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1 **Richard R. Lawless**

2 **(Pro Se, Amicus Curiae)**

3 **UNITED STATES DISTRICT COURT**

4 **SOUTHERN DISTRICT OF NEW YORK**

5 In re:

6 THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO,

7 as representative of

8 THE PUERTO RICO ELECTRIC POWER AUTHORITY ("PREPA"),

9 Debtor.

10 Case No. 17-BK-4780 (LTS)

11 (Title III)

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12

13 **MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF AND TO SUBMIT EVIDENCE**

14 **OF MATERIAL MISREPRESENTATIONS**

15 **Introduction**

16 Richard R. Lawless ("Movant"), respectfully moves this Court for leave to file an

17 *amicus curiae* brief and supporting exhibits in the above-captioned Title III

18 proceeding. Although Movant is not a party, he is a federally recognized

19 whistleblower under the Dodd-Frank Act who has uncovered evidence directly

20 relevant to the integrity of these proceedings.

21 The interests of justice, transparency, and the integrity of this Court's record

22 warrant consideration of the materials Movant seeks to submit.

---

23

24 **Background**

- 25 1. Movant is a former financial executive and investigative journalist who
- 26 provided evidence of municipal bond fraud to the U.S. Securities and
- 27 Exchange Commission ("SEC") and other federal agencies.

2. Through Freedom of Information Act (“FOIA”) disclosures and related investigative files, Movant has obtained documentation—previously withheld from Congress and the public—that demonstrates material misrepresentations and concealment of risk in connection with Puerto Rico’s bond issuances, including PREPA obligations.
3. Movant has reason to believe that certain counsel representing government entities in this proceeding have made statements inconsistent with documentary evidence in their possession, raising concerns of misrepresentation to this Court.

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## **Argument**

### **1. Authority to Allow Amicus Participation**

This Court has broad discretion to permit amicus filings where they “assist in a case of general public interest, supplement the efforts of counsel, and draw the court’s attention to law that might otherwise escape consideration.” *Leigh v. Engle*, 535 F. Supp. 418, 420 (N.D. Ill. 1982). The PREPA restructuring is a matter of national economic significance, affecting over \$9 billion in bond debt and the reliability of Puerto Rico’s power grid.

### **2. Unique Interest and Perspective**

As a federally recognized whistleblower with direct knowledge of fraud investigations into Puerto Rico’s bond offerings, Movant brings a unique perspective and evidence that parties to this proceeding may not present, either due to conflicts of interest or incentives to suppress damaging information.

### **3. Assisting the Court in Preventing Misrepresentation**

The integrity of judicial proceedings requires that no false statements or material omissions be permitted to influence the Court’s decisions. Allowing Movant to submit his amicus brief and accompanying exhibits will aid the Court in ensuring a complete and accurate record.

**Relief Requested**

For the foregoing reasons, Movant respectfully requests that this Court:

1. Grant leave for Movant to file an *amicus curiae* brief;
2. Permit Movant to submit supporting documentary evidence (attached as Exhibits A–E) relevant to alleged misrepresentations in this proceeding; and
3. Direct that the Clerk docket Movant’s brief and exhibits as part of the record in this case.

---

**Conclusion**

Movant does not seek to delay or disrupt these proceedings but only to ensure that the Court has before it all relevant evidence, including materials withheld from Congress and the public. The interests of justice and judicial integrity weigh heavily in favor of granting this motion.

Respectfully submitted,

---

*Richard R. Lawless*

30279 Reding Avenue

Murrieta, CA 92563

Phone: (951) 440-5230

Email: richardrlawless@gmail.com

Dated: September 7, 2025

**Richard R. Lawless**

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Tel: (951) 440-5230

Email: richardrlawless@gmail.com

2025 OCT 1 PM 2:30  
CLERK'S OFFICE USDC PR

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September 24, 2025

Clerk of Court

United States District Court

District of Puerto Rico

Federal Building & U.S. Courthouse

150 Carlos Chardón Street, Room 150

San Juan, PR 00918-1767

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**Re:** In re Puerto Rico Electric Power Authority (PREPA), Title III Case No. 17-BK-4780 (LTS)  
(Related Case No. 17-BK-3283 (LTS))

Dear Clerk of Court:

Enclosed please find for filing in the above-captioned case the following document:

- **Motion for Leave to File Amicus Curiae Brief**
- **Amicus Brief**
- **IFP if Needed**

I respectfully request that this filing be docketed in Case No. 17-BK-4780 (LTS) and reflected in the related lead case, 17-BK-3283 (LTS). A certificate of service is included, reflecting service upon the parties required by the Court's rules and the PROMESA Title III procedures.

Please do not hesitate to contact me if there are any issues with this submission. Thank you for your assistance.

Respectfully submitted,

/s/ Richard R. Lawless

Richard R. Lawless

Pro Se Party / Interested Party

2025 OCT 1 PM 2:30

CLERK'S OFFICE USDC PR  
RECEIVED AND FILED

**Re: In re Puerto Rico Electric Power Authority, Title III Proceedings under**  
**PROMESA**  
**Case No. 17-BK-4780 (LTS)**

Dear Clerk of Court,

Enclosed please find the following documents for filing in the above-captioned matter before Judge Laura Taylor Swain:

1. Motion for Leave to File Amicus Curiae Brief and to Submit Evidence of Material Misrepresentations;
2. Amicus Curiae Brief of Richard R. Lawless; and
3. Exhibits A–E (supporting documentary evidence).

I respectfully request that these documents be docketed in the official record of this case and brought to the attention of the presiding judge.

Please kindly confirm receipt and filing of these materials. Should the Court require any additional copies or information, I will promptly provide them.

Thank you for your attention and assistance.

Respectfully submitted,

*Richard R. Lawless*

**DECLARATION OF RICHARD R. LAWLESS**

**IN SUPPORT OF AMICUS CURIAE BRIEF**

I, Richard R. Lawless, declare under penalty of perjury pursuant to 28 U.S.C. § 1746 as follows:

**1. Background**

I am over the age of 18 and competent to testify to the matters set forth herein. I am a former financial executive and investigative journalist.

**2. Whistleblower Status**

I am a federally recognized whistleblower under the Dodd-Frank Wall Street Reform and Consumer Protection Act. In that capacity, I made disclosures to the U.S. Securities and Exchange Commission ("SEC") and other agencies concerning systemic fraud in Puerto Rico's municipal bond offerings, including the Puerto Rico Electric Power Authority ("PREPA").

**3. SEC Submission and Acknowledgment**

My submission was assigned file number PREPA B-2949. The SEC's Whistleblower Office classified my information as "specific, significant, and credible."

**4. Evidence of Withheld Information**

a. I obtained through the Freedom of Information Act ("FOIA") and related investigative processes documentary evidence showing that federal regulators knew of widespread fraud in Puerto Rico's bond issuances.

b. Among these materials is **Report HR 1049**, which acknowledges regulator knowledge of material misrepresentations before PROMESA hearings.

c. I also obtained a **22-page Treasury-SEC email chain**, which confirms that whistleblower disclosures were intentionally withheld from Congress during the consideration of PROMESA.

d. I presented these matters in a videotaped briefing to over 40 SEC enforcement attorneys.

**5. Misrepresentations in Current Proceedings**

I have reviewed filings and statements in Case No. 17-BK-4780 (LTS). In my



professional judgment and based on my knowledge of the withheld evidence, certain representations by government counsel are materially misleading or incomplete.

**6. Purpose of Declaration**

I submit this declaration to ensure the Court has before it a complete factual record and to prevent any decision from being based on misrepresentations or omissions. My only interest is to assist the Court in preserving the integrity of these proceedings.

---

I declare under penalty of perjury that the foregoing is true and correct.

Executed on September 7, 2025, at Murrieta, California.

---

**Richard R. Lawless**

30279 Reding Avenue

Murrieta, CA 92563

Phone: (951) 440-5230

Email: richardrlawless@gmail.com

(Signature) *Richard R. Lawless*

1 **BRIEF OF RICHARD R. LAWLESS AS AMICUS CURIAE IN SUPPORT OF JUDICIAL**  
2 **INTEGRITY AND COMPLETE RECORD DISCLOSURE**

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3  
4 **Statement of Interest**

5 Amicus Curiae, Richard R. Lawless (“Amicus”), is a federally recognized  
6 whistleblower under the Dodd-Frank Wall Street Reform and Consumer  
7 Protection Act. Amicus has provided documentary evidence to the U.S. Securities  
8 and Exchange Commission (“SEC”) and the U.S. Treasury Department concerning  
9 widespread fraud in the issuance of Puerto Rico’s municipal bonds, including the  
10 bonds of the Puerto Rico Electric Power Authority (“PREPA”).

11 As a former financial executive and investigative journalist, Amicus uncovered  
12 evidence—subsequently verified through Freedom of Information Act (“FOIA”)  
13 disclosures—that demonstrates material misrepresentations by both bond issuers  
14 and government counsel. Amicus respectfully submits this brief to ensure that the  
15 Court has before it the evidence necessary to prevent material misstatements  
16 from influencing these proceedings.

---

17  
18 **Summary of Argument**

19 The integrity of these Title III proceedings depends on the Court’s access to  
20 accurate, complete, and non-misleading information. Documentary evidence in  
21 Amicus’s possession, including the document identified as **“Report 1049” (HR**  
22 **1049)**, SEC whistleblower records, and Treasury–SEC email communications,  
23 demonstrates that federal regulators had knowledge of significant fraud in Puerto  
24 Rico’s bond issuances *prior* to the enactment of PROMESA and prior to the  
25 restructuring negotiations.

26 Despite this, counsel for government entities in these proceedings have made  
27 statements that omit or contradict these findings. Permitting such statements to  
28 stand unchallenged risks misleading the Court, undermining public confidence,  
29 and perpetuating injustice against creditors, ratepayers, and the public.



---

## Argument

### I. This Court Has Discretion to Accept Amicus Participation

District courts have broad discretion to allow amicus briefs that “assist in a case of general public interest, supplement the efforts of counsel, and draw the court’s attention to law or facts that might otherwise escape consideration.” *Leigh v. Engle*, 535 F. Supp. 418, 420 (N.D. Ill. 1982).

The PREPA Title III proceeding is one of the most consequential restructurings in U.S. history, involving billions of dollars, critical infrastructure, and the trust of the financial markets. The public interest strongly favors consideration of relevant whistleblower evidence.

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### II. Amicus Possesses Unique and Relevant Evidence

Amicus brings to this Court evidence unavailable from other parties, including:

1. **SEC Whistleblower File PREPA B-2949** – Designating Amicus’s submissions as “specific, significant, and credible,” documenting systemic fraud in PREPA bond issuances.
2. **Report HR 1049** – An internal Treasury–SEC memorandum acknowledging knowledge of fraud prior to PROMESA hearings, withheld from Congress and the courts.
3. **22-Page Treasury–SEC Email Chain** – Demonstrating deliberate withholding of whistleblower disclosures from Congressional oversight committees.
4. **Presentation to SEC Enforcement Staff** – Videotaped briefing by Amicus to over 40 SEC attorneys confirming red flags in Puerto Rico bond offerings.

These materials collectively establish that regulatory agencies and counsel had actual knowledge of material misrepresentations yet failed to disclose them in proceedings before Congress and this Court.

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**III. Misrepresentations and Omissions Threaten the Integrity of the Proceedings**

Statements by government counsel have minimized or denied awareness of fraud in PREPA bond issuances. These statements conflict with the documentary record in Amicus's possession. Allowing such contradictions to go unaddressed risks tainting judicial findings with incomplete or inaccurate facts.

The duty of candor to the tribunal requires full disclosure of material information. *Model Rule of Professional Conduct 3.3(a)(1)* prohibits attorneys from knowingly making false statements of fact or law. By omitting evidence known to them through regulatory files, government counsel risk violating these obligations.

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**IV. The Court Should Admit the Amicus Brief and Exhibits to Ensure a Complete Record**

Admitting this Amicus Brief and accompanying exhibits will not delay the case or prejudice the parties. To the contrary, it will protect the Court's decision-making from reliance on incomplete or inaccurate information. The public interest, the rule of law, and the integrity of this historic restructuring weigh heavily in favor of full consideration of this evidence.

---

**Conclusion**

For the foregoing reasons, Amicus respectfully requests that this Court grant his motion for leave to file, accept this Amicus Curiae Brief, and consider the attached exhibits (HR 1049, SEC whistleblower file excerpts, FOIA disclosures, and related evidence) as part of the record.

Respectfully submitted,

*Richard R. Lawless*

30279 Reding Avenue

Murrieta, CA 92563

Phone: (951) 440-5230

Email: richardrlawless@gmail.com

Dated: September 7, 2025

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### **Exhibits**

- **Exhibit A** – SEC Whistleblower Summary.
- **Exhibit B** – Report HR 1049 Summary
- **Exhibit C** - HR 1049 Report
- **Exhibit D** – 22 Page Internal E-Mail Between SEC and Treasury
- **Exhibit E** – IFP Request if Needed

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- **Exhibit A – SEC Whistleblower Summary.**

## **Congress Legislated on a Lie: The SEC Buried My Whistleblower Testimony**

By Richard R. Lawless

Dodd-Frank Protected Whistleblower

In June 2016, Congress passed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), creating an unelected fiscal board to oversee Puerto Rico's finances and laying the groundwork for the largest municipal bankruptcy in U.S. history. Lawmakers insisted the island's collapse was sudden, unforeseeable, and demanded extraordinary federal intervention.

But that narrative was false — and I know, because I was the whistleblower who tried to warn them.

As a Dodd-Frank protected whistleblower, I presented evidence showing Puerto Rico's public utility, PREPA, was operating as a Ponzi scheme. PREPA was insolvent as early as 2010, yet it continued selling bonds by borrowing new money to pay old investors. Hundreds of millions in equipment funds vanished annually. PREPA even paid for high-grade oil while accepting cheap sludge fuel, a scheme that cost Puerto Rico more than \$1.5 billion.

I submitted this [testimony](#) — supported by a detailed presentation — to the Securities and Exchange Commission, the Department of Justice, and the Treasury Department well before Congress held hearings on PROMESA. Yet when lawmakers convened on April 13, 2016, none of them had access to what I had reported. The SEC withheld it. Congress legislated in the dark.

Watch the whistleblower testimony

here: <https://www.youtube.com/watch?v=Tysqoqf9B7I&t=120s>

## **The Disclosures That Were Buried**

From my PowerPoint presentation, delivered to federal regulators in 2015–2016:

1 - PREPA was “technically bankrupt” by 2010. Auditors knew it, yet prospectuses  
2 painted PREPA as solvent.

3  
4 - False debt ratios: PREPA reported a 1.2:1 debt coverage ratio; the real figure was  
5 0.62:1. Uncollected revenues were booked as income.

6  
7 - Circular borrowing: Bond documents admitted PREPA would need to borrow to  
8 make payments — the very definition of a Ponzi structure.

9  
10 - Fuel fraud: PREPA bought high-grade oil on paper but accepted cheap sludge in  
11 reality, generating \$1.5 billion in overcharges.

12  
13 - Disappearing funds: At least \$300 million annually earmarked for equipment  
14 upgrades never reached projects.

15  
16 - Credit ratings for sale: Moody’s, Fitch, and S&P assigned investment-grade  
17 ratings while PREPA was insolvent, collecting large fees to facilitate the fraud.

18  
19 - Kickbacks and corruption: Testimony alleged benefits and contracts flowed to  
20 politically connected insiders, even family members of investigators, ensuring  
21 accountability was blocked.

22  
23 Every one of these disclosures was provided to the SEC, DOJ, and Treasury before  
24 the PROMESA hearings — and every one was withheld from Congress.

## 25 **The Laws Broken**

26  
27 The conduct I exposed, and the concealment that followed, implicate multiple  
28 federal statutes:



1 - Securities Fraud (15 U.S.C. § 78j(b), SEC Rule 10b-5): PREPA's bond prospectuses  
2 misrepresented solvency and revenues.

3  
4 - Mail and Wire Fraud (18 U.S.C. §§ 1341, 1343): Fraudulent offerings marketed to  
5 investors across the U.S.

6  
7 - Bank Fraud (18 U.S.C. § 1344): Credit lines for fuel purchases were misused to  
8 service debt.

9  
10 - RICO (18 U.S.C. §§ 1961–1968): Ongoing pattern of fraud, kickbacks, and misuse  
11 of funds.

12  
13 - False Statements (18 U.S.C. § 1001): Regulators misled Congress by omission.

14  
15 - Obstruction of Justice (18 U.S.C. §§ 1505, 1512): Whistleblower evidence was  
16 buried to protect institutions.

17  
18 - Honest Services Fraud (18 U.S.C. § 1346): PREPA officials, banks, and regulators  
19 deprived investors and the public of their right to honest services.

## 20 **What Congress Never Saw**

21  
22 Had lawmakers known what the SEC knew, the narrative underpinning PROMESA  
23 would have collapsed. No legislature could justify imposing an unelected board  
24 and sweeping austerity while ignoring clear evidence of systemic fraud.

25  
26 PROMESA's passage depended on the illusion of inevitability — that Puerto Rico's  
27 collapse came suddenly, without warning.

28  
29 The truth was the opposite: Puerto Rico's collapse was engineered through

1 fraudulent debt cycles, abetted by Wall Street banks, whitewashed by credit rating  
2 agencies, and concealed by the very federal agencies charged with oversight.

### 3 **The Human Cost**

4  
5 This concealment devastated ordinary people. Puerto Ricans endured rolling  
6 blackouts, crumbling infrastructure, and punishing austerity. Thousands of small  
7 businesses closed under unsustainable energy costs. U.S. retirees, pensions, and  
8 mutual funds — many of them middle-class savers — lost billions.

9  
10 HR 1049, Puerto Rico's own legislative investigation in 2015, warned: "The people  
11 of Puerto Rico shall not be held responsible ... for inadequate, negligent and/or  
12 speculative financial decisions." Yet that is exactly what Congress imposed when it  
13 passed PROMESA without the full record.

### 14 **Concealment as Policy**

15  
16 The question today is not whether PREPA's finances resembled a Ponzi scheme.  
17 Both my testimony and HR 1049 prove they did. The question is why the SEC and  
18 other agencies buried this evidence, misleading Congress and the American  
19 people.

20  
21 By legislating without disclosure, the United States created law on a foundation of  
22 lies — shielding powerful institutions while sacrificing Puerto Rico's people and  
23 investors.

24  
25 The SEC must answer for why it suppressed whistleblower evidence, why it  
26 allowed Congress to legislate on false pretenses, and why those responsible for  
27 systemic fraud remain unprosecuted. Until that accountability comes, PROMESA  
28 will stand as a monument  
29 not just to financial collapse, but to deliberate concealment by those sworn to  
30 prevent it.

1 Full whistleblower testimony  
2 video: <https://www.youtube.com/watch?v=Tysqogf9B7I&t=120s>

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- **Exhibit B** – Report HR 1049 Summary

## **The Hidden Ponzi That Almost Became Law**

**By Richard R. Lawless**

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### ***“Paid with New Money”: A Law Built in the Dark***

On **April 13, 2016**, Congress held a pivotal hearing on H.R. 4900 — the **Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA)** — in the House Natural Resources Committee. Debate framed Puerto Rico’s fiscal collapse as sudden and severe. Chairman Bishop and Treasury Secretary Jack Lew touted the proposed oversight board as “essential,” with Lew stating, “*The question to us is, does the bill’s restructuring authority work? It has to work...*” [GovInfo](#).

But there was a glaring absence: **House Report HR 1049**, issued nearly a year earlier on June 24, 2015, documented that PREPA had been operating like a Ponzi scheme — insolvent since 2010 and financed through cycles of new debt covering old obligations. Yet this warning was never disclosed during the hearing, nor made part of the congressional record.

---

### ***HR 1049: The Buried Warning***

HR 1049, a 23-page legislative report authored by Puerto Rico’s House, revealed shocking details:

- “By 2010, PREPA was technically bankrupt.” (p. 14)
- “PREPA paid previous bondholders with capital received from new investors... owed interests were capitalized and regrouped whenever a new debt was issued.” (p. 15)
- “Investors allowed PREPA to issue bonds ... a cycle that is repeated over and over, and in which the original debt is never paid.” (p. 17)

- “This practice could constitute a fraud scheme for which ... the Securities Exchange Commission could take action.” (p. 17–18).

Yet despite these incontrovertible findings, the report—referred to DOJ, SEC, and Treasury—was omitted from the congressional debate on PROMESA.

---

### ***When Awareness Meets Action — Or Avoidance***

The timeline is telling:

| Date | Event |
|------|-------|
|------|-------|

|               |                             |
|---------------|-----------------------------|
| June 24, 2015 | Puerto Rico issues HR 1049. |
|---------------|-----------------------------|

|           |                                            |
|-----------|--------------------------------------------|
| Late 2015 | DOJ, SEC, and Treasury receive the report. |
|-----------|--------------------------------------------|

|                |                                              |
|----------------|----------------------------------------------|
| April 13, 2016 | PROMESA hearing held; HR 1049 not disclosed. |
|----------------|----------------------------------------------|

|               |                           |
|---------------|---------------------------|
| June 30, 2016 | PROMESA enacted into law. |
|---------------|---------------------------|

Secretary Lew and congressional leaders leaned on Treasury’s support and assurances in their advocacy [GovInfo](#). Meanwhile, the evidence that PREPA was not just broke, but trapped in a debt spiral, never surfaced.

---

### ***Ponzi Scheme Hallmarks — Exposed Through HR 1049***

| Ponzi Hallmark         | HR 1049 Findings                                                              |
|------------------------|-------------------------------------------------------------------------------|
| False assurances       | PREPA was “technically bankrupt” by 2010 but continued issuing bonds. (p. 14) |
| Concealment            | DOJ, SEC, and Treasury suppressed HR 1049 during the PROMESA debate.          |
| Old debt paid with new | “Owed interests...regrouped whenever a new debt was issued.” (p. 15)          |

## **Ponzi Hallmark**

## **HR 1049 Findings**

Collapse upon inflows PROMESA triggered the **2017 bankruptcy**, the largest in  
stop U.S. municipal history.

---

### ***Consequences of Concealing the Truth***

Replacing proactive intervention, concealment engineered collapse:

- **Puerto Ricans** endured blackouts, austerity, and decaying infrastructure.
- **Small businesses** closed under unsustainable energy rates.
- **Mainland investors** — retirees, pension funds, mutual funds — suffered staggering losses.

HR 1049 had posed a plea: *“The people of Puerto Rico shall not be held responsible... for inadequate, negligent... decisions...”* (p. 20). Congress, however, legislated without that context — and the damage was profound.

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### ***Accountability by Suppression***

When fraud is documented but buried, it becomes the state’s tool—no indictment needed. The DOJ, SEC, and Treasury didn’t withhold HR 1049 by accident—they ensured it was invisible to Congress. The real scandal isn’t that PREPA collapsed. It’s that the truth was known and legislated anyway.

---

### **Additional Material (for media and courts)**

#### **A) Quote Appendix – HR 1049 vs. Ponzi Hallmarks**



| <b>Hallmark</b>            | <b>HR 1049 Evidence</b>                                               |
|----------------------------|-----------------------------------------------------------------------|
| False assurances           | "By 2010, PREPA was technically bankrupt." (p. 14)                    |
| Concealment                | Agencies suppressed HR 1049 from Congressional and public record.     |
| Old debt with new          | "Owed interests... regrouped whenever a new debt was issued." (p. 15) |
| Collapse once inflows stop | PROMESA's enactment led directly to the 2017 bankruptcy.              |
| Referral ignored           | Report referred to DOJ, SEC, and Treasury — no action taken. (p. 19)  |

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**Exhibit C- HR 1049 Report**

TRANSLATION 7/15 MIP

# **COMMONWEALTH OF PUERTO RICO**

17<sup>th</sup> Legislative  
Assembly

5<sup>th</sup> Ordinary  
Session

## **HOUSE OF REPRESENTATIVES**

### **FINAL REPORT**

#### **H. R. 1049**

**(House of Representatives Resolution 1049)**

**JUNE 24, 2015**

#### **TO THE PUERTO RICO HOUSE OF REPRESENTATIVES:**

Your Small and Medium Businesses, Commerce, Industry and Telecommunications Commission of the Commonwealth of Puerto Rico House of Representatives, having previously studied and taken into consideration the H.R. 1049, has the honor of presenting before this Legislative Body a Final Report on said Resolution, including findings, recommendations and conclusions.

#### **SCOPE OF THE MEASURE**

House Resolution 1049 warrants Small and Medium Businesses, Commerce, Industry and Telecommunications Commission to carry out an investigation with regard to the operational energy expenses of several industries, pymes and businesses located in the Island, taking into account recent decisions made by

the Puerto Rico Electric Power Authority (“PREPA”); evaluate different alternatives in the current energy market and would portend to mitigate the economic impact they represent; and analyze the liquidity and financial claims of bondholders, and how decisions made thereof translated into energy rates/tariff increases.

In accordance with provisions stated in the Exposition of Motives of House Resolution 1049, PREPA’s finances management must be part of the study and investigation such that the conclusions arrived at could be made public to the people of Puerto Rico. Likewise, it should investigate prospective effects of the new energy reform implemented thereof to the operational energy costs of diverse industries, pymes and businesses working in the Island, and evaluate alternatives in the energy market.

To achieve the objectives established in Resolution 1049, the Small and Medium Businesses, Commerce, Industry and Telecommunications Commission conducted public hearings and analyzed extensive documentation which allowed it to arrive at the conclusions and recommendations set forth in this document.

## **ANALYSIS OF THE MEASURE**

The Small and Medium Business, Commerce, Industry and Telecommunications Commission of the House of Representatives, in accordance with its ministerial duty of analyzing measures referred by the House of Representatives, carried out an ample process of collecting data and essential documents which PREPA provided during the first investigative phase of this legislative measure. The Commission, after compiling all the information, held public hearings on May 12, 22 and 28 of 2015; and on June 4 and 16 of 2015. In addition, it held an executive meeting on June 4, 2015. The following individuals appeared in those public hearings and executive meetings:

**May 12, 2015:**

1. Eng. Edwin Rivera Serrano, PR Power Authority Executive Director from 2005 to 2007;
2. Mr. Otoniel Crux Carrillo, PR Power Authority Executive Director from 2011 to 2012; and
3. Eng. Josue Colon Ortiz, PR Power Authority Executive Director from 2012 to 2013.

**May 22, 2015:**

1. Eng. Luis Garcia Passalacqua, Ex-President of the PREPA Government Board; and
2. Eng. Jose Del Valle Vazquez, Ex-President of the PREPA Government Board.

**May 28, 2015:**

1. CPA Luis Figueroa Baez, Finance Director of the PREPA; and
2. Eng. Sonia Miranda Vega, PREPA Environmental Protection and Planning Division Director.

**June 4, 2015:**

1. Eng. Luis Garcia Passalacqua, Ex-President of the PRPA Government Board; and
2. Atty. Luis Aviles Pagan, Ex-President of the PRPA Government Board.

**June 4, 2015 (Executive Meeting):**

1. CPA Arturo Ondina, Ernst & Young Consulting Partner.

**June 16, 2015:**

1. Mrs. Lisa Donahue, PRPA Principal Restructuring Officer

**FINDINGS**

According to the Restructuring Officer, Lisa Donahue, PREPA currently has a debt approximating \$8.3 billion. To understand how PREPA incurred in such debt, this Commission analyzed the prospectus and financial statements

regarding bonds issued between the years 2000 and 2012, as well as the engineering reports issued in accordance with the 1974 Trust Agreement, as amended, (from hereon “Trust Agreement”) which regulates PREPA and its relationship with the representatives of the bondholders and, of course, with the latter.

Article 4 of the Trust Agreement establishes the application that would be given to the issued bonds, namely:

“ARTICLE IV

CUSTODY APPLICATION OF PROCEEDS OF BONDS.

Section 401. A special fund is hereby created and designated “Puerto Rico Water Resources Authority Power System Construction Fund” (herein sometimes called the “Construction Fund”), to the credit of which such deposits shall be made as are required by the provisions of Section 208 of this Agreement. There shall also be deposited to the credit of the Construction Fund any moneys received from any other source for paying any portion of the cost of any Improvements. One or more separate accounts may be created for the Construction Fund for use for specific projects.

The moneys in the Construction Fund shall be held by the Authority in trust, separate and apart from all other funds of the Authority, and shall be applied to the payment of the cost of any Improvements and, except for any moneys in separate accounts, in the Construction Fund received from the United States Government or any agency thereof or from the Commonwealth of Puerto Rico or any agency thereof, pending such application, shall be subject to a lien and charge in favor of the holders of the bonds issued and outstanding under this Agreement and for the further security of such holders until paid out or transferred as herein provided”

Section 402. Payment of the cost of any Improvements shall be made from the Construction Fund as herein provided. Moneys in the Construction Fund shall be disbursed by check, voucher, order, draft, certificate or warrant signed



by the Executive Director or by any officer of the Authority designated by him for such purpose.”

On the other hand, Section 208 of the Trust Agreement establishes that the issued bonds would finance the Capital Improvement Plan, including repayment of moneys advanced for paying refinancing costs, together with their accrued interest:

“Section 208. Revenue bonds of the Authority may be issued under and secured by this Agreement, subject to the conditions hereafter provided in this Section, from time to time for the purpose of paying all or any part of the cost of any Improvements, including the repayment of moneys advanced for paying such cost and, if deemed necessary by the Board, the payment of the interest to accrue on such money advances to the day of such payment and for the providing moneys for deposit to the credit of the Reserve Account.

Before any bonds shall be issued under the provisions of this Section, the Board shall adopt a resolution or resolutions authorizing the issuance of such bonds, fixing the amount and the details thereof, describing in brief and general terms Improvements which are to be acquired or constructed or which were acquired or constructed from any moneys to be repaid from the proceeds of such bonds, and specifying the mount, if any, of the proceeds of such bonds to be deposited to the credit of the Reserve Account.”

According to the Trust Agreement and to statements from former Executive Directors and Government Board Presidents, financing for PREPA operations has to come from money collected from the rates imposed to the public corporation subscribers. After having been asked some questions, these former functionaries indicated that the operations of the corporation could never be

financed through issuance of debt as long as said practice would constitute an ultra vires action against the Trust Agreement itself.

Likewise, the Trust Agreement stipulates in Section 702 of Article 7 that consulting engineers, as said term is defined in Section 101, page 15, shall approve the improvements to be carried out with the bonds issued by PREPA:

“Section 702.

The authority further covenants that it will construct all Improvements for the construction for which bonds shall be issued under the provisions of this Agreement, or for which moneys repairable from the proceeds of bonds issued under the provisions of this Agreement shall have been advanced to the Authority, in accordance with plans theretofore adopted by the Board and approved by the Consulting Engineers and that upon the completion of such Improvements, it will operate and maintain the same as a part of the System...”

Likewise, and in accordance with Section 706, Article 7 of the Trust Agreement, the consulting engineers appointed by PREPA have the duty to recommend to the Board the need to revise rates/tariffs, yet it has not been done since 1989:

“Section 706.

It shall be the duty of the Consulting Engineers to prepare and file with the Authority and with the Trustees on or before the 1<sup>st</sup> day of May in each year a report setting forth the recommendations as to any necessary or advisable revisions of rates and changes and such other advices and recommendations as they may deem desirable. After the outstanding 1947 Indentured Bonds have been paid or provision has been made for their payment and the release

of the 1947 Indenture, it shall be the duty of the Consulting Engineers to include in such report their recommendations as to the amount that should be deposited monthly during the ensuing fiscal year to the credit of the Reserve Maintenance Fund for the purposes set forth in Section 512 of this Agreement.”

This Commission did not find a single instance from 1989 to the present whereby the consulting engineers recommended a revision of the rates, as required in Section 706.

Between the years of 2000 and 2012, PREPA Government Board authorized an issuance of bonds that raised said corporation the sum of \$11,449,840,000, of which \$2,720,441,711 were used for capital works while \$164,649,287 were used to pay financial consultants and advisors who worked for PREPA. The remaining \$8,564,749,002 was used for the prepayment of interests, as well as to refinance previous capital investments, and to capitalize their respective interests, thereby circularly refinancing its debts and interests, with complete disregard for the amortization of the original debt.

The information contained in the paragraph above arises from the content of the issued bond prospectus for the time period indicated above. However, the information with regard to the capital improvements for which the financing by way of the issuance of bonds was being solicited was not defined in each particular work. This Commission could only obtain detailed evidence of works

for the 2013-1014 fiscal year from PREPA personnel, which included only energy transmission and fuel distribution projects, but not energy generating projects which certainly comprise a considerably larger expense with amounts, as estimated by this Commission, falling in the millions. With regard to previous years, this Commission's President visited PREPA's headquarters, and despite requesting that same data for the years between 2000 and 2012, it was never provided. However, with the evidence at hand, we detected that PREPA repeatedly underestimated the costs of these improvements and capital investments for each project, which amount to 200% in excess from the budgeted amount, without reaching a 100% project completion. There are instances within the 12-month period evaluated, where PREPA incurred in costs exceeding the budget, construction was not finished and the project was abandoned.

A sample of this economic imbalance and disaster, which should have been denounced by the consulting engineers and the bondholders themselves before agreeing to their loans is as follows, based on 22 out of 265 projects analyzed for the 2013-1014 fiscal year, that is, a sample of 8% of projects analyzed:

### 2013-2014 FISCAL YEAR

| Project       | Region   | Estimate            | Spent                | Percentage of<br>Incurred Costs | Percentage of<br>Completion |
|---------------|----------|---------------------|----------------------|---------------------------------|-----------------------------|
| 9793          | San Juan | \$ 4,692,684        | \$ 5,721,299         | 122%                            | 76%                         |
| 16987         | San Juan | 38,054,201          | 36,145,082           | 95%                             | 65%                         |
| 18653         | San Juan | 250,000             | 509,753              | 204%                            | 100%                        |
| 19647         | Carolina | 200,000             | 435,176              | 218%                            | 100%                        |
| 9793          | Carolina | 4,692,684           | 5,721,299            | 122%                            | 76%                         |
| 36701         | Carolina | 200,000             | 182,123              | 91%                             | Cancelled                   |
| 19647         | Carolina | 2,000,000           | 435,176              | 218%                            | 100%                        |
| 14897         | Bayamon  | 22,317              | 102,974              | 461.42%                         | 95%                         |
| 8581          | Bayamon  | 18,225,000          | 25,548,043           | 140.18%                         | 27%                         |
| 17118         | Bayamon  | 4,633,000           | 8,494,949            | 183.36%                         | ?                           |
| 14896         | Bayamon  | 22,317              | 102,974              | 461.42%                         | 95%                         |
| 19455         | Caguas   | 175,000             | 350,665              | 200.38%                         | ?                           |
| 17072         | Caguas   | 455,841             | 875,590              | 192.00%                         | ?                           |
| 07885         | Caguas   | 530,000             | 690,271              | 130.24%                         | 100%                        |
| 19445         | Caguas   | 175,000             | 350,665              | 200.38%                         | ?                           |
| 17072         | Caguas   | 455,841             | 875,590              | 192.00%                         | ?                           |
| 13536         | Ponce    | 450,000             | 761,107              | 169.13%                         | 70%                         |
| 16515         | Ponce    | 15,592,087          | 21,733,319           | 139.39%                         | 90%                         |
| 18609         | Mayaguez | 200,000             | 434,819              | 217.41%                         | 27%                         |
| 18630         | Arecibo  | 225,000             | 513,879              | 228.39%                         | 100%                        |
| 15636         | Arecibo  | 325,000             | 280,719              | 86.38%                          | 15%                         |
| 786           | Arecibo  | 2,485,197           | 3,309,174            | 133.16%                         | only purchased<br>equipment |
| <b>TOTALS</b> |          | <b>\$94,061,169</b> | <b>\$113,574,646</b> | <b>120.75%</b>                  |                             |

PREPA, in one year, as seen in the table above, has had a deficit in its estimates of 22 of approximately 265 projects, excluding power generating costs, which are the most costly. It is this Commission's understanding that these alarming instances should have been registered several years ago. But as previously pointed out, PREPA did not provide the information requested.

Errors calculating estimated costs versus actual costs incurred may be attributed to flaws in project estimates; excessive equipment, goods and materials purchasing costs; and excesses in the required labor work forces in charge. But it must be undoubtedly attributed to a faulty and unhealthy administration of public funds. Bondholders must have been aware of the above because in their determination analysis made prior to decide on the issuance of bonds to the PREPA, this information was available and no false representations were made. The numbers were available and, more importantly, the consulting engineer, appointed by the bondholders and PREPA, had to personally approve any such investment with his signature. No engineering report informing about or denouncing the excessive costs being annually registered for fuel distribution and energy transmission infrastructure projects were included in any of the issued bonds.

With regard to this matter, this Commission also analyzed how PREPA capital improvement plans decreased following the 2000-2004 year period when 46% of the moneys, that is almost half of what was issued in the debt, was spent either in the Construction Fund or to finance the Capital Improvement Plan. During 2004-2008 only 15% of the capital raised by the issuance of debt was used to finance the Capital Improvement Plan, the rest was used to refinance the debt, according to Mr. Luis Figueroa Baez, PREPA Finance Director. However, from 2009 to 2012 only 18% of the debt was used to finance the Capital Improvement Plan, while the remainder was used to refinance the existing debt, capitalize interest and issue advanced notes to pay future interest.

With regard to Article 7 and the performance of the consulting engineers, this Commission found that for the last 20 years the same person has been executing or subscribing the Engineer Report, which has to be submitted pursuant to the Trust Agreement. The subscriber is Eng. George Romano Jr., who has worked for different firms. This Commission believes this is not synonymous to a healthy administration, and that it should have been questioned by PREPA's highest administrative body, something that did not happen until this Commission brought forth the anomaly to the attention of the current PREPA officials.



It was also found that consulting engineers signed for approval, under different names, and have carried out construction work for PREPA, which is contradictory per se with Section 706 of the Trust Agreement. Said provision of the agreement demands that those external consultants, chosen between the bondholders and the public corporation itself, must be independent contractors. Within that parallel appointment practice process, they ceased to be independent because they had to evaluate the same infrastructure projects they were supposed to build.

This Commission also found that the consulting engineers were negligent and failed in the obligation imposed to them by the Trust Agreement (Section 706) when they allowed PREPA's energy-generating stations and the whole system in general to become obsolete; in violation of federal regulation established by the Mercury and Airborne Toxic Emissions Standards (MATS).

Another finding was that the consulting engineers were not impartial to PREPA's refinancing scheme; because while knowing that the electric power authority did not have sufficient income to comply with its financial obligations, they allowed the use of funds allocated for capital improvements



to be used in the maintenance of an infrastructure they knew was soon to become obsolete.

PREPA's current economic insolvency was the product of, among other factors, negligent acts on the part of its creditors, who in spite of knowing that PREPA's financial and competitive situation was weak, and knowing that its infrastructure was obsolete, they negligently granted PREPA a good credit rating; disregarding that by 2010, PREPA was technically bankrupt. This fact was corroborated by Arturo Ondina, CPA and consulting partner of Ernst & Young, firm who has audited PREPA for the past 12 years. This occurred while the financial consultants and consulting engineers indicated in their reports that the PREPA financial condition allowed it to issue more bonds, when the fiscal reality was that PREPA was not generating sufficient income to repay the debt.

Those individuals and/or consulting firms knew that any funds granted to PREPA would be used to pay fees, underwriters and commissions to the financial intermediaries who issued the debt, from \$40 to \$60 million dollars per four-year period, as well as to refinance the outstanding debt, and not for

any works plans and improvements to generator plants. Mr. Figueroa Baez mentioned this fact in one of the hearings this Commission conducted.

This Commission realized that PREPA paid previous bondholders with capital received from new investors, to the point that owed interests were capitalized and re-grouped whenever a new debt was issued. The abovementioned was done to benefit the financial community that issued the debt and who today is collecting same, without any moneys having been invested in improvements to infrastructure, all to the detriment of the best interest of the people of Puerto Rico. We believe that the actions and circumstances mentioned above caused the economic insolvency which has plagued PREPA in the past years. Said debt was sold at discount, a large quantity of it between .60 to less than .50 cents to the dollar with the agreement to pay to the dollar in full upon its maturity. Plus, the annual return yield was agreed to set high interest rates, and the principal and return are three-fold exempt from payment of local and federal taxes, in accordance with the Jones Act. When Mrs. Lisa Donahue was asked whether she knew of any other issuances of debt with characteristics so benefitting to investors, she replied that she did not know of any other investment tool or instrument that is three-fold tax exempt. This goes to show that the financial intermediaries and the institutional holders, despite being fully aware of

PREPA's fiscal situation, had no qualms with Unjustly Enriching themselves and with having the consequences of their negligent acts be paid for by the people of Puerto Rico.

Meanwhile, and fully aware that PREPA did not have the resources to repay the debt, investment firms, banks, credit houses, consulting engineers, and PREPA itself failed to bring out into public light the need to make adjustments to the rates charged by PREPA, an act contrary to what the holders were bound to do pursuant to the last paragraph of Section 502 of the Trust Agreement. Bondholders had the contractual obligation to commit PREPA to increase tariffs and rates in an adequate and timely manner in order to avoid the situation this public corporation has to bear today. This act is known as a laches or negligent act ("acto de incuria"). They did not act in time, yet now they demand strict compliance.

PREPA, in an act out of the scope of its own standard procedure of annual issuance of debt, which usually occurred no more than twice a year, in 2010 carried out 8 issuances in a row whereby it reduced its capital improvement plans in order to justify the issuances and then were used for prepayment of interests and to finance PREPA operations without ever recommending a rate

increase to the Board. Officials called to appear at the hearings coincided that the aforementioned issuances were carried out with the bondholders' consent every time presentations were held in New York with the financial intermediaries, underwriters and others, with the consulting engineer's endorsement, prior to the issuance of said debts. Therefore, the institutional bondholders bought this debt with the knowledge and with consent of what was going on financially in the corporation, which was ailed with technical insolvency or bankruptcy.

Investors allowed PREPA to issue bonds, then, PREPA borrowed from private banks to pay the bond's interests; then, borrowed from the Government Development Bank (from herein "GDB") to pay back the private bank loans, and the GDB, in turn, issued more bonds to refinance all. Afterwards, PREPA would issue a new debt to pay GDB's outstanding interests, pay principal and pre-pay the new bonds' interests for several years -a cycle that is repeated over and over- and in which the original debt is never paid. This practice could constitute a fraud scheme for which the federal agencies that regulate financial instruments and the Security Exchange Commission could take action against and/or pursue civil suits against these institutions. That is the reason why we

are referring this Report and its findings to those entities, so that they may assume the appropriate jurisdiction over these acts.

PREPA's current administration has recognized that it does not know of any corporation who has issued this type of debt and maintained good Investment Credit Rating before credit institutions, while issuing, as PREPA did, a \$4,000,000,000 debt in one year.

All surmised herein has been occurring for years and has proven to be an excessive and onerous burden on the operational costs of thousands of small and medium businesses throughout the Island. Due to rates that have gone unrevised for decades and a fuel adjustment clause questioned by many, hundreds of businesses have already closed and others are in the process of doing so faced with the lack of capital to invest in energy generating mechanisms which would allow them total independence from the system PREPA provides. That is why this Commission has determined its own recommendations and conclusions, and they are the following:

## **RECOMMENDATIONS**

In order to prevent what we have described in this Report from happening again, and to keep control of PREPA's treasury and its operations, we recommend:

1. That this Report be forwarded to the Justice Department of the Commonwealth of Puerto Rico and the United States of America for their corresponding actions;
2. That this Report be forwarded to the United States Securities Exchange Commission for its corresponding action;
3. The annulment of the current agreement with the consulting engineers firm and initiation of a claim against its underwriters of the last 20 years and request restitution of the moneys paid to them;
4. An investigation of PREPA projects estimates department for possible judgement flaws in the past years;
5. An investigation of purchasing costs for equipment, goods, and other services from PREPA's suppliers, under a presumption of possible overbilling for construction works in the past years;
6. An investigation of costs incurred for construction projects work-force in the past years;

7. Adoption of a rate adjustment process that no longer has the detrimental effect it has had until now for small and medium business owners in Puerto Rico; and
8. That the necessary guidelines and norms be defined by an audit so that events that led PREPA to its current economic situation are not allowed to happen again.

## **CONCLUSION**

The people of Puerto Rico shall not be held responsible for nor be guarantors of inadequate, negligent and/or speculative financial decisions taken by professionals, investors and financial groups on behalf of PREPA. Our fellow citizens granted that group the terms and conditions they needed to benefit from the production of energy in Puerto Rico in order to safeguard their investment, namely, the following:

- A prospectus under SEC regulations;
- Intervention from external auditors
- A Trust Agreement that provided said professionals the tools they needed, including the right to name a contractor to foresee and monitor PREPA, requesting, if necessary, rate adjustments, and

giving him access to PREPA's records and facilities, as well as soliciting funds to create capital improvements;

- Unequaled tax exemptions;
- Contracts with credit house financed by our government;
- Recurrent issuance of bonds;
- Legal opinions for every issuance;
- A stable, democratic government;
- Shut down of the government during a particular four-year period where payment of the debt continued over payroll and other obligations, just as our Constitution demands; and
- A just, accessible and expeditious state and federal judicial system.

Investors and administrators' unilateral decision not to use the aforementioned tools adequately to safeguard their own interest is the reason why PREPA arrived at the deep technical insolvency ailing it today, which, in 2010 was eliminated for accounting purposes and which a year later was confirmed, when a two hundred million dollar debt was already in existence. The public corporation's financing by way of 8 simultaneous issuances of debt of over



\$4,000 million with the consent of the financing intermediaries and consulting engineering firm had the effect of plunging the corporation into deep insolvency.

Noteworthy is the fact that the aforementioned took place in the face of the credit houses, whom, knowing this, and therefore PRPA's technical insolvency, allowed this public corporation, and thus the people of Puerto Rico, to continue running into debt.

It is necessary for the PREPA to expunge itself from the fiscal situation it is in and adopt the recommendations expressed herein, as well as those made by PREPA's current administration. All without it translating into additional costs to the people of Puerto Rico and putting forth the aforementioned findings for the consideration of the Puerto Rico Justice Department to conduct an investigation with regard to the matter.

Based on all the findings included in this Report, the Small and Medium Businesses, Commerce, Industry and Telecommunications Commission of the House of Representatives of the Commonwealth of Puerto Rico, having previously studied and taken into consideration House Chamber Resolution

1049, is honored to submit before this Honorable Legislative Body the Final Report on this measure, including findings, recommendations, and conclusions.

Respectfully submitted,

(Illegible signature)

Hon. Javier Aponte Dalmau

President

Small and Medium Businesses, Commerce,  
Industry and Telecommunications Commission

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6 **EXHIBIT D – 22 Page Internal Email between the SEC and Treasury Dept**

7

8 The attached 2013 email was secured through FOIA Requests and reflects a 22-  
9 page discussion between the SEC and Treasury Dept confirming the fraudulent  
10 nature of this six hundred-million-dollar PREPA bond. The SEC and Treasury  
11 allowed the bond to be issued and it, of course, defaulted two years later. What  
12 the SEC and Treasury Dept did was a crime. Withholding this knowledge from  
13 Congress during the PROMESA Hearings was also a crime.

This message was sent securely using ZixCorp.

**From:** Adam.Chepenik@treasury.gov  
**Sent:** Fri, 2 Aug 2013 09:35:17 -0400  
**To:** (b)(6)  
**Subject:** Puerto Rico  
**Attachments:** Puerto Rico Summary for NY Fed and SEC 8\_2\_2013.doc

Hi (b)(6),

Apologies in advance for sending such a long e-mail.

However, I wanted to send over several articles that you may want to read.

(b)(5)

More broadly, outflows in the muni space continue to accelerate (another \$2.24 bln in outflows this week... the 10<sup>th</sup> consecutive week of outflows) which is creating general market volatility in the muni space.

In terms of what is pasted below (and attached as a word doc), first, (b)(5)

(b)(5)

Next I included a few articles that highlight what Bloomberg, Reuters and the Rating Agencies are saying about the deal.

The last two articles are from an economist who forecasts real growth will decline by 3.3% on the Island because the new taxes in the FY2014 budget and the local paper which evaluates the current macro-economic environment.

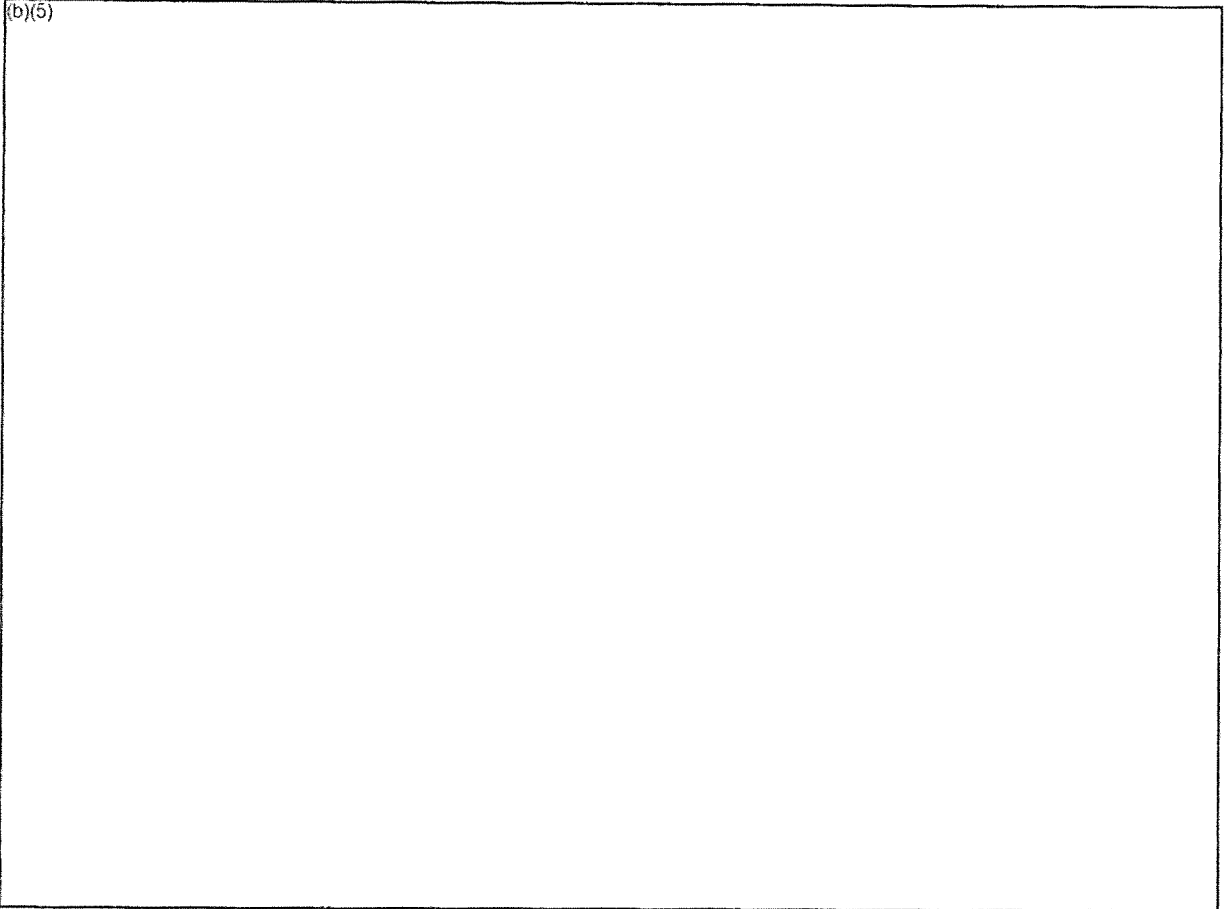
(b)(5)

I am available to discuss any of the material below by phone with you as well.

All the best,  
Adam

(b)(5)

(b)(5)



*Bloomberg Article* (b)(5)

**Worst Over for Puerto Rico as June Yields Too Much: Muni Credit**

By Michelle Kasko

July 29, 2013

<http://www.businessweek.com/news/2013-07-29/worst-over-for-puerto-rico-as-june-yields-too-much-muni-credit>

Puerto Rico debt is rallying the most this year as lawmakers of the self-governing commonwealth shrink its chronic budget deficits and take steps to bolster one of the nation's weakest pension systems.

As investors prepare for next week's \$600 million bond sale by the island's electric agency, the first of 2013 from the commonwealth, the extra yield buyers demand on Puerto Rico debt is close to the smallest since at least January, data compiled by Bloomberg show.

The island's securities are tax-exempt nationwide, drawing demand even as Puerto Rico's fiscal challenges have pushed it to the brink of speculative grade. The bonds are rebounding from the worst monthly loss in five years after legislators reduced the budget gap to the least since 2009 and moved to trim pension costs, said Joseph Rosenblum, director of municipal credit research at AllianceBernstein LP in New York.

"They're in a better position than January," said Rosenblum, whose company manages \$31 billion of local debt, including Puerto Rico bonds. "They are certainly addressing many of the issues that were cited against them" by ratings companies, he said.

#### **June Tumble**

Puerto Rico securities lost about 5 percent in June, the worst performance since 2008, Standard & Poor's data show. The \$3.7 trillion municipal market fell 3 percent, part of broader fixed-income declines amid bets that the Federal Reserve would scale back its bond purchases.

"We're definitely taking a look given where the yields have backed up to," said Daniel Solender, who helps manage \$19.5 billion of local debt, including Puerto Rico, at Lord Abbett & Co. in Jersey City, New Jersey.

The island of 3.7 million people tends to have higher interest rates than U.S. states because the major credit-rating companies grade the commonwealth one step above junk with a negative outlook.

The extra yield buyers demand on 30-year Puerto Rico bonds was 2.12 percentage points July 25, near a 2013 low of 2 percentage points set July 18. The gap is still down 28 percent from the start of the year even as Puerto Rico 10-year yields are coming off their second-biggest weekly increase this year.

#### **Sideline Squatters**

"There are investors on the sidelines who will buy on cheapness," said Tom Weyl, director of muni research at Barclays Capital Inc. in New York. "Puerto Rico has positive credit news. They should be stable for a while."

Governor Alejandro Garcia Padilla, 41, who took office in January, signed a budget last month for the fiscal year that began July 1 that uses \$750 million of deficit financing, the smallest gap since at least 2009, according to the Government Development Bank for Puerto Rico. Lawmakers this year boosted the retirement age and increased public workers' pension contributions.

The Puerto Rico Electric Power Authority, operator of the largest U.S. public power system, plans to sell debt three weeks after Detroit filed a record municipal bankruptcy and as muni mutual funds have seen nine straight weeks of withdrawals.

Detroit's bankruptcy shouldn't affect the bond deal because investors have already digested the filing. Jose Pagan, interim president at the Development Bank, said from San Juan.

#### **Contagion Rejection**

"There's been no contagion in terms of Detroit," he said. "We're going to time our entry into the market and make sure that it's the most efficient. We don't foresee any major issues."

The Puerto Rico authority is rated one step above junk by Moody's Investors Service. It's the biggest commonwealth sale in almost 16 months, Bloomberg data show.

Agency bonds maturing in July 2026 traded July 25 with an average yield spread of 2.6 percentage points, the smallest since July 17.

The island's leaders still face the challenge of bringing down a jobless rate that was 13.2 percent in June, higher than in any state. Also, Puerto Rico's pension liability as a percentage of revenue is about 234 percent, more than 49 states, according to Moody's. Only Connecticut has a higher ratio.

The performance of Puerto Rico debt in the next few months will depend on demand across the municipal market as supply of commonwealth bonds is set to increase, Rosenblum said.

Along with the electric agency sale, Puerto Rico is poised to refinance about \$600 million of general obligations as soon as September. The Puerto Rico Highways & Transportation Authority plans to borrow from \$750 million to \$1 billion about 30 days after the general-obligation sale, Pagan said. Those deals will repay two \$400 million loans from U.S. banks, said Pagan, who declined to identify the institutions.

#### **Market Week**

Localities from California to Massachusetts are set to borrow \$4.6 billion of debt this week, the slowest non-holiday week since June, as municipal borrowing costs rise.

At 2.93 percent, 10-year benchmark muni yields are near the highest April 2011. That compares with 2.56 percent for similar-maturity Treasuries.

The ratio of the yields, a measure of relative value, is 114 percent, compared with a five-year average of about 100 percent. The higher the ratio, the cheaper municipal securities are against federal debt.

The municipal market has lost about 1.6 percent this month, compared with a 0.3 percent decline for Treasuries, Bank of America Merrill Lynch data show.

#### *Article today from Reuters on the Deal:*

#### **Reuters: Puerto Rico to test shaky bond market with new offering**

August 2, 2013

By Edward Krudy

- \* Puerto Rico comes back to muni market with Prepa bonds
- \* Prepa officials court investors in New York
- \* Ten-year yields on Puerto Rico GO bonds at 5.9 percent

NEW YORK, Aug 2 (Reuters) - Puerto Rico is turning to investors for the first time in more than year next week, but a shaky U.S. municipal bond market plagued by months of outflows could prove a tough customer for the fiscally troubled island.

The U.S. Commonwealth, whose shaky finances have led to the highest borrowing costs amongst the largest municipal borrowers, has not sold bonds in the \$3.7 trillion U.S. muni market since July, 2012.

Now, Puerto Rico Electric Power Authority (Prepa) is aiming to sell a \$600 million deal to fund power plant and transmission network improvements across its facilities. It will be the first test for a series of financings. Island issuers have plans to refinance more than \$3 billion of debt by the end of this year.

The sale could be any day next week.

Puerto Rico and Prepa officials have been in New York this week hawking the new bonds, hoping that an overhaul of its underfunded public pension system approved earlier this year has put its budget on a stable enough footing to entice investors to buy its debt again.

"Unfortunately for them the market for credit in munis right now is rather soft, primarily because you continue to see outflows from the longer-term funds and your high-yield funds so that is going to put the wind in their face," said Lyle Fitterer, a fund manager at Wells Capital Management.

Fitterer says he is looking at the deal but has not yet made a decision on whether to participate.

Municipal bonds have sold off sharply since the start of the year, a move accelerated by expectations the Federal Reserve will curtail its bond buying program later this year as well as Detroit's bankruptcy filing last month.

Municipal bond funds have seen weekly outflows for most of the last five months, with a record of \$4.5 billion in one week in June.

The market has been punishing lower-grade issuers more severely. The S&P Municipal Bond Puerto Rico Index fell over 4.1 percent in July compared to a drop of 1.1 percent for investment grade bonds, according to S&P Dow Jones Indexes.

It is not only the current bond market that will be a headwind for Prepa. Its credit rating was downgraded by Moody's in June to Baa3 from Baa2, one step above junk. In addition, Fitch downgraded Prepa in July to BBB minus.

#### **DEAL QUESTIONED BY LAWMAKERS**

The deal has also raised eyebrows in Puerto Rico where lawmakers have questioned the wisdom of borrowing that is expected to increase Prepa's debt servicing costs by tens of millions of dollars.

"How do you plan on paying back these bonds?" Eduardo Bhatia, president of Puerto Rico's Senate, asked Prepa officials at a hearing before the Senate Treasury and Public Finance Committee on Wednesday.

Bhatia pointed to Prepa's estimate of a \$283 million operating loss during fiscal year 2013, which ended in June.

"In Puerto Rico, there has developed a culture of taking out loans and not paying them back. That has ended," said Bhatia.

The bonds could add about \$35 million to \$38 million a year to Prepa's debt service costs, said Jesus Garcia, vice president of the Government Development Bank, at Wednesday's hearing.

Prepa says it is the largest government-owned utility company in the United States with 1.5 million customers. It is still small, however, compared to big U.S. private sector utilities such as ConEdison, which delivers electricity to 3.3 million customers in New York.

#### **PUERTO RICO BONDS MIXED**

Puerto Rico policymakers agreed in early June to hike taxes by \$1.5 billion as part of a budget that is key to the Caribbean island avoiding a Wall Street downgrade of its massive debts to junk-bond status. Moody's welcomed the tax increases but highlighted collection risks.



Still, the yields on Puerto Rico's bonds tell a mixed story of how investors view the debt.

The premium that Puerto Rico pays on its 10 year general obligation debt over top-rated AAA municipal bonds has risen to 320 basis points compared to 290 basis points at the start of year. The premium on 30-year debt, however, has fallen to 255 basis points from 275 basis points, according to Municipal Market Data, a unit of Thomson Reuters.

Puerto Rico's 10-year debt currently carries a yield of 5.9 percent. The 30-year bond yields 6.7 percent.

Puerto Rico expects to follow the Prepa deal by refinancing some \$3.38 billion in existing debt this year. The deals depend on Puerto Rico filing the commonwealth government's Comprehensive Annual Financial Report (CAFR) for fiscal year 2012, which officials say will be completed this month.

The Prepa bonds will be used to convert eight oil-fired power generating units at the San Juan and Aguirre power plants to natural gas and improve Prepa's transmission and distribution systems.

The projects are aimed at lowering the cost of electricity in Puerto Rico and cutting plant emissions so that Prepa can comply with strict new Environmental Protection Agency regulations taking effect in 2015.

Prepa planning director Sonia Miranda defended Prepa's financial projections and listed a number of steps it is taking to lower operational costs, including cracking down on electric theft, reducing the workforce through attrition and cutting back on overtime and outside contractors.

*Another Reuters Article:*

**Reuters: Puerto Rico issues bonds for energy**

By Cate Long  
July 30, 2013

<http://blogs.reuters.com/muniland/2013/07/30/puerto-rico-issues-bonds-for-energy/>

Though it has not borrowed in the bond market this year, the Commonwealth of Puerto Rico appears to have started by taking two loans from unnamed banks. Unfortunately we don't have much information about these transactions, so the amount and purpose are unclear (July 9, July 29). The Puerto Rico Electric Power Authority (PREPA) has filed a bond offering that is expected to come to market on August 5th. Janney Montgomery's Alan Schankel wrote about the deal:

For the first time in more than a year, we expect to see a new bond issue from Puerto Rico, in the form of \$600 million Puerto Rico Electric Power Authority (Baa3/BBB/BBB-) with all three rating agencies affirming outstanding ratings. Pricing is expected next week.

**What is PREPA?**

The largest public power provider in the US, PREPA depends on fuel oil for 61 percent of its energy production. Although improved from a 73 percent share five years ago, this dependence on high cost fuel has stunted demand. Much of the utility's capital investment plan, including \$2.3 billion in the past 5

years, and \$1.5 billion in the coming 5 years, is focused on conversion of energy production to natural gas, with oil projected to account for only 10 percent of fuel by 2017.

PREPA has been in a tough spot because it has needed to import the oil to run the generators that produce electricity. Oil prices have been on a roller coaster (mainly up) since 2008. But there is a bigger issue for PREPA. The Puerto Rico economy continues to stall and electricity demand is plummeting:

As S&P noted in its rating report, 'PREPA's credit profile is strongly linked to the economy it serves.' The June release of the island Economic Activity Index indicates a 4.5 percent economic contraction YoY, the sharpest drop in three years, with the electric power generation component of the index falling by 9.1 percent YoY.

The riskiness of bonds is usually evaluated across several metrics. The primary metric is the debt service coverage ratio, which is how much cash flow is available to service the bond and interest payments. It's similar to the cash you have left after household expenses to cover credit card payments. For PREPA, the coverage ratio is extremely thin.

|                                                                                                                                        | Fiscal Years Ended June 30 |             |                           |                           |                              |
|----------------------------------------------------------------------------------------------------------------------------------------|----------------------------|-------------|---------------------------|---------------------------|------------------------------|
|                                                                                                                                        | 2009                       | 2010        | 2011                      | 2012                      | 2013 <sup>(1)</sup>          |
| Revenues <sup>(2)</sup>                                                                                                                | \$4,007,268                | \$4,165,733 | \$4,411,213               | \$5,052,678               | \$4,853,002                  |
| Less: Current Expenses                                                                                                                 | 3,377,772                  | 3,429,095   | 3,705,192                 | 4,415,265                 | 4,122,315                    |
| Net Revenues                                                                                                                           | \$ 629,496                 | \$ 736,638  | \$ 706,021                | \$ 637,413                | \$ 730,687                   |
| Principal and Interest Requirements <sup>(3)</sup>                                                                                     | \$ 435,042                 | \$ 297,579  | \$ 480,233 <sup>(4)</sup> | \$ 327,685 <sup>(4)</sup> | \$ 534,324 <sup>(4)(5)</sup> |
| Ratio of Net Revenues to Principal and Interest Requirements, per Trust Agreement                                                      | 1.45                       | 1.85        | 1.47                      | 1.95                      | 1.37                         |
| Ratio of adjusted net revenues to Principal and Interest Requirements, net of municipalities' consumption and subsidies <sup>(6)</sup> | 0.92                       | 1.25        | 0.95                      | 1.07                      | 0.81                         |
| Electric energy sales (in millions of kWh)                                                                                             | 18,516                     | 19,235      | 18,501                    | 18,112                    | 17,962                       |
| Percentage change in electric energy sales from prior year                                                                             | (5.5)%                     | 3.9%        | (3.8)%                    | (2.1)%                    | (0.8)%                       |

The 1.37 times principal and interest coverage ratio number for 2013 says that debt service can be paid with a 0.37 percent cushion. Note the 0.81 percent number below, which adjusts the cash flow by subtracting subsidies and power transfers to municipalities. This is essentially what PREPA gives away without receiving revenues. It's like leakage in a water system. It is draining cash flow from PREPA and it must be covered with more borrowing to sustain debt service. This is a municipal issuer on a downward spiral. Traditionally the Puerto Rico Government Development Bank would loan money for shortfalls to PREPA, but the GDB has severe liquidity and balance sheet issues itself.

The repayment for these bonds is the revenue of the PREPA system. Bond investors should hope that the Puerto Rico economy does not slow any more.

Credit rating agency reports on this bond offering (requires free registration)

S&P – BBB stable

Fitch – BBB- stable

Moody's – Baa3- negative

**Ratings agency reports are listed below.**

***S&P Rating Agency Report:***

**Puerto Rico Electric Power Authority's 2013A Power Revenue Bonds Rated 'BBB'; Parity Debt Rating Affirmed At 'BBB'**

Publication date: 26-Jul-2013

<http://www.standardandpoors.com/prot/ratings/articles/en/us/?articleType=HTML&assetID=1245355110005>

Standard & Poor's Ratings Services has assigned its 'BBB' rating to Puerto Rico Electric Power Authority's (PREPA) 2013A power revenue bonds, and affirmed its 'BBB' rating on PREPA's parity debt. The outlook is stable.

After the July 1, 2013 debt payment, PREPA had \$7.9 billion of power revenue bonds outstanding. A pledge of the electric system net revenues secures the bonds.

Bond proceeds will fund capital expenditures in fiscal 2014 and 2015 as well as 30 months of interest expense.

"The rating reflects our opinion of both the continuing weakness of the island's economy and the utility's own challenges," said Standard & Poor's credit analyst Judith Waite. These challenges include:

- An isolated electric system, which requires the utility to maintain a capacity margin of at least 50%;
- High rates due to dependence on fuel oil for 61% of energy production;
- Large capital requirements to convert generating plants to gas, bury distribution wires, and upgrade and extend the transmission system;
- Weakened debt service coverage in 2012 and 2013; and
- Limited liquidity, exacerbated by delinquency of public corporation receivables.

The rating also takes into account steps PREPA's management is taking to lower the cost of electricity by converting generating plants to gas, reducing operating costs and energy theft, increasing collection of government receivables, and strengthening transmission efficiency. Management also intends to increase the percentage of power provided by renewable sources.

The stable outlook reflects our opinion of PREPA's ability to maintain adequate credit metrics while continuing to fund its capital investment program with substantial amounts of debt. The authority's commitment to reduce its own operating costs and the Puerto Rico government's commitment to honor its financial obligations to PREPA support this. Progress in both of these endeavors will be important factors in maintaining the rating during our two-year outlook horizon. Moreover, the authority's goal of reducing its dependence on oil and improving the electricity system's overall reliability and efficiency will be an important component of Puerto Rico's economic growth, and successful execution of the planned conversion and upgrade will also be important factors in maintaining the rating. We do not expect to raise the rating during the outlook period.

***Moody's Rating Agency Report:***

**Moody's assigns Baa3 rating to PREPA Power Revenue Bonds, Series 2013A; outlook is negative**  
Global Credit Research – July 25, 2013  
Issuance Amount \$600 million

[http://www.moodys.com/research/Moodys-assigns-Baa3-rating-to-PREPA-Power-Revenue-Bonds-Series--PR\\_278617](http://www.moodys.com/research/Moodys-assigns-Baa3-rating-to-PREPA-Power-Revenue-Bonds-Series--PR_278617)

**Opinion**

Moody's Investors Service assigned a Baa3 rating to the Puerto Rico Electric Power Authority's (PREPA) \$600 million of Power Revenue Bonds, Series 2013A. The outlook is negative.

**SUMMARY RATINGS RATIONALE**

The rating reflects the current rating and outlook for the Commonwealth of Puerto Rico's general obligation bonds (Baa3; negative) as well as the rating of entities that are based on or capped at the GO rating, including the Government Development Bank of Puerto Rico (GDB) (Baa3; negative), which is an important source of liquidity for PREPA.

The rating also reflects continued weakness in the economy of Puerto Rico. In addition, the rating reflects uncertainty about the execution of a long-term fuel diversification and cost reduction plan that is designed to put the Authority on a sounder financial footing. PREPA also has a sizable Capital Improvement Program (CIP), which contemplates further issuance of additional debt, and uncertainty remains in terms of PREPA's ability to execute the construction program that is intended to enable many of its power plants that currently utilize high cost oil to be capable of burning natural gas.

Moody's notes that PREPA has made some progress on its long-term diversification plan. Two of its generating units at the Costa Sur power plant have already been converted and are already capable of burning natural gas. PREPA's CIP program for fiscal years 2014 through 2108 includes the conversion to burn dual fuel of an additional six oil fired electric utility steam generating units and the San Juan Combined Cycle units.

For a detailed credit analysis of PREPA, please see our rating update report dated June 19, 2013.

**OUTLOOK**

The negative outlook reflects the negative outlook for the Commonwealth and the GDB as well as the liquidity pressures at PREPA that will continue. The negative outlook also considers the uncertainty about the execution of the long-term strategic plan to convert high cost oil-based power generation to lower cost natural gas, which will enable PREPA to control rates and help spur economic growth on the island.

**What could change the rating - Up**

In light of the negative outlook, the rating is not expected to move upward over the near-to-medium term. The outlook could stabilize if the Commonwealth of Puerto Rico stabilizes and/or PREPA shows progress on the execution of its fuel diversification and cost reduction strategy.

**What could change the rating - Down**

The rating could be pressured downward if receivables from government entities remain high and unrestricted cash balances decline, debt service coverage ratios fall significantly below projected levels,

or the ratings of the Commonwealth and GDB decline. In addition, the rating could move down if PREPA fails to renew its committed bank facilities, which are set to expire this year.

*Fitch Rating Agency Report:*

**Fitch Rates Puerto Rico Elec Power Auth's \$600M Rev Bonds 'BBB-'; Outlook Stable**  
July 26, 2013

[http://www.fitchratings.com/creditdesk/press\\_releases/detail.cfm?pr\\_id=797965](http://www.fitchratings.com/creditdesk/press_releases/detail.cfm?pr_id=797965)

Fitch Ratings assigns a 'BBB-' rating to the Puerto Rico Electric Power Authority's (PREPA) planned issuance of \$600 million series 2013A power revenue bonds. The 2013A bonds are scheduled to price the week of Aug. 5, 2013, via negotiated sale. Fitch also affirms PREPA's outstanding \$7.95 billion in parity power revenue bonds at 'BBB-'. The Rating Outlook is Stable.

**SECURITY**

The power revenue bonds are secured by a senior lien on net revenues of the electric system.

**KEY RATING DRIVERS**

1. **SOLE POWER PROVIDER:** PREPA is essential to the Commonwealth of Puerto Rico as it is the sole provider of electricity on the island. PREPA is the largest municipal power system in the U.S., in terms of customers (1.47 million) and revenues (\$4.9 billion).
2. **RECENT DOWNGRADE:** Fitch recently downgraded PREPA's debt rating (see press release dated July 1, 2013) to 'BBB-' from 'BBB+' due to persistently slimmer operating margins, cash flow and debt service coverage in recent years. The weakened financial position and lower debt rating reflect the impact of the ongoing economic recession, declining electricity usage, high fuel costs and growing account receivables, as well as Fitch's expectation that stronger financial performance is unlikely over the near term.
3. **WEAK FINANCIAL POSITION:** Fitch-calculated debt service coverage, after adjusting for contributions in lieu of taxes (CILTs), has remained close to 1.0x in recent years (0.91x unaudited for fiscal 2013), and is not expected to improve through fiscal 2016. Coverage rose to 1.16x in fiscal 2012 but reflected the refunding of scheduled debt maturities. Total debt and leverage metrics have risen steadily since 2009.
4. **RECEIVABLES REMAIN HIGH:** Total receivables remain high at 29% of revenues for fiscal 2013, an ongoing negative credit factor. Government, municipal and private customer receivables have returned to growth in fiscal 2013 despite efforts of the Government Development Bank of Puerto Rico (GDB) and the Commonwealth to improve collections. Persistently high fuel costs and the weak economy continue to drive receivables higher.
5. **GDB LIQUIDITY SUPPORT:** PREPA's reliance on borrowings from the GDB and other banks to periodically cover operating costs, debt service and the CILT payment remains a concern for Fitch. Beyond fiscal 2013, PREPA is projecting improved cash flow, adequate to cover total costs.



6. **REPARATIVE FISCAL INITIATIVES:** PREPA, in concert with the GDB and the legislature, has worked to put in place various initiatives aimed at improving revenue collections (reduce energy theft; reduce transfers to municipalities, etc.) and reducing operating costs. In aggregate, these measures could improve operating cash flow by up to \$120 million per year by fiscal 2014.
7. **DIVERSIFYING POWER SUPPLY:** A credit positive is management's focus on reducing dependency on costly oil-fired generation to reduce fuel costs and comply with environmental mandates. Via a combination of renewable power purchases and conversion of existing plants to dual fuel generation (oil and natural gas), oil generation dependency has declined from close to 100% pre-2000 to roughly 67% currently. If remaining plant conversions are completed, annual fuel costs could decline 40% (\$1 billion) by 2018.
8. **BROAD BUT WEAKENED SERVICE AREA:** PREPA's retail customer base is diversified and not as heavily dependent on tourism as other islands. However, the Commonwealth (GO debt downgraded to 'BBB-', Negative Outlook by Fitch) remains economically weak, with a declining population base, growing budget deficit and high debt burden.

#### **RATING SENSITIVITIES**

**WEAKER THAN EXPECTED FINANCIAL PERFORMANCE:** The current rating takes into account PREPA's weakened balance sheet, marginal debt service coverage and ongoing decline in energy sales through fiscal 2013. However, failure to stabilize operating margins as projected, or a continued heavy reliance on borrowings to adequately meet costs (in particular debt service) could result in further negative rating action.

#### **CREDIT SUMMARY**

PREPA is one of the largest public power systems in the U.S., and the sole provider of power to the Commonwealth of Puerto Rico, an island of about 3.7 million people. The authority has historically operated independent from the commonwealth and has been allowed to pass through the costs of fuel and purchased power costs on a monthly basis.

Higher generating reserves are required for PREPA as an island system that has a total of 5,839 megawatts (MW) of owned and purchased capacity compared with the 2013 peak load of 3,265 MW. Concentration of resources in oil exposes PREPA to volatile fuel costs and environmental mandates.

Fitch views the utility's efforts to diversify its energy mix positively, as the continued reduction in oil generation dependency should alleviate some of the pressure on future financial margins. Fitch will be monitoring PREPA's progress to stabilize its financial position and achieve stronger operating cash flow - sufficient to cover total costs, including debt service.

#### **WEAKENED FINANCIAL PROFILE**

The past six years of economic recession, coupled with rising fuel costs have contributed to a significant decline in electricity sales and reductions in PREPA's operating and cash flow margins through fiscal 2013. Net account receivables have returned to historically high levels, after progress had been made in reducing municipal receivables in fiscal 2009 and 2010. CILTs, in essence a utility transfer to government and municipal customers, have also continued to escalate unabated through the period.

While debt service coverage for fiscal 2008-2013 ranged from 1.23x to 2.12x, coverage of full obligations, which includes CILTs as an operating expense, was closer to 1.0x and declined to less than 1.0x in fiscal 2008, 2011 and 2013. Liquidity significantly tightened and additional borrowings were periodically necessary to meet total obligations.

Fiscal 2012 debt service coverage improved to 2.12x, or 1.16x adjusted for CILT payments, however, the improvement was mainly due to lowered debt service payments via refinancing, rather than improved cash flow.

A reluctance to raise base rates continues to persist, as base rates remain unchanged since 1989. Additionally, the lackluster Puerto Rican economy remains a negative credit factor as recovery may prove to be elusive.

### **REASONABLE OPERATING STRATEGY**

PREPA has developed a reasonable plan to restore prospective financial margins. In concert with the GDB and with the support of legislative initiatives, PREPA will be implementing measures to improve revenue collections and reduce operating costs (non-fuel). These measures, if successful, could improve operating margins by \$120 million per year by 2014.

Additionally, with PREPA's completed conversion of the Costa Sur generating facility to dual-fuel (25% of energy mix) fuel costs should begin to decline in fiscal 2014. Average customer bills, as measured by revenues/kwh sales, should see some rate relief due to the lower fuel cost component by fiscal 2014.

### **NO MEANINGFUL IMPROVEMENT EXPECTED THROUGH 2017**

Based on these initiatives and a somewhat aggressive electric sales growth forecast (CAGR 0.9% per year 2014-2017), PREPA's debt service coverage is projected to range from 1.31x-1.39x. Adjusting for CILT payments (actually netted against customer electric bills), debt service coverage will hover at just over 1.0x, as annual debt service payments are scheduled to increase over the same period.

PREPA's equity-to-total capitalization ratio is not likely to improve notably going forward (-6.1% as of fiscal year-end 2012) given the authority's \$1.5 billion five-year capital expenditure program and plans for debt funding

#### ***One More Article:***

#### **PREPA comes under senatorial fire for its upcoming bond issue: Bhatia question the decision-making process that led the public corporation to its weak current condition**

Negative remarks were led Senate President Eduardo Bhatia.

By Antonio R. Gomez

The Electric Power Authority (PREPA) came under fire at a public hearing of the Committee on Finance of the Senate, where the Senate President questioned the purpose of a bond issue of \$ 600 million scheduled for next week, and the process of decision-making that led to the public corporation to its weak current condition.

Negative remarks were led Senate President Eduardo Bhatia in an extensive interrogation.

PREPA officials stated their differences with the decisions taken by the public body for the past 20 years, which has resulted in keeping with inefficient technology and losing operation.

Among the approaches that Bhatia made to the Director of Planning and Environmental Protection of the PREPA, Sonia Miranda, are the numbers of customers that demand for the current fiscal year, the uses of the \$600 million and the reasons for that investment does not include the upgrade of plants that would make more efficient operation.

PREPA, contrary to what was the pattern of past years, claims an increase of over 50,000 customers over the previous fiscal year 2011-2012. Nevertheless, reports a reduction in sales during this year.

Miranda acknowledged the official numbers of PREPA and explained the reduction in sales to the fact that customers have reacted to rising costs of taking action to reduce energy use.

The PREPA spokesman at the hearing, which was convened precisely to evaluate the bond issue, confirmed that the \$600 million provided no money for infrastructure that will expand the use of natural gas generating plants of the agency.

Miranda explained that the money will be used for capital improvement program over the next two fiscal years and includes "construction projects led to the expansion, rehabilitation and improvements to the electrical system" and to meet new environmental standards introduced the federal government.

"I have profound disagreements with decisions on PREPA in the past 20 years," said Bhatia, adding that the process "was fatal to this country."

During the hearing it was reported that at the end of 2012, PREPA had an operating loss accumulated \$183 million and that the estimate for the fiscal year was \$414 million, which was reduced with savings plan to "only" \$283 million.

Per kilowatt hour sales for fiscal 2012 were reduced to levels comparable to those of fiscal 2000, officials said. Another fact that came to light at the hearing is that the debt of the Authority exceeds by more than \$500 million worth of assets.

It was reported that the cost of building the infrastructure to bring natural gas to the Central Aguirre, the next project of its kind in plans for PREPA and date of operation for 2015 is \$250 million and is not included in the \$600 million the bond issue.

Miranda said, however, that the agency will complete the project within the scheduled using other funding, including private investment in that infrastructure. He said based on the projections of the PREPA, not expected to be necessary to increase the rates it charges for its services.

*Article on the implication to growth on the Island because of the new taxes*

**New taxes could reduce Puerto Rico's real growth by 3.3%, slash 30K jobs in 2 years**

By: Michelle Kantrow

July 30, 2013



<http://newsismybusiness.com/new-taxes-could-reduce-puerto-ricos-real-growth-by-3-3-slash-30k-jobs-in-2-vrs/>

Nearly every empirical study of taxes and economic growth published in academic journals concludes that implementing the former has a direct impact on the latter.

Preliminary analysis conducted by economic analysis firm Heidie Calero Consulting Group suggests the impact of new taxes implemented in Puerto Rico this month could lead to a reduction of 3.3 percent real growth during the next two fiscal years, with a loss of up to 30,000 jobs.

This fiscal year's budget, which went into effect July 1, is pegged at \$9.77 billion, excluding \$575 million of debt service restructuring, which makes it about 8 percent larger than the Fiscal 2013 budget. The budget includes \$1.5 billion in additional revenue taxes stemming from new taxes on corporations and individuals.

The amount is broken down into: \$450 million from adjustments to the alternative minimum tax calculation, including a new National Tax on gross sales of businesses; \$270 million in higher corporate income tax rates; \$237 million from the expansion of selected business-to-business services; and \$533 million in other initiatives including hikes in crude oil and petroleum products taxes, as well as excise taxes on cigarettes.

New taxes are almost automatically conducive to higher prices, which the firm headed by Economist Heidie Calero believes will lead to lower real wages and consumption, thereby resulting in lower revenues than estimated.

If no further action is taken to boost the island's already bleak panorama, "Puerto Rico will continue to lose competitiveness," she said as part of the conclusions include in the latest edition of the company's "Economic Pulse" monthly publication.

#### **What should be done?**

The economist believes that a plan to increase public and private investment is urgent.

"Without investment, the economy will not grow and pharmaceutical exports alone cannot carry the weight of growth and jobs," she said. "A lot has to be undertaken in tourism, agriculture, telecommunications, and high value-added services, to name just a few sectors."

The firm also noted that public agencies "need to buy into performance budgeting processes."

"They will be reluctant to participate if they think that performance budgeting will be used simply as a way to reduce their funds. Statistical data and metrics need to be in place to gauge the effectiveness (or lack thereof) of public programs," the economist noted.

"Staff training is key. When performance budgeting is implemented, all civil servants involved must be trained in the new processes," she said.

Another urgent area to address is Puerto Rico's tax system, which needs to be made (1) suitable for finance public management, (2) simple to manage and enforce, (3) efficient in minimizing tax distortions on people and business behavior (4) neutral with respect to prices, and (5) equitable.

"The Internal Revenue Code of Puerto Rico with too many credits, deductions, exemptions, exclusions and preferential rates, does not meet any of these principles. New taxes in Puerto Rico may temporarily solve the budget problem but a tax and fiscal reform are badly needed."

*Article on the macro conditions in Puerto Rico right now:*

**Puerto Rico's new normal**

By: ALEX DÍAZ

August 1, 2013

[http://www.caribbeanbusinesspr.com/print\\_ed/puerto-ricos-new-normal-8810.html](http://www.caribbeanbusinesspr.com/print_ed/puerto-ricos-new-normal-8810.html)

We can no longer deny it. The way we're going, the economy will take another 10 years to recover. So as businesspeople, let's understand why and prepare for what's coming.

Japan has been at it for 20 years. Europe is now facing a similar fate. And now Puerto Rico: The prospect of another 10 years, probably more, of economic stagnation that is sure to stretch the capacity of every business on the island to make it through, hopefully figuring out a way to thrive—though for most, it will likely mean an extension of the current struggle to merely survive.

In Germany, the business community refers to it as the plight of shrinking economies, and the search is on there—as in nearly every European country—for ways to make the most of the situation.

So it is in Puerto Rico, but worse. The local economy is stuck at the bottom after losing an astonishing 13.1% of its gross product (GP) in the five fiscal years from 2007 to 2011. And those are only the years with negative growth. Last year (fiscal 2012) saw a 0.1% uptick that, while positive, felt like more of the same, driven as it was by one-time election-year spending by the previous administration that did little to boost the broader economy.

The pain, in fact, stretches back before 2007. The economy, which recovered from the brief 2000-2002 recession and peaked at 2.7% growth in 2004, began its descent by falling to 1.9% in 2005 and 0.5% in 2006 (fiscal years). The local economy was on the way down long before the U.S. mainland and Europe entered their own deep recessions. And while neither super region is out of the woods yet, both are showing early signs of improvement.

Puerto Rico isn't. "We are just trying to run in place right now," said economist Joaquín Villamil, chairman of Estudios Técnicos, "and we have to realize that the way things are shaping up, we will be running in place for another decade or more."

In various recent presentations, Villamil has flashed a slide projecting annual GP growth of 1.75% from fiscal 2015 to 2021, when the economy will presumably return to where it was when the recession began in 2006. But he is the first to caution that current trends have already rendered that scenario too rosy.

"It will take quite a bit longer than that," he told CARIBBEAN BUSINESS. "So the time has come to recognize what awaits us and make the necessary adjustments. We have been suffering from too much denial, thinking that improvement is right around the corner. But that's just not so. There is nothing in the economy to suggest that."

In other words, this will remain a no-growth, zero-sum economy with a shrinking consumer market as far as the eye can see.

For economist Juan Lara, partner at Advantage Business Consulting, Puerto Rico isn't even finished contracting. "We probably ended fiscal 2013 [on June 30] with a 2% drop. So we aren't out of the woods yet," he said.

Since last August, the index of leading economic indicators of the Government Development Bank for Puerto Rico has trended downward. A string of reports in recent months has shown declines in retail sales, auto sales, labor-force participation, cement sales, electricity use, housing sales, manufacturing orders, personal income and, perhaps most damning, a dramatic loss of population as a growing number of people flee the island, which means fewer consumers to buy goods and services.

### **WHAT TO DO? FIND YOUR NICHE**

When faced with such dire straits, "we as businesspeople can either roll over and die—you know, dwell on the negative—or we can become resourceful and find opportunities that others miss," said Manuel Morales Jr., a marketing executive turned serial entrepreneur who served as president of the Puerto Rico Chamber of Commerce (CofC) in the late 1970s and on the board of Banco Popular de Puerto Rico for more than two decades.

Calling himself a research buff and pouring over volumes of econometric tables and market data, Morales acknowledged the daunting challenges ahead, but insists success can be had. "You have to do your homework. Do the research. And if you apply some vision to it and become relentless, you will discover niches that are just begging for a business to step up and fill," he said.

The population is aging? "There are all kinds of services our elderly citizens need, especially in the health and medical industry," he explained, his finger pointing to a Puerto Rico Planning Board statistic showing consumer spending on medical services up by a whopping 31% since 2006.

The population is declining? "Take advantage of the growing Puerto Rican diaspora in the States to establish relationships and grow your business there, which creates jobs here," he said.

Crime is a problem? "The security business is booming, and there are still opportunities for more," he noted.

Personal income is down? "Yes, it fell 12.4% since the recession began, but consumption went up, since people are moving into the underground economy in droves and receiving a lot more in federal transfer payments. Consumers may be down, but many are alive and kicking," he said.

One huge opportunity begging for attention, Morales continued, is procurement by federal agencies, to which other observers add state and municipal governments.

"This is unbelievable," he said, this time pointing to U.S. Census Bureau statistics indicating that only 4.9% of all federal spending on the island is on procurement, versus 91% spent on grants and transfer payments. "Look at Hawaii. Only 49% is grants and transfers, and 13.2% is procurement." Yes, he acknowledged, Hawaii is richer and has a full congressional delegation to create procurement opportunities. "But that still doesn't negate the fact that we can bring far more federal procurement to the island than we are doing today. And that money would go into productive business activity that creates jobs, not on transfer payments that have a smaller multiplier."

The local government, he added, deserves much of the blame. "We have never had a policy in place." But businesses can make it happen on their own. "It takes getting off your butt, making some calls, getting on that plane and placing the bids. Our businesses can compete with anyone, but they have to get out there and compete," he said.

### **INNOVATE!**

Villamil, also a former CofC president, boils it down to the analysis popularized by NYU Stern School of Business economist and author William Baumol in his 2010 book, "The Microtheory of Innovative Entrepreneurship."

"He makes the distinction between replicative entrepreneurs, who focus on businesses that provide traditional goods and services—things like coffee bars and grocery stores—and innovative entrepreneurs, who instead create demand in local and export markets with new, creative products," Villamil explained. "The calling in today's economy is for more innovative entrepreneurs. That's what our businesspeople have the opportunity to become."

As if correcting himself, he added: "Actually, that is what they will have to become if they want to compete and win. Innovative entrepreneurs are the ones with the best chances of prospering in a tough economy." He offered the examples of such local companies as Aireko, Paciv, Avantech, "and so many others that are getting it done in a variety of niches. This is happening. The only question is whether it will happen with enough companies to lift the economy."

That, in fact, was one of the causes adopted by architect and planner Pablo Figueroa during his own CofC presidency, which just concluded. After a year working on laws and development initiatives with the government, his message to the island's corporate decisionmakers is clear.

"It is up to each of us, up to each business, to become creators of our own fate," he told CARIBBEAN BUSINESS. "We can't sit around waiting for the government to act. The government has a huge role to play, and as a business community, one of the things we must do is collaborate with our leaders to improve the economy. But in the end, we have to realize it won't be the government that gets it done for you. The government isn't the innovator. We are the innovators. We are the ones who must collaborate among ourselves to identify the opportunities and seize them."

Figueroa repeated what was easily his biggest message in the past year at the helm: "The first thing we must do is become aware of the fast pace of change and embrace it, not shrink from it. Technology is changing. Emerging markets are growing. This entire economic malaise and the fact it will last so long—that in itself has become a big change. All these changes are coming at us at the same time, and we have to adapt."

Innovation, Figueroa added, might sound like a sophisticated word, but "in arroz y habichuelas, it means something very simple, something we all know instinctively. It means that we have to bregar [Spanish for finding a way to get it done]. We can all understand that concept."

Yet another change to embrace, he continued, is networked entrepreneurship, captured in Puerto Rico by such regional consortia as Intenor and Inteco, and by the many business incubators popping up across the island. Globally, the practice is best captured by Colorado consultant Brad Feld, featured in a recent MIT Business Review article quoted by Figueroa.

"Feld calls them start-up communities, and it happens when a group of entrepreneurs collaborate and share resources to launch a product. The message is clear: Come together and do something. Do

something! Move! Brega. It doesn't have to be a start-up. It can be a group of existing companies. It's the collaboration and networking that makes the difference. The battlefield in Puerto Rico may be full of mines," he said, referring to energy costs, population decline, public debt and the island's other explosives. "But what are we going to do, allow those obstacles to stop us, or maneuver around them and outfox reality? We have no choice but to do the latter."

## FINANCIAL HEADWINDS

That takes a particularly resourceful and inventive businessperson, said CPA and export consultant Luis Torres Llompart of professional services firm Kreston TLSR, and also a former CofC president. "My worry is that not enough of them will choose to fight. The opportunities are there, but there are far fewer of them, and one tough economy that makes it extremely difficult for those who want to get ahead," he said.

One tough economy, indeed, which makes understanding it—knowing where the mines are, if you will—is the first step to take.

Take banking, for example. It is no secret that banks remain extremely tight in their lending practices, not having recovered from the lethal combination of construction loans that fell victim to the extended recession and a plethora of poorly made commercial loans that forced other banks to fold.

"Banks used to receive clients with the attitude and willingness to make a loan happen," said Emilio Piñero, the retired former chief of commercial banking at Banco Popular. Today, by contrast, "the default is a big 'no.' From the get-go, the borrower is an out dressed as a baseball player."

The reasons, he explained, are complex, but "can be summed up in four letters: FDIC," or the Federal Deposit Insurance Corp., the principal bank regulatory agency in the U.S. (including Puerto Rico) that took over the former Westernbank and sold it to Popular. The FDIC used the same resolution formula in Puerto Rico that it applies in the States: Persuade solid banks to buy toxic assets from sick institutions by providing an 80% guarantee.

In addition to Westernbank's toxic portfolio, the FDIC sold bad assets from R-G Premier Bank (taken over by Scotiabank) and Eurobank (taken over by Oriental Bank). Doral Bank and FirstBank, meanwhile, suffered from bad commercial and construction loans and, in the case of Doral, derivatives gone bad, thus freezing their own lending, while Spanish bank Banco Bilbao Vizcaya Argentaria chose to leave the market and was acquired by Oriental. While less of a victim, the contagion spread to the other bank on the island, Banco Santander, which is therefore as much under the FDIC's magnifying glass as the rest of them.

"So from having about 10 banks making commercial loans, three are gone and the others are outright scared," Piñero added. "The ones that bought the toxic assets have spent a big chunk of their time cleaning them up and asking the FDIC to live up to the 80% guarantee, and the rest of the time they are doing everything they can to keep the FDIC from critiquing or classifying their loans, so they would just as well not make any new ones and hope that the entire crisis goes away as soon as possible."

That probably won't happen before April 15, 2015, or another two years. That is when the agreement with the FDIC expires, and "no one knows for sure what will happen after that. It will depend on how they all end up, or how they ultimately dispose of those assets," Piñero said.



In the meantime, he noted, "don't expect much change in lending activity, which is horrible, because commercial loans serve as a sort of lubricant for the whole economy. They used to supply the capital for businesses to expand."

Making matters worse, Piñero continued, Puerto Rico has never had a thriving equity market of angel and venture-capital investors, and less so of companies lining up to issue publicly traded stock, as companies of all types and sizes do in the States.

Resourceful entrepreneurs have the option of looking stateside for capital, both debt and equity, he said. "That's always an option, and I have seen it happen." But thus far, the volume has been small.

Then there is the possibility of a local coalition coming together to persuade FDIC officials to do things differently. "It shouldn't treat Puerto Rico the same as it does a far wealthier, more solid regional economy in the States," the banker added. "Our fundamentals are different. It would do itself a favor by pulling back somewhat and giving banks the space to do some business and get stronger."

### **SHRINKING MARKET**

FDIC aside, banks today are facing another hurdle: a 15% delinquency on mortgage loans, also a victim of the extended stagnation—magnitudes higher than the historical range of 2%-4%.

That, in turn, connects back to the broader bloodbath in property values, which still haven't recovered from the estimated 30% dive of recent years and the \$30 billion or so in lost wealth by property owners (residential and commercial).

That has come on top of the estimated \$12 billion hit suffered by retirement accounts, institutional investors, mutual funds and, most notably, wealthy individuals from the collapse of bank stocks.

"The wealth effect has been real," said Piñero, referring to the popular phrase used in the States to describe the aftermath of a stock market crash. "Those of us who held that wealth have simply held back from our consumption and investment activity."

That is only one blow to the midsection of Puerto Rico's once vibrant consumer market, which considering that personal consumption represents a stunningly high 88% of the local economy, largely explains the depth and length of the recession.

Also contributing to the consumer stupor has been the historic loss of jobs. Since the recession began in 2006, Puerto Rico has lost 230,000 jobs. The labor-force participation rate, which hovered at the 46%-48% range since 1952—in itself anemic by U.S. and international standards (the global average is 62%)—fell to an all-time low of 39.6% two years ago and is now at 40.7%.

That has translated into a personal income drop of 12.4% in the past seven years, according to Planning Board figures. A bigger underground economy and a 70% hike in federal transfer payments have kept consumers active, but at a reduced pace—and favoring big-box chain retailers instead of locally owned small and midsize businesses, which largely explains the latter's historically high bankruptcy rate and all the boarded up windows on display along the island's now distressed commercial thoroughfares.

Puerto Rico's wages have been further depressed by the inability of local companies to grant normal pay hikes to the one million or so who have managed to keep working. As reported recently by CB Online (cb.pr), the average weekly wage in Puerto Rico is \$499, according to the latest report from the U.S. Bureau of Labor Statistics. That is 45% below the U.S. national average of \$903 per week and nearly

29% less than Montana, the state with the lowest pay at \$700. As of 2010, roughly one-third of workers in Puerto Rico earned the federal minimum wage, compared with only 16% on the mainland.

The Center for a New Economy, a local think tank, has documented that low wages have long made welfare competitive with work in Puerto Rico. This is even more so today, and will continue to be as the wage stagnation extends for another decade or more, keeping large hordes—currently about 55% of the population—drawn to welfare and transfer payments.

"As businesspeople, we have become accustomed to this consumer market, particularly since food stamps and other welfare payments became predominant some 30 to 40 years ago," Morales said. "The coming years will just be worse; we have to prepare for that and make the necessary adjustments."

## EXODUS, AGING

Speaking of adjustments, how about adjusting not just to consumers with less money, but also to having fewer consumers to begin with, courtesy of the accelerating exodus of Puerto Rico residents to the U.S. mainland.

According to the U.S. Census Bureau, population peaked at 3.8 million in 2000 (3,808,610, to be exact) before going downhill by nearly 150,000 people to 3.66 million today. That is the net decline after factoring in the residents who have given up and left the island, plus deaths, minus births and those who have moved to Puerto Rico.

The 150,000 loss is a 4% decline, which doesn't rival the population drops in Japan and various European countries. But a recent analysis by the Puerto Rico Statistics Institute anticipates population plummeting to those levels before mid-century—to 2.5 million, or a 40% drop, by 2050, roughly the same population the island had in 1950.

As we become fewer, we are also becoming older. As has been widely reported by this newspaper, aging will also contribute to the shrinking of the consumer market. From 15.4% of the population in 2000, elders ages 60 and older now represent 21%, and are expected to log in at nearly 40% of the projected 2.5 million population by 2050.

"Older people spend a lot less and cost more, especially in healthcare," Villamil stated. "When you combine it with the number of people we can expect to be on welfare, the group that will actually be working, spending and paying taxes will simply not sustain the economy. If we are already having troubles balancing the budget and stimulating the economy at the same time, imagine a few years from now. It is a recipe for collapse."

It is also a recipe for the sort of business and policy ingenuity Puerto Rico hasn't seen since the last time it faced a collapsed economy—following the Great Depression of the 1930s and 1940s.

"I repeat," Figueroa said, "we simply have no choice."

## *Article on muni outflows*

**U.S. municipal bond funds report \$2.24 bln weekly outflows Thu, Aug 01**



WASHINGTON, Aug 1 (Reuters) - U.S. municipal bond funds reported \$2.24 billion of net outflows in the week ended July 31, nearly twice the previous week's \$1.23 billion, according to data released by Lipper on Thursday.

The four-week moving average was negative at \$1.56 billion in outflows, said Lipper, a unit of Thomson Reuters.

Apprehension about municipal bonds helped fuel the 10th week of outflows, said Tom Roseen, head of research services at Lipper. When Detroit filed for the largest municipal bankruptcy in U.S. history, investors began to wonder if there were other "possible culprits" in the market who could default and pulled money out.

Investors in the municipal bond market also remain worried the Federal Reserve could end its monetary stimulus program and create interest rate risk for fixed income, Roseen said, noting that funds for taxable debt also experienced outflows this week.

"Until people realize they can get better yield than on Treasuries, we will continue to see outflows," Roseen said about municipal bond funds.

On Thursday, yields on top-rated 10-years were 2.71 percent on Municipal Market Data's benchmark scale and highly rated 30-year bonds 4.22 percent.

Ten-year yields were 99.6 percent of comparable Treasuries and 30-years were 111.9 percent, according to MMD, a Thomson Reuters company. Because Treasuries are taxed, they typically have higher yields than tax-exempt municipal bonds and the ratios showed top-shelf municipal bonds are currently cheaper than Treasuries.

Funds that hold high-yield municipal bonds, which usually have lower ratings, saw outflows of \$580.18 million in the week after \$231.71 million in outflows last week, Lipper said.

There were \$56.86 million in outflows from exchange-traded funds, as well, compared with the \$10.02 million investors pulled out of the funds the previous week.

Still, when it came to individual bonds, there was still appetite, data from BondDesk Group LLC showed. Retail investors bought 2.2 municipal bonds for every one they sold in the week ended July 31, the same as the week before. The number of bonds bought totaled 84,761, while the number of bonds sold was 38,923.

SENSITIVE PRE-DECISIONAL

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