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**BY ELECTRONIC MAIL**

January 26, 2018

Justo González  
Executive Director  
Puerto Rico Electric Power Authority

**Re: Fourth Amendment to Emergency Master Service Agreement – Observations,  
Feedback not Required**

Dear Mr. González:

In accordance with the contract review policy of the Financial Oversight and Management Board for Puerto Rico (“FOMB”) established pursuant to Section 204(b)(2) of PROMESA, we have reviewed the proposed Fourth Amendment to the Emergency Master Service Agreement (“Proposed Amendment”) between the Puerto Rico Electric Power Authority (“PREPA”) and Cobra Acquisitions LLC (the “Contractor”) that were submitted to the FOMB on January 19, 2018.

After reviewing the Proposed Amendment, the FOMB concludes “Observations, Feedback not Required” because the FOMB has identified areas of risk, however, such areas of risk are not considered high and do not require feedback from the contracting party. It is the contracting party’s responsibility to take corrective action based on the observations provided and proceed with the procurement as they see fit. Our observations are described in the annex attached hereto.

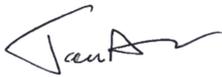
Please note that our review is solely limited to the compliance of the Proposed Amendment with PREPA’s Fiscal Plan dated April 28, 2016 certified by the FOMB and the other matters indicated in the attachment. The review performed by the FOMB does not cover (i) whether the procurement activities related to the selection of the Contractor complied with all the applicable rules and regulations or (ii) any requirements under the Agreements applicable to the Contractor and its compliance

therewith. Any material change to the Proposed Amendment must be submitted beforehand to the FOMB for its review.

Please note that this letter and its annex do not constitute legal advice nor guarantee that the Proposed Amendment complies with all applicable laws, rules, and regulations. This letter is delivered as of the date hereof and we reserve the right to provide additional observations and modify this letter based on information not available when the review was conducted.

This letter is issued only to PREPA and solely with respect to the Proposed Amendment.

Sincerely,

A handwritten signature in black ink, appearing to read 'Jaime A. El Koury', with a stylized flourish at the end.

Jaime A. El Koury  
General Counsel

CC: Mr. Gerardo Portela Franco

**Fourth Amendment to Emergency Master Service Agreement between Puerto Rico Electric Power Authority and Cobra Acquisitions LLC**

The Financial Oversight and Management Board for Puerto Rico established a contract review policy pursuant to section 204(b)(2) of the Puerto Rico Oversight, Management, and Economic Stability Act. Accordingly, there was a review of the documents submitted by the Government in connection to the proposed Fourth Amendment to the Emergency Master Service Agreement (“Proposed Amendment”) between Puerto Rico Electric Power Authority (“PREPA”) and Cobra Acquisitions LLC (the “Contractor”). After the initial review, there are the following observations:

*i. Consistency with then-applicable, or the future, fiscal plan for the contracting party*

There is clear strategic overlap between the desired outcomes of this contract, and the maintenance, and economic development goals, of both PREPA’s, and the Commonwealth’s Fiscal Plan. The contract covers emergency restoration repairs to the island’s transmission and distribution grid, to restore power to the island. Having a functional transmission and distribution system is a pre-condition to having a well-maintained and efficient power system, as well as a functioning economy. All of these are strategic goals of the relevant Fiscal Plans.

Further, so long as the costs to fund this project remain fully Federal Emergency Management Agency (“FEMA”) reimbursable, there will be no material financial impact on any Fiscal Plan.

Therefore, by adding no costs while applying a material benefit, the contract is aligned with the then-applicable, and likely future, relevant Fiscal Plans. Accordingly, the reimbursement process should be monitored, and if there is less than 100% reimbursement, an analysis on impact on the budget should be made.

*ii. Competitive and transparent procurement and tender process and consistent with relevant federal regulations*

The observations are based on 2 CFR 200 “Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards”, specifically §200.318 “General procurement standards,” and other applicable FEMA documents.

Please note as per the OCPC cover letter, “As reflected in the enclosed materials, executive personnel from the Federal Emergency Management Agency (“FEMA”), the United States Army Corps of Engineers, the Governor’s Authorized Representative, the PREPA Board of Governors, PREPA operational management, the Governor’s designated coordinator for power restoration services, and OCPC were each engaged in and endorsed the approach reflected in the Power Restoration Contract.”

	<b>General Requirements</b>	<b>Policy Reference</b>	<b>Observations</b>
<b>1</b>	<b>Was the procurement initiated under emergency or exigent circumstances?</b>	<b>2 CFR 200.320(F)(2)</b>  "Procurement by noncompetitive proposals. Procurement by noncompetitive proposals is procurement through solicitation of a proposal from only one source and may be used only when one or more of the following circumstances apply...The public	Page 2 of the PREPA request letter mentions that this amendment is being entered under PREPA's emergency procurement procedures "due to the ongoing emergency situation."  The original MSA states that the contract shall be in effect for twelve months. The contract may need to be competitively re-bid once exigent circumstances time period has ended, even if still within 12 month contract period.

	General Requirements	Policy Reference	Observations
		exigency or emergency for the requirement will not permit a delay resulting from competitive solicitation...."	<p>There are indications in the documentation that an RFP may be issued for these services. Recommend requesting and reviewing any available details around a planned procurement for these services including a timeline.</p> <p>Document reference: PREPA Request for FOMB Approval of Cobra Contract Amendment 4.pdf, PREPA MSA-Cobra (10-19-17).pdf</p>
2	<b>If yes, was documentation provided which supports the rationale for the exigent circumstance exception to a competitive procurement?</b>	<p><b>2 CFR 200.318(i)</b></p> <p>"The non-Federal entity must maintain records sufficient to detail the history of procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price."</p>	<p>An explanation was provided on page 2 of the PREPA request letter which states, "While the emergency situation is ongoing, PREPA has begun the process of issuing an RFP for the ongoing restoration of the electric grid once the emergency period has passed."</p> <p>Please see inquiry in ítem 1 regarding any forthcoming RFP.</p> <p>Document reference: PREPA Request for FOMB Approval of Cobra Contract Amendment 4.pdf</p>
3	<b>Has the Cost Estimate been provided?</b>	<p><b>2 CFR 200.323(A)</b></p> <p>"The non-Federal entity must perform a cost or price analysis in connection with every procurement action in excess of the Simplified Acquisition Threshold including contract modifications. The method and degree of analysis is dependent on the facts surrounding the particular procurement situation, but as a starting point, the non-Federal entity must make independent estimates before receiving bids or proposals."</p>	<p>Exhibit B-1 of Amendment 4 includes an amended Contractor's Rate Schedule. However, a price or cost analysis does not appear to have been provided related to this Amendment 4. Without a defined scope of remaining work and cost or price analysis, it is unclear how the increase in contract amount was determined.</p> <p>The contract ceiling value is being recommended to increase by more than double the original contract value. Including additional detail as to how the increase was derived and determined to be reasonable would be beneficial in providing greater transparency.</p> <p>It is also noted that in a letter dated December 23, 2017 from FEMA, FEMA states that it has reviewed the documentation and determined the original exigent circumstances procurement to be valid and that the rates are reasonable.</p> <p>Recommend that additional explanation as to how the contract ceiling increase was established is provided.</p> <p>Document reference: Exhibit D - Amendment 4</p>

	General Requirements	Policy Reference	Observations
			(Final approved by OCPC).pdf
4	Is rationale for contract type (price structure) included in the RTA?	<p><b>2 CFR 200.318(i)</b></p> <p>"The non-Federal entity must maintain records sufficient to detail the history of procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price."</p>	<p>Per page 6 of PREPA's response to FEMA (supplemental), it mentions that Cobra offered a blended daily rate which was noted as comparable to the rates offered by other contractors for the original contract amount. The amended blended daily rate for Amendment 4 appears to be lower than the original blended daily rate.</p> <p>While the price structure was provided based on a time and material or time and equipment type arrangement, it is unclear how the provided rate table relates to the scope of work in order to support the increase in contract amount.</p> <p>Please see inquiry in ítem 3 regarding how the increased ceiling was established.</p> <p>Document reference: PREPA Response to FEMA - Supplement dated December 14, 2017.pdf, Exhibit D - Amendment 4 (Final approved by OCPC).pdf</p>
5	If the Contract is structured as time and materials, has a determination been made that no other contract is suitable and does the contract include a ceiling price that the contractor exceeds at its own risk?	<p><b>2 CFR 200.318(j)(1)</b></p> <p>"The non-Federal entity may use a time and materials type contract only after a determination that no other contract is suitable and if the contract includes a ceiling price that the contractor exceeds at its own risk."</p>	<p>The original MSA included a ceiling price of \$200,000,000, which is to be increased per Amendment 4 to \$445,429,800.</p> <p>Additional detail surrounding the contract increase may allow for greater transparency as to why a significant increase in contract ceiling price is being recommended. The requested contract increase should relate to specific work requirements remaining to bring the electrical grid to a point where a contract for non-exigent but ongoing restoration work can be awarded.</p> <p>Please see inquiry in ítem 3 regarding how the increased ceiling was established.</p> <p>Document reference: Exhibit D - Amendment 4 (Final approved by OCPC).pdf</p>
6	Other Observations	N/A	<p>Article 29 in the original MSA regarding Compliance with Laws, Regulations, and Executive Orders: "The Contractor acknowledges that starting on October 25, 2017, FEMA financial assistance will be used to fund this Contract. From and after this date, the Contractor shall comply with applicable Federal and Commonwealth of Puerto Rico laws, regulations, executive orders, policies,</p>

	General Requirements	Policy Reference	Observations
			<p>procedures, and directives, including but not limited to the Federal Cost Principles set forth in 2 C.F.R. Part 200 for Contractor's material costs, and applicable FEMA regulations in 44 C.F.R. Chapter I. Any failure to secure approvals or funding from FEMA or some other source (except due to the Contractor's sole fault) shall not relieve PREPA from its obligations for payment under this Contract.”</p> <p>The final sentence above establishes that PREPA will be obligated for payment under this contract even if FEMA funding is withheld. The availability of FEMA funding will likely be reliant on the quality and organization of underlying supporting documentation of work performed and costs incurred.</p> <p>Recommend that PREPA take steps to provide oversight over the contractor and ensure that adequate supporting documentation of work performed and costs incurred are being maintained to support FEMA reimbursement.</p> <p>Document reference: PREPA MSA-Cobra (10-19-17).pdf</p>

**Other observations**

*iii. Reasonability of contract terms*

*Review of contract costs*

First, we should note that the cost is difficult to benchmark because much of it is aggregated. That said, we can make some assumptions: 1) first we will break down expected labor cost; 2) we will benchmark equipment costs where available, and 3) we will reaggregate these to create a synthetic benchmark for the rates in the contract.

Because this process does not create a direct benchmark, we consider it an indicator of pricing reasonableness, but a more detailed breakdown is needed in the contract to do this exercise well. Gaining cost transparency, as we suggest as part of our mitigation measures, is thus a critical next step to understand Cobra’s margins, and the reasonableness of the contract.

*Difficulty in benchmarking costs*

The nature of the contract makes it difficult to evaluate the reasonableness of the contract costs. We would need more information to do a proper evaluation, but an outside-in evaluation reveals that the rates may be higher than expected. More analysis would be needed to make a definitive conclusion.

To explain, Exhibit B-1 in “Exhibit D – Amendment 4 (Final approved by OCPC.pdf)” gives the most granular detail available on how the rates were derived for the contracts. In the Exhibit, ~80% of the total cost comes from a single line item: “Blended rate, skilled linemen and equipment, Transmission/Distribution/Substation.” This line blends the cost of all labor and equipment at a rate of \$3,760 per day. Without further detail into how this figure was constructed, it is difficult to offer a perspective on whether it is reasonable.

That said, we can make an effort to make a bottoms-up calculation of what the daily rate should be, and compare it to the \$3,760 per day.

### *1) Estimating labor costs*

To do this, we would begin by estimating labor costs. The Bureau of Labor Statistics, estimates that average wages for Electrical Power-Line Installers and Repairers nationally is \$34.49. This figure varies nationally, and in normal times it is lower in Florida and Puerto Rico, with base wages in the \$20s depending on the metropolitan area. That said, there is a premium associated both with emergency work, and with attracting a mainland workforce to work in Puerto Rico. Press reports reveal a range of wages for electrical repair lineman as estimated between \$50 and possibly as high as \$100 per hour (a figure typically for overtime or Sunday work). If we use the top rate of \$100/hr figure as the gross cost of labor to Cobra (a figure that includes, overhead, margin, training, etc.), it would likely be an extremely generous reading of their costs. For the sake of conservatism in our estimates of labor costs, we will make this concession in estimation.

### *2) Estimating equipment costs*

If one assumes a 12-hour day, typical in emergency situations, that would mean that of the \$313 hourly cost per FTE (\$3760/12 hours), \$100 is for labor, and the remaining \$213/hr would need to be covered by the cost of equipment.

A few things to note about this remainder:

1. The ratio of labor to equipment costs seems low here, implying a high margin for Cobra is embedded in the equipment costs. About 32% of the costs of this contract are for labor, assuming all capital expenses are included in this line item. Although this figure would be appropriate for a new capital project, maintenance projects such as this, even those with a significant re-build component, would have a labor ratio closer to 40-60%.
2. The list of equipment as specified in Exhibit C of “PREPA MSA-Cobra 10-19-17” would not seem to justify this high equipment cost. The list includes 273 pieces of equipment that has a wide variety of costs, from the simple “twelve standard haul trucks” to the much more expensive “five MD 500 rotary aircraft.” Though the list includes no unit costs or predicted intensity, we can estimate costs for about half of the items from FEMA’s Schedule of Equipment:

Cobra List	Quantity	FEMA List	FEMA Cost/hr (Upper ranges)	Assuming 100% utilization	
				Total cost/hr	Per person/hr
<b>Pressure Digger</b>					
Pressure Digger	5	Derrick, Hydraulic Digger (90ft)	\$54.66	\$ 273.30	\$ 0.41
<b>Puller</b>					
3500-4000# Four Drum	10	Wire Puller Machine	\$19.85	\$ 198.50	\$ 0.30
<b>Tensioner</b>					
Tensioners 72" Bullwheel	10	Wire Tensioning Machine	\$14.50	\$ 145.00	\$ 0.22
<b>Trucks</b>					
Pickup Truck	60	Truck, Pickup	\$27.50	\$ 1,650.00	\$ 2.49
<b>Specialty Truck</b>					
Flat Bed Haul Truck	4	Flat bed utility trailer	\$3.10	\$ 12.40	\$ 0.02
Standard Haul Truck	12	Truck, Dump	\$77.80	\$ 933.60	\$ 1.41
<b>Rotary Aircraft</b>					
MD 500	5	Helicopter	\$576	\$ 2,880.00	\$ 4.35
Total of costed items	106			\$ 6,092.80	\$ 9.20

This list includes both inexpensive and expensive items, and if these 106 items were utilized 100% of the time, it would imply a cost of \$6,092 per hour. Spread out over the costs of the 662 FTEs, brings this to a \$9.20 per person per hour cost. If the 106 items costed here are representative of the 273 items in the MSA, then the total per person hour costs of the equipment should be about 2.6 times, this or ~\$24 / hr / person in equipment costs. This figure is significantly lower than the \$213 gap that the cost of labor implies.

### 3) Developing a synthetic benchmark

Removing the \$24 per hour from the \$213 leaves a gap of \$189 per hour that cannot be readily explained, hinting that the costs may be too high. The gap between the rate that was built up in this exercise of \$124/hr, and the given rate of \$313/hr, cannot be readily explained with available contract information.

#### iv. Absorption of risks by the government

Other commercial terms within the contract, do seem to be reasonable. For example:

- For Time and Materials work, the contract allows for "contract release", which defines key terms for each purchase order (e.g., scope of work, quantities, value and a start date) (Articles 1 and 2 of the "PREPA MSA-Cobra 10-19-17")
- Provisions do exist to generate Change Orders and its related process is well defined (Article 7 of the "PREPA MSA-Cobra 10-19-17")
- The payment process is well defined (Article 7A of the "PREPA MSA-Cobra 10-19-17").

A risk though in the contract left unaddressed is that, because of the limited delivery Key Performance Indicators included in the contract, PREPA is bearing all the quantity risk, and there is no assurance of what percentage of the project will actually be completed over the next 77 days. There is no documentation of what percentage of the expected work has currently been completed, and what percentage of the work is expected to be completed over the next 77 days. PREPA should make clear their expectations, and that they have the right to terminate the contract if the actual rate of progress deviates too significantly from the expected progress, at PREPA's judgment.

To minimize the government's risk exposure on this contract, a number of mitigation steps are recommended, including but not limited to:

- Obtain more clarity around rates including:
  - Clear breakdown of blended rate into labor and equipment rates

- Breakdown of labor by hour and type of work
- Breakdown of equipment by asset and utilization
- Understand the reason for the rate decrease between what was found in the MSA and Amendment 4 (Exhibit D)
- Obtain a clear view on what percentage of the work has been completed by Cobra thus far
- Obtain a clear view on the forecast for the number of days that will be required to finish Cobra's scope of work

### **Observations on Compliance with General P.R. Government Contracting Laws and Regulations for the Proposed Amendment**

The Extension was evaluated to confirm compliance with applicable Puerto Rico government contracting laws and regulations. Following are some key observations applicable to each contract:

- Although the preambles of the Original Contract and the Amendment mention PREPA's Enabling Act, they do not include the specific provision that authorize PREPA to execute contracts as required per P.R. LAWS ANN. Tit. 3, § 8613(b).
- The Contractors articles of incorporation do not appear to have been included as required per P.R. LAWS ANN. Tit. 3, § 8613(d).
- Article 14 of the Original Contract does not expressly include PREPA's right to terminate the Contract, without prior notice, due to negligence or abandonment of the Contractor's obligations as per P.R. LAWS ANN. Tit. 3, § 8615(m).
- Contract does not appear to include clause certifying that there is no economic interest by a public official with the power to approve or authorize the contract as per P.R. LAWS ANN. Tit. 3, § 8615(f).
- Contract does not appear to include clause certifying that no executive agency may execute contracts with or in benefit of ex public officials as per P.R. LAWS ANN. Tit. 3, § 8615(h).
- Contract does not appear to include authorization from the Governor of Puerto Rico or a person delegated by given the dollar size of the contract as per ACT NO. 3-2017, ARTICLE 18; OFFICE OF THE CHIEF OF STAFF MEMORANDUM NO. 2017-001; OGPE CIRCULAR LETTER 141-17.