal representative and authorized officer, and respectfully files with the Puerto Rico Energy Bureau (“Energy Bureau”), Arctas Final Substantive and Legal Brief in accordance with the July 3, 2019 Resolution and Order regarding Completeness Determination and PREPA’s IRP Filing and Procedural Calendar.

This brief covers the proposed amendments to the agreements between PREPA, EcoEléctrica, and Naturgy; the process to build replacement peakers; and the potential process to for a repowering/new generation for Palo Seco. Accordingly, Arctas respectfully STATES and PRAYS:

I. Proposed EcoElectrica and Naturgy Agreements with PREPA.

A. Overview.

We are concerned that the submissions and testimony relating to the proposed power and LNG purchase agreements between EcoEléctrica LP (“EcoElectrica” and/or “ECO”), Puerto Rico Electric Power Authority (“PREPA”) and Naturgy Aprovevisionamientos S.A. (“Naturgy”) rely on an incorrect assumption of a de facto monopoly to justify the absence of competitive bids, and do not accurately present the true costs and risks of amending those agreements to PREPA, its creditors, or the ratepayers of Puerto Rico. The proposed payments to be made by PREPA may be significantly higher, by tens of millions of dollars per year, and perhaps approaching \$100 million per year, than can be credibly justified.

Puerto Rico law Act 17-2019 mandates that each Integrated Resource Plan has the goal of selecting “...energy supply sources...satisfying, in the short, medium, and long-term the...needs of Puerto Rico’s energy system and of its customers at the lowest reasonable cost.” The submissions regarding the Agreements, do not satisfy that standard or even credibly allege that the Agreement terms are at the lowest reasonable cost.

Certain issues raised herein, and others are raised in Arctas Capital Group, LP Informative Motion Presenting Recommendations for the Proposed Approval of the EcoElectrica Agreements filed February 13, 2020 in the instant proceeding (the “Arctas Feb 13 Motion”). We incorporate herein

section VI Specific Contract Terms, 2. Issues in the Proposed PPOA of the Arctas Feb 13 Motion.

Definitions. Herein we refer to the proposed Amended and Restated Power Purchase and Operating Agreement between EcoEléctrica and PREPA as the “ECO PPOA” and the Amended and Restated Natural Gas Sale and Purchase Agreement between Naturgy and PREPA as the “Naturgy GSPA”, collectively the “Agreements.”

Multiple approvals required. PREPA, EcoEléctrica, Naturgy and the Energy Bureau are understandably eager to have the proposed Agreements resolved. However, they cannot ultimately be executed or take effect until multiple approvals occur. Questions may come from the Federal Oversight & Management Board (“FOMB”), the Public-Private Partnerships Authority (“P3A”), bondholders, creditors, and the bankruptcy courts, and consumer and elected representatives (collectively the “PREPA Constituencies”). It is important to the recovery and future of the island’s electrical system and competitiveness to minimize later surprises, re-evaluations and delays that may negatively impact EcoElectrica and all future projects proposed by PREPA in this IRP proceeding, even if that means delays in approval now.

B. Obstacles to approving the Agreements.

1. No competitive process took place.

The original privately owned coal based fired power plant located in Guayama ("AES") and EcoElectrica contracts were awarded through a competitive procurement process, where detailed pricing proposals were evaluated to choose the lowest cost submissions. There is no suggestion any such competitive process occurred here with the proposed Agreements, nor (with one flawed exception) has any testimony or evidence been submitted to show that either the ECO PPOA terms or the Naturgy GSPA terms reflect either market or arm's length negotiations (In the lone exception, Siemens' and Sargent & Lundy's evaluation shows the Naturgy contract adder is at or above the high (expensive) end of the market range for similar "adders" in the region).¹

The failure to use a competitive bidding process appears to have resulted in multiple expensive or overreaching terms from the perspective of PREPA and ratepayers. We first deal with the competitive procurement issue, then others below.

¹ PREPA's response to PREB-PREPA-10-09 quotes the Siemens report for the market range of fixed-cost adders to the base gas costs in an LNG contract. PREPA erroneously concludes the proposed Naturgy GSPA adder is within the range. Siemens uses Trinidad LNG price ranges to make its evaluation of the adder. When the base fuel cost is subtracted from the Naturgy price and the Trinidad price, leaving only the adder, the Naturgy GSPA 2020 \$5.80/mmBtu adder is apparently at or outside the \$5.70/mmBtu upper limit of the wide range suggested by Siemens, despite a down market and an LNG terminal and regasification facility already paid for by PREPA through the PPOA capacity payments. The adder is also a higher price than previously assumed in the IRP.

2. No sole source exception applies to LNG purchases through EcoEléctrica.

PREPA sent a November 4, 2019 letter (the "PREPA Nov 4 Approval Request") to the Energy Bureau requesting that the Energy Bureau approve the Agreements. Section III (Compliance with Applicable Legal Requirements) states that per PREPA's enabling act, Act 83-1941 PREPA is generally required to seek and obtain competitive bids before awarding contracts, but that per Act No. 83-1941, Section 15(2)(d) there is an exception when "*there is only one supply source*". This is referred to as the "sole source exception."

PREPA then goes on to state "*Such circumstances exist in the case of Naturgy, which owns the only currently active LNG import terminal and LNG storage facility on the south shore of Puerto Rico and (through a Tolling Services Agreement with ECO) controls the entire existing capacity of this LNG import terminal to receive and vaporize LNG for the delivery of natural gas for power generation purposes. Given this, Naturgy has a de facto monopoly over the supply of gas into the southern part of the island and, thus, the sole source exception set forth in paragraph (d) of Section 15(2) of PREPA's enabling act applies.*"

PREPA's claim that Naturgy has a "monopoly", with no contrary arguments is unsubstantiated and unfounded.

a) The claim that a Naturgy "monopoly blocked competitive procurement is incorrect.

The submission for approval of the Agreements is based on the premise that no competitive procurement process for LNG (even for Costa Sur) could have occurred, due to Naturgy having exclusive rights to deliver LNG to PREPA. This is then said to constitute a monopoly that exempts the fuel contract from normal procurement procedures. The apparent rationale presented by PREPA is: (i) EcoEléctrica owns the only LNG terminal; (ii) EcoEléctrica has (voluntarily) given its majority owner Naturgy the sole right to "toll" gas volumes for PREPA through that terminal, *even if the new PPOA is structured as "tolling agreement" expressly requiring PREPA to procure and deliver LNG to EcoEléctrica*; (iii) Naturgy is therefore the only possible supplier of LNG to PREPA; (iv) because of that it is not somehow possible to have a competitive LNG procurement; and (v) PREPA therefore needs to accept for 12 years whatever price Naturgy proposes today, never revisited over time.

Arctas discusses below why this rationale is contrived and deeply flawed.

b) A single fuel terminal does not create a “sole source” exception.

The “sole source exception” requires there to be “only one supply source”, which applies to fuel supplies and is not the same as only one LNG terminal. There are many relevant analogies. Jurisdictions throughout the U.S. allow customers to purchase electricity from multiple competing electricity providers, but the electricity all travels over the same transmission lines. A gas pipeline owned by a single party can bring gas from multiple sources, suppliers and locations, to multiple buyers. Roads and ports are another example. Operating a terminal, and selling fuel, are not the same thing. They are typically done by different unrelated parties. If the Puerto Rico Ports Authority were privatized, PREPA would presumably not tolerate a new private operator saying it had granted one of its owners a de facto monopoly for oil imports at the privatized fuel terminal, so that PREPA could only buy fuel from that one party and not conduct competitive procurement for oil. But that is what they are proposing the Island accept here. On the other hand, PREPA is the only possible buyer of electricity from EcoEléctrica, and the only significant buyer of natural gas for power (other than EcoEléctrica itself). As such, PREPA is in a position to insist that EcoEléctrica and Naturgy not create an artificial

contractual barrier to block competitive bids when awarding contracts in compliance with Puerto Rico fuel procurement laws.

Significantly, PREPA's statement that Naturgy "*... owns the only currently active LNG terminal and LNG storage facility on the south shore of Puerto Rico...*" is completely false—Naturgy does not own the LNG terminal and LNG storage facility. EcoEléctrica owns the terminal, storage and power plant. (Naturgy is a shareholder in EcoEléctrica, with a large but not majority interest.) To the extent the remainder of the PREPA rationale depends on the false allegation that Naturgy owns the LNG terminal, the PREPA Nov 4 Approval Request should be rejected by the Energy Bureau without further analysis. In particular, the notion that the Request for Approval triggered a 30-day time clock is untenable. It would be hard to believe that any court would rule in favor of any timed 30 day review requirement, or other timed review period, triggered by a false primary assumption or other incomplete factual allegations. If PREPA or its counsel by error or inadvertently mistakenly believed the terminal is owned by Naturgy, that could explain the erroneously claimed sole source exception and make further discussion moot.

c) There is no “de facto monopoly” just because two parties draft a self-serving undisclosed agreement.

The rejection of the Agreements need not rest solely on the erroneous allegation that Naturgy owns the LNG terminal. The PREPA Nov 4 Approval Request references a Tolling Services Agreement purporting to grant Naturgy a "de facto monopoly" over the LNG terminal. First, PREPA's enabling act could, but did not, extend the reach of the sole source exception to "de facto" monopolies over fuel facilities, nor contractually fabricated or unproven monopolies. Neither EcoEléctrica, Naturgy or PREPA has disclosed to the Energy Bureau, to the best of Arctas knowledge, the agreements between them, or how any agreement could override PREPA complying with Puerto Rico procurement laws by seeking competitive bids before awarding contracts. With hundreds of millions of dollars a year at stake, the Energy Bureau and other authorities cannot rely on an alleged de facto monopoly based on a contract it has not seen and cannot verify as to terms or validity, any more than a court could do if the parties there refused to produce a contract challenged there. As a \$400 million per year EcoEléctrica customer² --and its only customer--

² On January 22, 2020, PREPA submitted its initial response to ROI #10, and included in its response a Sargent & Lundy report titled CS-0022 Eco and Naturgy Renegotiation Report_19 November 2019 (“S&L Report”), attached to the response as PREPA ROI_10_8 Attach 1.pfd. The S&L Report indicates that the historical total average annual payments to EcoEléctrica totaled approximately \$417 million between the years 2009-2018

PREPA and its lawyers cannot possibly expect the Energy Bureau or anyone else to believe they could not condition the restructured arrangements on seeing and submitting the contract that purports to restrict or exempt their compliance with applicable procurement laws that require competitive bids. Such agreements between Naturgy and EcoElectrica would be and should be part of a discovery process in any court proceeding if an adverse claim of monopoly is risen and the same would apply to the Energy Bureau prior to approval of the proposed Agreements.

d) Whatever new contract structure has been created could not create a legitimate monopoly binding on PREPA.

Somehow, during 2019 discussions, ECO and Naturgy apparently convinced PREPA to convert the ECO PPOA into a “tolling agreement” with EcoEléctrica, which for the first time makes PREPA responsible for purchasing and delivering the fuel to EcoEléctrica to convert into electricity. (Note: A “tolling agreement” is one where a party pays monthly or annually for the right to bring fuel (usually oil or gas) to the front end of a facility and have it converted for them into something else, and delivered at the back end to the party). The proposed Agreements indicate that PREPA must pay approximately

\$150mm per year for the EcoEléctrica facility to be available to generate power, but PREPA still gets no electricity unless PREPA, which has no LNG purchasing staff or history, goes out and procures the LNG itself. Even if that change in structure makes no sense, it should have made the next step easy to implement – PREPA acquires the LNG fuel, delivers it to EcoEléctrica's pier, where EcoEléctrica unloads it, delivers it into storage tanks, and converts it into power.

Except, the Energy Bureau is told by PREPA that PREPA can't actually deliver the LNG to EcoEléctrica and/or EcoEléctrica can't accept it, even though that's exactly what the proposed new Agreements require *PREPA to do*. Why? Because it is alleged that Naturgy has exclusive rights to “toll” LNG through the facility, forcing PREPA to buy the LNG from Naturgy (and then momentarily take title to the LNG converted into natural gas at a location near the EcoEléctrica power plant for an imaginary moment), before it is immediately delivered to EcoEléctrica's fuel lines. To recap, Naturgy, as the largest owner of EcoEléctrica, forces PREPA to agree to amend its power contract so that PREPA, not EcoEléctrica, must deliver LNG to EcoEléctrica to get electricity, but then Naturgy claims that the tolling arrangement can't be carried out because Naturgy has recently gotten Naturgy/EcoEléctrica to agree in a separate undisclosed contract that

only Naturgy can bring fuel to EcoEléctrica.

PREPA's has for the last 8 years purchased gas for Costa Sur from Naturgy that Naturgy "tolled" through EcoEléctrica, apparently without complying with competitive fuel procurement laws, or other arm's length arrangements to assure LNG was purchased at market prices. Any "exclusive" rights EcoEléctrica had given Naturgy originally to toll LNG since 2012, could only have applied to LNG/natural gas delivered to PREPA for PREPA's Costa Sur generation units, not LNG/natural gas converted into electricity at the EcoEléctrica power plant which was always EcoEléctrica's responsibility. Historically, there was obviously no right for Naturgy to import LNG for EcoEléctrica, which EcoEléctrica did itself.

So, EcoEléctrica's shareholders apparently decided to cosmetically restructure the ECO PPOA to also look like the Costa Sur fuel procurement from Naturgy, to then allege all LNG had to be procured through Naturgy which now had "exclusive" rights. The change in EcoEléctrica's agreement with its largest owner Naturgy to say that Naturgy could also toll natural gas to be used to generate electricity at EcoEléctrica, is apparently both recent (presumably reflected in what the ECO PPOA refers to as "the Amended and Restated LNG Tolling Services Agreement dated September 5, 2019"), and contrived to

make the sole source argument more plausible. There appear to be additional benefits to EcoEléctrica, not fully described in the PREPA Nov 4 Approval Request, that in certain circumstances shift to PREPA the risk of having to make capacity payments to EcoEléctrica or generate higher cost electricity if PREPA gets no power because no LNG shows up, which are discussed below. Whether any fuel import taxes are avoided by having PREPA be the named LNG importer is also not discussed in the PREPA Nov 4 Approval Request.

If Naturgy and EcoEléctrica want to claim that somehow Naturgy has exclusive rights to toll LNG/natural gas for conversion to electricity they should produce to the Energy Bureau the amended tolling services agreement referenced in the proposed ECO PPOA that supposedly provides Naturgy that right. And explain why, if they are proposing EcoEléctrica's existing PPOA be converted to a tolling agreement, they can simultaneously claim that PREPA cannot in fact toll anything, but can only somehow deliver LNG through Naturgy to get electricity despite Naturgy not owning the EcoEléctrica pier, EcoEléctrica LNG tanks, or EcoEléctrica power generation equipment.

3. The proposed LNG pricing and terms are not market based.

If there was actually a legitimate reason to twist a globally standard PPOA

arrangement into a tolling agreement with EcoEléctrica, the Agreements could have been drafted to accommodate PREPA going out, sourcing the fuel from the provider with the best terms, and delivering it to EcoEléctrica. Or deliver it to Naturgy if one wants to pretend that Naturgy has the sole right to deliver LNG to EcoEléctrica. (It is public knowledge that most or all of the LNG brought to EcoEléctrica has been physically delivered from Trinidad not by Naturgy but by Engie, as successor to EcoEléctrica's original LNG supplier, Cabot). If there was a legitimate reason to go further, and have PREPA buy the LNG from Naturgy, a transparent fuel procurement process could have been structured where EcoEléctrica cooperates to allow PREPA (via its representatives) to conduct a typical industry competitive RFP/procurement for LNG. That would ensure the ratepayers of Puerto Rico are getting the best LNG price and terms and allow transparency to authorities like the Energy Bureau whose approval is required.

PREPA has for 20 years purchased power from EcoEléctrica at a negotiated price originally offered in an RFP for power. The EcoEléctrica offer was selected as the lowest cost bid for an LNG-fired plant and one of the two lowest overall proposals (the other was the coal plant proposed by AES). As a result, EcoEléctrica was awarded a Power Purchase and Operating Agreement (“PPOA”) 25 years ago, under which it was responsible not only for delivering electricity, but for also procuring the fuel to convert to

electricity. The terms of the electricity and the relation of the energy price to fuel prices were effectively set by the original competitive bid.

Competitive bids could have been obtained again for the proposed Agreement terms. However, PREPA apparently did not have the benefit of any commercially recognized experts in arranging LNG supply, price, and commercial terms or did not disclose any such advisors in this instant proceeding. And they perhaps were not told that single LNG terminals are more the rule than the exception globally and are not an impediment to competitive procurement on behalf of the ultimate buyer. Perhaps the absence of qualified LNG procurement consultants was due to price or time constraints, the resource requirements of the IRP process, or being satisfied with meeting the minimum savings required in the FOMB approved fiscal plan; anything else was not as important. Whatever the reason, a utility buyer not having or relying on an experienced player in the LNG market can result in lopsided agreements when (as here) major global LNG institutions are across the table.

A full review by any established LNG consultant would reveal a number of circumstances globally where a single "monopoly" LNG terminal, pipeline or fuel terminal does not interfere with the ultimate customer's involvement with managing or co-managing, overseeing or approving LNG or other fuel procurement. Such a consultant, and likely PREPA's counsel King & Spalding

(if requested), could supply examples of contracts where other electric utilities are doing exactly that. PREPA could have, for example, commissioned a survey of recent industry LNG purchase and sale agreements executed in the last twenty-four months. If they had found, for example, that comparable agreements had prices of, say, 115% HH + a \$3.50 "adder", they could have agreed to a price capped at that level, perhaps shared savings below that level, or executed a fuel RFP in conjunction with EcoEléctrica to obtain LNG for conversion to electricity. The RFP could have been for a three, five or ten year supply of LNG for all or part of generation capacity PREPA is purchasing from EcoEléctrica. Some portion of the volumes could be agreed to be bought on the short term or "spot" market. PREPA would have final approval over any pricing or terms that deviated from the pre-agreed RFP standard.

No such competitive procurement process has yet found its way into the proposed Agreements. Instead, and not surprisingly, the LNG pricing the Energy Bureau has been asked to approve and pass through to ratepayers, would likely be seen within the LNG industry as far higher than other similar recent LNG purchase contracts, far higher than current or recent LNG spot prices, and higher (in terms of energy price once the LNG is converted) than was being paid under the existing PPOA.

When the proposed Agreements were being renegotiated, PREPA was in the

midst of dealing with a perfect storm:

- multi-level power and financial crisis of historic proportion
- multiple recent PREPA executive directors
- a new governor and PREPA Board members
- the complex multi-party IRP review
- ongoing issues with assuring reliable generation,

all while having limited financial capacity, and substantial human resource constraints. The burden that should not have been added, was any coercion or pressure to enter into contracts at prices above market, above prior contracts, without competitive bids, while switching to a never-before-utilized contractual structure, all justified by the supposed grant of a “de facto monopoly” by EcoEléctrica to its largest owner.

C. LNG pricing and ECO PPOA capacity payments neither justified or reasonable.

1. Above-market LNG pricing.

The issue of whether there is competitive pricing is not just a theoretical one. It has significant cost implications for Puerto Rico. There was no report from any recognized LNG industry commodity/commercial expert, on key aspects of the Naturgy GSPA, or price comparisons with other LNG contracts. This is important because costs for both LNG and natural gas are at historic lows and projected to stay that way for the foreseeable future.

However, perhaps EcoEléctrica and PREPA could have credibly argued that no competitive procurement was needed, if they had taken steps to assure PREPA got market-based LNG prices. But they have not indicated that this occurred. To do so, PREPA needed to have retained LNG market expertise at its side. A reputable global LNG procurement consultancy firm could have advised PREPA of the arrangements and price structures typical in the LNG industry, and the LNG prices that shopping has produced for buyers. They could have conducted the contract negotiations or sat side by side with PREPA and its lawyers advising on commercial terms while the lawyers ensured the drafting reflected those terms. The consultants would likely have advised what range of adder would be typical in a 115% Henry Hub-style contract. They would have expected an “adder” closer to market; perhaps as much as \$2-\$3 lower than the one proposed in the Naturgy GSPA, depending on whether LNG receiving, storage, regasification, and natural gas forwarding costs are covered in the ECO PPOA capacity charge being paid to the terminal owners.³ Such an LNG consultant might also opine, that the ECO PPOA, while characterized and being billed as a tolling agreement, must not actually give

³ PREPA has not made clear the costs associated with using the EcoEléctrica LNG terminal. On the one hand, in PREPA response to PREB-PREPA 10-09 a), PREPA indicates that the LNG price adder covers “regasification.” While on the other hand, in PREPA response to PREB-PREPA 10-08 a), PREPA makes claims of capacity payment discounts that are based on the existing capacity payment – which are the fixed payments covering ALL of the EcoEléctrica facilities, including the regasification equipment, pier, and LNG storage tanks. The cost to PREPA of having an LNG terminal available should reflect the fact that like the EcoEléctrica power plant, the EcoEléctrica LNG terminal has already been substantially paid for through 20 years of capacity payments in the existing PPOA. It should not be charged again as if it is a new facility, whether in a capacity payment or in an LNG “adder”.

any tolling rights to use the terminal to PREPA, otherwise how could it be said that Naturgy has exclusive tolling rights (but may pay either nothing or a nominal amount to EcoEléctrica for them)? Or, they might ask, "If EcoEléctrica is willing to grant tolling rights to Naturgy for free or a nominal amount, why can't they grant the same to PREPA, given the tens of millions of dollars a year PREPA is paying"?

2. Calculated annual savings are suspect.

Claimed savings for PREPA under the proposed Agreements are approximately \$100 million per year, of which \$71 million are derived from EcoEléctrica and \$29 million are derived from Costa Sur. The \$71 million/year savings is comprised of \$108 million/year in reduced capacity payments, which is offset by higher fuel costs (implied \$73 million/year) resulting in a net savings of \$35 million/year. Expected savings of \$36 million/year from increased EcoEléctrica dispatch from 75% to 84%, is justified by saying EcoEléctrica could have otherwise charged PREPA even higherrates for the additional 9% of dispatch than the already above-market rates Naturgy is offering. No evidence is given how often such additional dispatch will be utilized, and therefore what its true cost will be. The \$36

million combined with the net savings of \$35 million/year results in the \$71 million/year savings.⁴

Aside from the assumed \$36 million savings from hypothetical increased dispatch, the savings calculation logic comparing the old contract payment to the proposed new one makes sense—but only for the remaining months on the existing PPOA between EcoElectrica and PREPA that expires on March 2022, because PREPA would otherwise pay the higher capacity payments in the existing PPOA. For the subsequent years it doesn't make sense to assume the original higher capacity payments (which include costs for debt service and return on investment) would have continued beyond their 2022 expiration, until 2032. PREPA should reassess its estimate of ECO PPOA savings for the years after the existing PPOA expires two year from now in March 2022, basing savings on a reasonable cost to use a 20 year old, fully paid LNG terminal and power plant with no other customers, whose forward capacity payment would not include costs for repaying the original debt and equity investment to build the facility.

Savings that would be additive to the \$71 million for the first two years is uncertain. Savings attributed to Costa Sur are said to initially average

⁴ On January 22, 2020, PREPA submitted its initial response to ROI #10, and included in its response a Sargent & Lundy report titled CS-0022 Eco and Naturgy Renegotiation Report_19 November 2019 ("S&L Report"), attached to the response as PREPA ROI_10_8 Attach 1.pfd. The S&L Report, discusses the savings in Impact of Proposed Amendments, Financial Savings.

approximately \$10 million per year and increase to \$29 million per year in the future due to the forecasted widening of the spread between natural gas and oil prices. This requires an assumption that future oil prices will increase above the assumptions in PREPA's model, which given the push for green power and resulting lower demand for oil, is highly questionable. The IRP Scenario 4 assumes Costa Sur Units 5 & 6 shut down in year 2 of the IRP, so no savings beyond that should apply. Even in those two years savings are now uncertain as a result of the earthquake damage to Costa Sur Units 5 & 6, and the pending PREPA assessment of when those units will be fixed and return to service.

On the other hand, a proper analysis of savings would discuss the impact of automatic annual cost escalators in the ECO PPOA and Naturgy GSPA, compared to inflation assumptions in modeled savings, including any contract provisions that appeared to state prices in 2020 dollars but which were actually 2019 levels in the proposed Agreements that have since escalated.

3. ECO PPOA capacity payments appear to be grossly excessive.

Capacity Payments for the first 507 MW. The proposed ECO PPOA would require PREPA to pay very high "capacity" charges just to reserve the facility, in addition to paying the above-market costs for the LNG. Of course, the

capacity payments are lower than before; EcoEléctrica no longer needs to repay the over \$700 million of original construction and investment costs. PREPA has repaid these over the past 20 years. As a result, PREPA and its ratepayers are entitled to and should expect a dramatic cost reduction. Additionally, per the existing PPOA, the current capacity payment has escalated each year since 1994, and includes a significant amount that is due to the PR-CPI over-estimating the rate of inflation from 1994-2006⁵; the resulting annual capacity payments otherwise would have been much lower today. Those mistakes resulted in windfalls to EcoEléctrica and its owners; which should not be included in any “savings” calculation.

Due to no longer needing to pay for the EcoEléctrica LNG terminal and power plant, combined with the unexpected capacity payment increases due to the over-estimated PR-CPI, estimating discounts in the ECO PPOA to the capacity payments in the existing PPOA are highly inappropriate and paint a misleading picture about the true ECO PPOA capacity payment discounts. Instead of comparisons to the existing PPOA capacity payments, the ECO PPOA capacity payments going forward should be justified based on the costs to be incurred by EcoEléctrica to operate and maintain the LNG terminal and

⁵ It is public information that the PR-CPI was over-estimating the rate of inflation beginning before the existing PPOA was signed, eventually corrected as of 2006. The Puerto Rico Departamento del Trabajo y Recursos Humanos (DTRH) published a technical note that shows the difference in inflation between the overstated PR-CPI index and the corrected PR-CPI index for the years 1985 through 2006 (Departamento del Trabajo y Recursos Humanos (DTRH), Nota Técnica, Índice Oficial de Precios al Consumidor de Puerto Rico Revisión 2010, September 10, 2010, <http://www.mercadolaboral.pr.gov/lmi/pdf/metodologia/IPC.pdf>).

power plant and meet its contractual requirements. This calculation has apparently neither been made or presented to the Energy Bureau. To the contrary, PREPA noted in its response to PREB-PREPA 10-08 that it only can account for approximately \$61 million of the expected \$148 million average annual capacity payments. The remaining \$87 million should be explained and justified.

The additional 23 MW, and higher availability. No clear analysis or rationale is given for paying for an additional 23 MW in capacity from 507 MW to 530 MW, or higher availability, for a facility that has never been fully utilized and is not projected to be. The 23 MW capacity increase and resulting 5% higher capacity payment per year, as well as the ability to get availability from 93% to 95% by paying an apparently high “bonus” (which is not detailed), is alleged as a benefit without their true costs being disclosed. There is no description of when, or if, these costly “benefits” would ever be used, and therefore no disclosure of expected additional megawatt hours and how the all-in costs per megawatt hour for these compare with the costs of the same electricity available (without additional capacity payments or bonuses) from other PREPA generating plants. A proper analysis would show how these would have been useful in the last 20 years, and what the effective price per megawatt hour would be during the term of the ECO PPOA given the very limited (if any) potential use in the future.

D. New costs and risks are not explained or justified.

Given the complex risk shifting to PREPA in the proposed Agreements, the transactions have not been thoroughly explained, nor the costs and risks justified. Many important aspects have only been addressed superficially or have not been addressed by PREPA in either its request to the Energy Bureau to approve the Agreements or evidence it provided within this proceeding.

1. Change in contractual structure.

a) Missing explanations of why structure changed.

The original PPOA, like most PPOAs in Puerto Rico and globally, simply had EcoEléctrica delivering power to PREPA. It is now being replaced (not amended) by a completely new 76-page agreement, which rather than being described section by section is briefly summarized to the Energy Bureau in a handful of pages and a simplistic risk table. Missing explanations include:

- after EcoEléctrica was solely responsible for procuring fuel and converting it to power for PREPA at a pre-agreed price formula for 20 years, why PREPA must now deliver LNG to the terminal to get the electricity it is paying for;
- why PREPA has to tell the Energy Bureau that (due to the “de facto monopoly” described above) it can only contract to buy LNG from

Naturgy, but cannot get either of its law firms to provide a definitive legal opinion that this is correct;

- how a tolling agreement and gas sales contract – as contrasted with a power purchase agreement – is eligible for a fast 30 day Energy Bureau review applicable to power purchase agreements, but at the same time exempt from competitive procurement.

b) Economic risks from the new “tolling” structure are not fully described or analyzed.

It should be explained why there was no evaluation from PREPA's or EcoEléctrica's counsel of changing legal and commercial risks to PREPA for conversion from a traditional PPOA to a tolling agreement. The submitted reports in this instant proceeding from Sargent & Lundy do not evaluate the increased fuel risk exposure to EcoEléctrica between the prior PPOA and the proposed ones. All circumstances should be identified and evaluated in which, if LNG is not delivered Naturgy, the damages payable to PREPA by Naturgy are capped and do not cover PREPA's damages of having to continue to pay capacity payments whether it gets electricity or not, and the higher cost of replacement fuel (oil, LPG) EcoEléctrica uses instead. If there is no risk to PREPA, or if PREPA is somehow better off being the stated but not actual LNG supplier, that should also be clearly explained. Explicit

language could be added that PREPA has no economic responsibility for fuel delivery, and Naturgy holds PREPA harmless for damages, capacity payments, and higher fuel costs incurred when fuel is not available or any other scenario where PREPA would not have incurred the costs under the original PPOA.

2. Fear of PURPA.

PREPA apparently justifies the contract price and terms by stating that EcoEléctrica is a Qualifying Facility under PURPA. Therefore, in the absence of a new PPOA, EcoEléctrica could become a “merchant” plant without a contract and require PREPA to pay avoided costs for the energy EcoEléctrica produces, which may be higher than the price in the ECO PPOA. As such, the PREPA concern is that EcoEléctrica has negotiating leverage that will increase if the PPOA expires or is terminated (meaning the proposed Agreements are the best PREPA can do). A thorough legal and commercial analysis from both PREPA and EcoEléctrica’s perspective would identify if this is a real threat or not, and how the economics and negotiations would play out. It is likely from EcoEléctrica’s and Naturgy’s perspective that having a power plant with no PPOA after 2022, because the owners pursued above market costs for an LNG terminal and power plant the island had already paid for, will not resonate with EcoEléctrica’s stakeholders or the public and private owners of EcoEléctrica's partners.

3. Failure to assure future EcoEléctrica availability if needed.

There is no provision or requirement for an ECO PPOA extension at PREPA's option after the 2032 expiration, or alternatively (if the owners do not wish to continue) to turn over the plant to PREPA for a nominal value. If the parties are assuming EcoEléctrica will be retired in 12 years, an extension option should be an easy provision to agree on in case, as is likely, the funds to replace a perfectly good (and repowerable) facility are not forthcoming or are used for renewables or other priorities. At minimum, the contract should be extendable year to year by PREPA with adequate (12-18 months) advance notice. In a contract that appears to be above or far above market, an ability for PREPA to unilaterally extend at the same price or a lower price should not be controversial, in case it cannot negotiate agreement on an acceptable extension at the time. While the Aurora model showed EcoEléctrica could be replaced by a new 300 MW plant at Costa Sur, the new plant may only seem better to the model because the proposed EcoEléctrica capacity and fuel payments are unreasonably high. By 2032, EcoEléctrica will have returned significant multiples on everyone's investment. If PREPA is entitled to take it over for a nominal cost, or pay only operating costs plus a margin, the model will likely show the EcoEléctrica power plant continuing rather than a new plant being built. Moreover, there is no assurance there will be capital available for new 300 MW plant.

The IRP contemplates up to approximately 3000 MW of solar plants coming online by the 2025 timeframe. These would have lives well past 2032. While the submissions allege that the Agreements support the IRP, there was no explanation of how an amendment extending only to 2032, with no PREPA extension options or buyout rights, would ensure EcoEléctrica would be available, if needed, to provide backup power and grid support for 3000 MW of solar plants with lives well past 2032.

4. Length of Agreements.

The rationale for agreeing to a 10-year term in the ECO PPOA and Naturgy GSPA should be provided, including an explanation of why a shorter term plus extension options for PREPA were not adopted. The San Juan New Fortress Energy (“NFE”) supply agreement term is only 5 years with multiple extension options at PREPA’s discretion. Why the major change in approach away from flexibility for PREPA? The rationale for approving the Agreements, should include a discussion of why PREPA did not choose current or future LNG spot price contracting, given the current low prices and oversupply condition which is expected to continue in the near to mid-term. Alternatively, the contracts could have price reopeners after 3 or 5 years, so PREPA could benefit from the glut of LNG expected to come into the market. (And escape the clearly above-market prices in the proposed Agreements.)

5. Take or pay requirements.

The original PPOA between EcoElectrica and PREPA had an indirect take or pay provision to ensure EcoEléctrica would run enough to consume the natural gas for the power PREPA had indicated it would need. In the new Agreements, the high take or pay could reduce PREPA's ability to dispatch future lower cost plants. A lower take-or-pay would allow PREPA to buy less expensive LNG on the spot market to reduce energy costs. It is important to understand the cost/benefits of the take or pay provisions in the Naturgy GSPA considering that PREPA took the opposite approach with the NFE contract, which has no annual take or pay requirements. There should be an explanation of how this contract will affect efforts to promote competition in the future.

Perhaps there is a strong rationale for the high take-or-pay for power, but it should be disclosed. Sometimes a high take-or-pay is a vehicle for getting low prices, but that has not been proposed here. This may be another area where the absence of an experienced LNG procurement advisor caused PREPA to think the take-or-pay provision proposed was the only option it had.

6. Additional LNG Delivery Points provision may inhibit competition.

The Naturgy GSPA contains a potentially useful provision allowing PREPA to ask Naturgy to evaluate other LNG delivery points besides EcoEléctrica, in anticipation of needing LNG at other power plants. But then it appears to give Naturgy the exclusive right (via a right of exclusive negotiation) to deliver LNG to those locations by diverting volumes from the Naturgy GSPA. PREPA should analyze how this provision may inhibit competition and affect other potential LNG suppliers interested in supplying LNG at the other LNG delivery points and how that could affect PREPA's overall LNG procurement efforts and pricing.

The lawyers could be asked if that preferential arrangement is acceptable, especially whether it allows the Naturgy GSPA to be modified to add more volumes to EcoEléctrica and Costa Sur to replace the diverted ones, all to avoid competitive procurement.

E. Standards for approving the proposed Agreements are not the same as for the IRP.

1. Approving the proposed Agreements or not is independent of approving the IRP.

Even with delivered natural gas and capacity payment overpricing in the Agreements, the Siemens Aurora model selects the Agreements because EcoEléctrica is cheaper than existing high PREPA cost generation. This is due to the fact that a significant percentage of PREPA's operating units are very

inefficient and use more expensive No. 6 fuel oil and very expensive diesel. Because EcoElectrica will continue to be cheaper than oil fired plants, as it has always been, knowing the final pricing and terms under the Agreements is not a determining factor to approve or not approve the IRP.

Approving the IRP does not require the Agreements to be approved, since either the continuation of the existing PPOA contract or an improvement in the proposed terms, would not change the relevant IRP conclusions. Over the IRP period, Scenario 4, Strategy 2 contemplates over 5000 MW of future generation facilities whose price and terms could be acceptable or unacceptable, but not knowing that today does not impair IRP approval. The proposed Agreements should be treated the same way. The IRP could assume a maximum cost (today's costs under the existing PPOA and GSA for the EcoEléctrica and Costa Sur power plants, respectively), but retain future authority over changes to the proposed Agreements. Even if it is determined that PURPA applies, as long as the EcoEléctrica power plant generates below PREPA's avoided cost, by definition it would still be selected (for operation and dispatch) in the same order since it is below the next lowest cost plant, so other IRP and Aurora decisions would be unchanged.

2. The possibility of PREPA overpaying or getting poor terms is a relevant Energy Bureau concern.

Any amount of PREPA overpaying an any agreement under the Energy

Bureau's jurisdiction, including the Agreements, jeopardizes the viability of adding other needed generation, including future solar generation and peaking generation – there is only so much money to go around.

The law (Act 17-2019) mandates that a key objective of the IRP process is to assure PREPA's customers the lowest reasonable short, medium, and long-term rates. By failing to use either competitive bidding or any other method to assess, adhere (or argue) that the ECO PPOA and Naturgy GSPA rates are reasonable, let alone the lowest reasonable, the Energy Bureau has not been given any basis to approve the Agreements or to conclude they are consistent with IRP standards.

Terms or pricing that are excessive or above market may diminish incentives to build other projects that could otherwise help lower generation costs paid by PREPA customers and/or encourage other suppliers to expect above market power prices. The ECO PPOA fixed capacity payments cost structure combined with the Naturgy GSPA fuel price - both over many years – plus other terms and conditions in the Agreements, should be analyzed from that perspective.

Using a competitive process of some sort, especially if the law requires it as the default process, is the best way to obtain favorable pricing and terms.

When competitive processes are not used and there is no good reason for an exception, it creates a bad precedent for future contracting. Some parties'

wanting to develop new projects (or financing such projects) may be less likely to be interested in making proposals, perhaps believing that competitive processes are formalities to select preferred or pre-arranged outcomes. This would predictably drive up prices for consumers, the pricing for any new projects will use the sole source Agreements (or NFE pricing) as a benchmark.

II. Proposed Peakers Replacement.

A. Unnecessarily limiting equipment choices will risk overpaying.

PREPA should avoid creating unnecessary requirements for the replacement peakers that limit the available technical solutions so that there is sufficient competition to keep overall costs low.

In PREPA's response to Arctas-PREPA-01-04, PREPA indicates that the specific gas turbine units used in the IPR modeling are only representative and that other units from reputable OEMs would also be acceptable.

In addition, in PREPA's response to Arctas-PREPA-01-01 a) PREPA stated that "*The IRP considered that the units would stay in place at each location deployed, so in any subsequent RFP, the mobile requirement is not necessary; with the exception of perhaps additional units to be purchased to address forced outages in the deployed peakers.*" Since PREPA already purchased in 2019 three 23 MW mobile units (which

could be used to address forced outages in the deployed peakers), it is unnecessary to specify in an RFP for replacement peakers that any of the units be mobile.

B. Offers from reciprocating engines and turbines should both be encouraged.

In the September 4 and 5, 2019 technical hearings, Siemens confirmed that reciprocating internal combustion engines (“RICE units”) are a good technology for integrating renewables. As such, an RFP for the replacement peakers should not require that bidders propose only gas turbines, but allow for any technology, including RICE units, that are suitable for operating service as modeled in the IRP – including with respect to peaking operations that support the grid and back-up renewables.

Similarly, bidders should be free to propose various fuels for primary and back-up fuel operations, provided fuel supply dependability and resiliency is sufficient and environmental requirements are met.

Finally, the RFP should encourage a solution where all peakers do not come from a single manufacturer. Having different types of engines at different sites will increase competition for all sites and reduce the one-size-fits-all, single source risk.

In summary, to obtain the lowest cost and favorable terms, the RFP for the replacement peakers should specify the requirements and let the bidders decide whether to propose the size of the units, gas turbines or engines, mobile or fixed,

and the primary fuels (natural gas from LNG or propane) and back-up fuels (diesel or No. 6 fuel oil) that they believe provides the best solution for PREPA.

III. Proposed Capacity Addition at Palo Seco.

A. Puerto Rico government resources should be available to all.

If PREPA wants to have or allow power plant bidders also arrange fuel supply, any Puerto Rico government assets or resources should be available on equivalent terms to any qualified bidder.

1. Land owned or controlled by any Puerto Rico government entity.

New natural gas fired generation at Palo Seco in the IRP is based on the presumption that a land based LNG terminal is feasible. IRP 7.1.2.9 references PREPA's own 2015 study of viable LNG terminal options in the San Juan harbor⁶ ("Galway Study"), which identifies a feasible location for land based LNG storage and regasification. The land where the identified land based LNG terminal would be located, and some of the surrounding land that could need to be controlled by the owner of the LNG terminal (for safety and security reasons typical and necessary to obtain required permits and approvals), is owned or controlled by PREPA or other Puerto Rico

⁶ IRP section 7.1.2.8, refers to the study as the June 2015 Galway Energy Advisors natural gas study for PREPA's northern power plants (San Juan and Palo Seco)

government entities. Any identified land, suitable for use all or in part for an LNG terminal, that is owned or controlled by PREPA or other Puerto Rico government entities should be made available to third parties on a reasonable equal basis in any competitive process for an LNG terminal to supply LNG to PREPA power plants.

2. Access to PREPA berths and dock

PREPA's response to ARCTAS-PREPA-02-04, B, i, states "*The agreement of PREPA and, during the term of the NFEnergía-PREPA Firm Sale and Purchase Agreement, NFEnergía, would be required in order for any entity seeking to develop any "SJ LNG Alternatives" to use the two berths or dock area directly in front of the San Juan steam plant to receive LNG and construct any required infrastructure.*" The aforementioned two berths and dock area ("PREPA berths and dock area") were identified in PREPA's Galway Study as the only viable locations within the San Juan harbor for LNG ship berthing and LNG unloading. If the permission NFEnergía ("NFE") acquired to use the PREPA berths and dock area, or its right to "veto" anyone else's use, was obtained as a result of PREPA relinquishing directly or indirectly in any way control it had over the PREPA berths and dock area to NFE, or any other entity, it should be disclosed and explained.

Given that the only identified viable locations within the San Juan harbor for

LNG ship berthing and LNG unloading are the PREPA berths and dock area, in order to obtain the lowest cost natural gas delivery to PREPA power plants, PREPA should ensure they are available to anyone under reasonable economic terms. PREPA and NFE should provide the Energy Bureau the relevant documents and detailed explanation of terms and conditions, if any, that result in NFE advantage or superior rights versus third parties to use the PREPA berths and dock area.

It would be helpful to ensuring the ratepayers costs are as low as possible, for PREPA to identify and recommend options to the Energy Bureau that would ensure dock and berthing area locations controlled by a single party are not an obstacle to a competitive process for the LNG supply to new capacity at Palo Seco and other PREPA generating units in the San Juan area.

Moreover, the Energy Bureau and other public agencies should understand the legality of any arrangements that would in effect create a private monopoly or a “de facto monopoly” using public facilities, especially in this case whereby control of the PREPA berths and dock area may have a negative effect on PREPA’s ability to procure fuel in accordance with Puerto Rico law, and thereby obtain the lowest cost LNG and delivered natural gas to its power plants.

If any prior agreements, such as the agreements for repowering San Juan 5 & 6, do not give full access (to allow any RFP bidder to use) to the locations

identified in the Galway study, that issue could be addressed in the inevitable future amendments and force majeure/delay discussions and settlements that will likely occur in the coming months.

B. A Palo Seco RFP could be structured not to include or advantage an LNG terminal owner.

Unless all RFP bidders have access to the PREPA berth and dock, such that no one, including NFE, has a competitive advantage with respect to access and use, there should be no expectation from PREPA that an RFP for additional capacity at Palo Seco that requires or allows bidders to also propose natural gas supply will garner much participant interest beyond NFE. Many potential bidders would assume that NFE will either be selected to build the power plant, or will effectively control who is selected.

If it is the case that PREPA decides not to assure equal access to the PREPA berth and dock, PREPA should establish an RFP such that all the bidders for the Palo Seco power plant are on an equal footing. For example, PREPA could:

- Separate natural gas fuel supply and delivery from the power plant RFP, and not allow participants in one to participate in the other.
- Rather than require or allow prospective bidders to individually negotiate LNG fuel supply with NFE (as PREPA and King & Spalding stated would be the case at the August 13, 2019 IRP technical hearing), PREPA should negotiate fuel procurement directly from LNG suppliers. PREPA should pre-

determine with NFE and specify in the RFP terms and conditions for LNG receipt, regasification, and natural gas forwarding to a delivery point at the Palo Seco plant boundary.

- The RFP terms should provide for the winning bidder and PREPA to cooperate to develop and permit the natural gas pipeline that would be required from the PREPA dock to the Palo Seco plant boundary.
- The winner of the Palo Seco power plant RFP would ultimately be the counterparty in the LNG supply and natural gas delivery contract negotiated by PREPA, with NFE perhaps providing terminal services at global market rates to the LNG supplier, the Palo Seco owner, and PREPA.

If PREPA decides not to create a level playing field for LNG supply and natural gas delivery (at Palo Seco) because of the contractual agreements made with NFE regarding the PREPA berths and docks, it could be very unfortunate for the ratepayers. The situation should not be compounded by conducting an RFP for additional capacity at Palo Seco that allows NFE's advantage to be leveraged so as to crowd out competition to supply natural gas to and build and operate the new power plant at the best combination of lowest cost and favorable terms.

IV. Recommendations.

A. Proposed ECO PPOA and Naturgy GSPA.

1. Standard of review.

A full review of the proposed ECO PPOA and Naturgy GSPA agreements by the Energy Bureau would always be essential, but more so if the submissions for approval are incomplete, inaccurate, or leave out material analysis to enable reviewers to fully compare the proposals to the current contracts and to market comparables where no competitive process is undertaken. Failure to include reports or evaluations from industry experts comparing the proposed terms to others in the industry, would indicate an incomplete record for the Energy Bureau to use to approve or disapprove the Agreements.

An incomplete record is clearly present here. PREPA's letter summarizing the contracts and urging approval, which includes the argument that a monopoly prevents competitive procurement, is based on erroneous and incomplete ownership and other assumptions, and (unsurprisingly) does not provide a corresponding legal opinion reflecting the same firm conclusion. The Energy Bureau should not be expected to approve the proposed Agreements under these circumstances.

In contrast to the Agreements, Arctas believes the IRP could be approved, based on the testimony received so far, but that the approval of the ECO PPOA and Naturgy GSPA deserves further scrutiny. Any improvement in

price or contract terms that result from a rejection and resubmission, would obviously also fit within the IRP, just as cheaper solar or peaking plants than those assumed will fit. Approving the IRP without first approving the ECO PPOA and Naturgy GSPA, is no different than the multiple other unapproved future PPOAs the IRP contemplates. Given the circumstances as they unfolded with respect to the proposed Agreements, we are convinced that an appropriate review of the proposed Agreements is best served by having the Energy Bureau consider the issues raised herein and determine if any follow-up with PREPA or EcoEléctrica is warranted.

2. Proper response to missing or inaccurate information.

The Energy Bureau could easily decide it has questions about the completeness of the disclosures and descriptions made to it regarding the proposed Agreements, or that other agencies or PREPA constituencies will have such questions that could later delay the proposed Agreements. If so, the proper course may be to affirm its prior finding that approval of the Agreements is not in the public interest, and suggest that parties return with evidence of a professional, independent market survey of LNG prices, a contract whose terms and risks are thoroughly disclosed and explained, and a competitive procurement strategy for LNG that clearly complies with Puerto Rico law.

Because of the apparent large amount that the capacity payments in the new agreement exceed the known annual EcoElectrica costs identified by PREPA in its response to PREB-PREPA-10, the Energy Bureau might also decide to require evidence of an arm's length negotiation, and ultimate reasonableness, of the capacity payment under any proposed contracts brought to it---even if the arrangements meet the FOMB fiscal plan \$80mm minimum savings target for PREPA's FY 2020 and even if Siemens' Aurora model shows EcoElectrica dispatching below other PREPA plants. Just because the new capacity payments or all-in costs are lower, does not make them reasonable and certainly not the "lowest reasonable". Thorough reviews by the Energy Bureau with expert advisors, of the regional and global competitiveness and reasonableness of the capacity prices, energy prices, fuel prices, terms and risks should be a prerequisite before the costs paid by PREPA under the Agreements are allowed to be passed through to Puerto Rico consumers or be considered legitimate operating costs superior to other PREPA creditors.

B. Peakers Replacement

For the proposed peakers replacement, the Energy Bureau should ensure multiple equipment types and manufacturers are allowed (and ideally selected) to increase versatility, reliability, and reduce risk of anyone counterparty or solution not performing as expected.

C. Capacity Addition at Palo Seco

For Palo Seco, the Energy Bureau should ensure a level playing field such that all potential suppliers have equal access to either the PREPA dock facilities, or to the LNG terminal.

CONCLUSION

WHEREFORE, Arctas requests the Commission consider and adopt in its decision the recommendation herein.

WE CERTIFY that this day we have sent this Final and Substantive Legal Brief, regarding Case No. CEPR-AP-2018-0001 using the Energy Bureau's electronic filing tool at: <https://radicacion.energia.pr.gov>.

RESPECTFULLY SUBMITTED in San Juan, Puerto Rico, this March 6, 2020.

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CERTIFICATE OF SERVICE

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