

**FINANCIAL OVERSIGHT AND MANAGEMENT BOARD
FOR PUERTO RICO**



José B. Carrión III
Chair

Members

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

*Natalie A. Jaresko
Executive Director*

BY ELECTRONIC MAIL

August 12, 2018

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

Dear Governor Rosselló Nevares:

This letter serves as a Notice of Violation pursuant to Section 202(c)(1)(B) of PROMESA that the Financial Oversight and Management Board (the “Oversight Board”) has determined, in its sole discretion, that the proposed Puerto Rico Electric Power Authority (“PREPA”) revised budget for fiscal year 2019 (“FY19”), submitted to the Oversight Board on August 6, 2018, is not compliant with the revised version of the New Fiscal Plan for PREPA (the “Oversight Board PREPA Fiscal Plan”) as certified by the Oversight Board on August 1, 2018. The Oversight Board looks forward to reviewing a revised budget that it hopes it can determine is compliant with the Oversight Board PREPA Fiscal Plan so that the Oversight Board can certify on or before the deadlines set forth in this letter.

Background

At the Oversight Board’s eleventh public meeting, held on December 5, 2017, the Oversight Board outlined an approach to the FY19 integrated budget review process, including guiding principles and key milestones.

By letter dated December 13, 2017, the Oversight Board, pursuant to Section 202(a), set a schedule for PREPA’s submission to the Oversight Board of the proposed budget for FY19, and requested that the budget be prepared in accordance with the principles established by the Oversight Board.

By letter dated December 21, 2017, the Oversight Board provided a revised schedule for the FY19 budget process due to the delay in the certification of the Oversight Board PREPA Fiscal Plan.

By letter dated January 5, 2018, the Oversight Board provided guidelines for Milestone 1 (complete inventory listing), which was due on January 10, 2018.

Hon. Rosselló Nevares

August 12, 2018

Page 2 of 4

By letter dated February 5, 2018, the Oversight Board provided guidelines for Milestone 2 (proposed revenues), which was due on February 23, 2018.

By letter dated February 22, 2018, the Oversight Board provided a revised schedule for the FY19 budget process due to the delay in the certification of the Oversight Board PREPA Fiscal Plan.

By letter dated May 8, 2018, the Oversight Board set deadlines for intermediate steps before the FY19 budget for PREPA could be adopted and set May 25, 2018 as the date by which PREPA must provide its proposed budget and supporting detail, which includes a detailed reconciliation between the budget and the Oversight Board PREPA Fiscal Plan, budget to actual templates, and key performance indicators for reporting post-certification. The Oversight Board also requested that all the Oversight Board PREPA Fiscal Plan attributes, including revenue and expenditure measures, be incorporated into Milestone 4 (proposed expenditure budget and reporting templates), and required that total expenditures be consistent with the Oversight Board PREPA Fiscal Plan. Finally, the Oversight Board provided the revenue forecast as required by Section 202(b).

By letter dated June 29, 2018, the Oversight Board certified a revised version of the Fiscal Plan for the Commonwealth of Puerto Rico as developed by the Oversight Board. This revision required corresponding changes to the FY19 budget for PREPA as certified by the Oversight Board on June 30, 2018.

By letter dated June 30, 2018, the Oversight Board certified the FY19 budget for PREPA as set forth in the Unanimous Written Consent dated June 30, 2018

By letter dated August 1, 2018, the Oversight Board provided a revised revenue forecast to the Governor for use in developing the revised budget for PREPA.

PREPA's Submission

The Oversight Board and PREPA's management have been in discussion over several collaborative working sessions, in advance of the August 17, 2018, budget certification and the Oversight Board recognizes that PREPA and its advisors have worked hard with the Oversight Board's and advisors in the development of the revised FY19 Budget.

PREPA's budget submitted on August 6, 2018 is not compliant with the Oversight Board PREPA Fiscal Plan and does not meet the requirements set forth by the Oversight Board in its correspondences with PREPA. The Oversight Board requires further revisions and additional information from PREPA before it can approve PREPA's revised budget on August 17, 2018.

Pursuant to Section 104(c), the Oversight Board requests all outstanding information in the correspondence with PREPA as outlined above. This will enable the Oversight Board to review the proposed budget in its entirety and determine its compliance with the Oversight Board PREPA Fiscal Plan.

A summary of items that remain outstanding are included below.

Review of Budget Compliance

The following items represent variances that are in violation with the Oversight Board PREPA Fiscal Plan¹ and budget milestones guidelines:

<p>Inconsistent budgeted expenses as compared to those outlined in the Fiscal Plan</p>	<p>Does not comply with the operating and maintenance labor expenses as laid out in the Oversight Board PREPA Fiscal Plan for the following items:</p> <ul style="list-style-type: none"> - Salaries and wages - Overtime pay - Christmas bonus elimination - \$125 per month per person in medical benefit costs²
<p>Non-Compliance with Certain Milestone 2 and 4 Guidelines</p>	<p>Does not adhere to various required budget milestone guidelines. Certain key documents and data points required for reasonability testing of projections and budget-to-actual reporting are still outstanding.</p>

The following item represents additional requirements to be included as part of the revised proposed budget to be submitted by PREPA:

<p>Breakdown of operating labor and maintenance expenses</p>	<p>The revised proposed PREPA budget shall include a breakdown of operating labor and maintenance expenses, including allotted amounts for the Christmas bonus and healthcare insurance contributions, along with any supporting information and documentation.</p>
---	---

Furthermore, below you will find the remaining schedule for developing, submitting, and certifying the budget for PREPA as follows:

1. By **August 15, 2018**: The Governor shall submit a revised proposed budget which has been approved by PREPA’s Governing Board in electronic format and any supporting documentation to the Oversight Board, including a detailed breakdown of operating labor and maintenance expenses as described above.

¹ Preliminary observations of violations identified as of August 9, 2018, include inconsistencies with the Certified Fiscal Plan dated August 1, 2018, incomplete submission, guidance not followed and missing supporting information.

² The \$125 per month per person rate is based on estimation and interpretation of Act 26-2017. This limitation excludes employees and dependents with pre-existing conditions. The savings currently estimated are based on best available data from PREPA.

2. By **August 17, 2018**: (a) If the Governor submits a revised, compliant budget to the Oversight Board on or before August 17, 2018, the Oversight Board shall approve it and issue a compliance certification to the Governor. (b) If the Governor fails to submit a revised, compliant budget to the Oversight Board, the Oversight Board shall submit its own compliant budget to the Governor on August 17, 2018 and that budget, pursuant to PROMESA §202(e)(4), shall be (i) deemed to be approved by the Governor, (ii) deemed to be subject to a compliance certification issued by the Oversight Board to the Governor, and (iii) in full force and effect as of the date of compliance certification issued by the Oversight Board.

Conclusion

We are committed to reviewing the revised submission promptly and certifying a budget that is compliant with the Oversight Board PREPA Fiscal Plan.

Sincerely,



Natalie A. Jaresko

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

CC: Christian Sobrino Vega
PREPA Governing Board
José F. Ortiz Vázquez
Todd W. Filsinger
Gerardo Lorán Butrón