

PUMA Energy: Proposal to the Task Force



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Sen. Orrin Hatch
Chairperson Congressional
Task Force on Economic Growth in Puerto Rico
U.S. Congress Washington, DC

Dear Chairman Hatch & Task Force Members:

For PUMA, as a good corporate citizen in Puerto Rico, is really a pleasure to participate in initiatives aimed to strengthen the Island's economy. There is no doubt, that the implementation of PROMESA offers a new context to promote institutional reforms necessary to reactivate the economy.

Since 2010, our company has been in Puerto Rico's economic community and we have been very proactive providing solutions with the private sector and the government to improve the business environment. We have a strong commitment to be a part of the local economic recovery process. To that extent, we are glad to present to you and the rest of the task force, specific policy options that could be helpful to the Task Force.

Puma Energy is a global integrated midstream and downstream oil company active in over 47 countries. Formed in 1997 in Central America, Puma Energy has since expanded its activities worldwide, achieving rapid growth, diversification and product line development.

The company directly manages over 7,650 employees. Headquartered in Singapore, it has regional hubs in Johannesburg (South Africa), San Juan (Puerto Rico), Brisbane (Australia) and Tallinn (Estonia).

Puma Energy's core activities in the midstream sector include the supply, storage and transportation of petroleum products. Puma Energy's activities are underpinned by investment in infrastructure which optimizes supply chain systems, capturing value as both asset owner and marketer of product.

Puma Energy's downstream activities include the distribution, retail sales and wholesale of the full range of refined products, with additional product offerings in the lubricants, bitumen, LPG and marine bunkering sectors.

In 2011, Puma Energy acquired in a bidding process at the U.S. Bankruptcy Court of Delaware, most of the assets of Caribbean Petroleum Company ("Capeco") for around \$82 million. As part of the transaction, Puma Energy agreed to substantially redevelop the former Capeco refining facilities into a state-of-the-art fuel storage depot, and to launch a significant program of environmental remediation in close cooperation with federal and local authorities.

In 2012, Puma Energy acquired all of Chevron's operations, including fuel marketing, retail service stations and aviation businesses, in Puerto Rico and the US Virgin Islands for \$86 million. Currently the product supplied to the U.S. Virgin Islands is being distributed out of Puerto Rico and we are evaluating entering new markets in the Caribbean, using the Bayamon Terminal as an important Hub for export.

Since 2013, the Regional Hub of the Americas was established in Puerto Rico, servicing 12 countries. We believe Puerto Rico has the potential to maximize its geographical position and other tax benefits to become a hub for global corporations.

By mid-2015, Puma Energy signed a purchase agreement of the British Petroleum site at the Luis Muñoz Marín International Airport in San Juan, Puerto Rico, which services over 4 million passengers per year. Puma's entrance at the LMM Airport brought operational and supply efficiencies as well as drove prices down from other competitors, contributing to indirect savings of around \$2M annually.

To date, Puma Energy has invested an excess of \$400 million in the acquisition, development and improvement of assets and infrastructure in Puerto Rico and will continue to invest in the development and maintenance of its assets.

Proposals to the Task Force

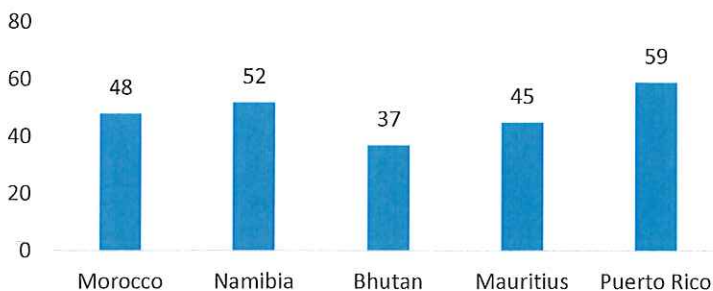
Our proposals to the Task Force focus in four areas:

- Strengthen and diversify Puerto Rico's energy system;
- Reform the Island's maritime transportation regulatory Act;
- A policy to maximize government opportunities in the LPG market;
- Improve the environmental regulation process

Energy policy

It has been extensively discussed that energy costs are harming Puerto Rico's global competitiveness. High energy rates discourage the arrival of new investment, particularly manufacturing companies and other capital intensive industries. Moreover, while the Island's energy system still operates under a public monopoly, that prevents lower rates. Other economies in the region have relatively lower industry energy costs.

Quality of energy supply
WEF global ranking



With a \$10 billion debt, the Puerto Rico Power Authority (PREPA) is literally insolvent and under receivership. As part of the debt restructuring agreement, the energy commission recently approved an increase in energy rates that could increase the cost of kilowatt per hour from .21 to .27 cents.

In 2014 Puma Energy entered the propane gas market through two gas stations with goals of 10 gas stations for 2016. Their market entry had a positive impact in the price of the product at a commercial level which resulted in a 50% drop in prices. The market was saturated and with Puma entering the market it leveled the competition.

At the moment the Puerto Rico Energy & Power Authority (PREPA) is undergoing a serious makeover under the control of a board and bondholders. They are searching all alternatives to slash prices and one of the proposals we offer is to change part of their industry into propane gas. Prices have dropped in the market and will allow a cheap energy alternative for PREPA.

On February 4 of 2016, as a condition from bond holders, to restructure PREPA's debt, the Governor of Puerto Rico signed into law Senate Bill 1523 or the Revitalization Act. The new statute reverts key components of Act 57 of 2014, and allow to PREPA to regain control over setting electricity rates and limit the PREC's powers as an independent regulator.

Also the Revitalization Act sets new additional charges for the private generation of renewable energy and limits the growth of renewable energy adoption as it pushes back compliance with previously established goals of renewable generation, currently slated for 20% by 2035. The new charges would apply to the generation of distributed energy by solar panels in residential or commercial facilities. Furthermore, the bill revises net metering processes to reduce the amount reimbursed by PREPA to its clients to a marginal, fixed cost and not the real cost.

Finally, the legislation would create a separate corporation, the PREPA Revitalization Corp., that will issue new bonds that will be exchanged for the PREPA bonds that are currently on the market through a new securitization that will also be used to finance the \$2.4 billion Aguirre liquefied gas facility. It will overhaul PREPA's board, create a new structure of contribution in lieu of taxes with cities and promote a hike in the utility rates through the Energy Commission. The restructuring will be financed through a so-called transition charge to consumers. As part of the deal, bondholders are accepting a 15% haircut of their investment. PREPA restructuring plan would reduce what it owes by \$600 million and offer debt-service relief for five years of more than \$700 million. Bondholders would take a 15 percent loss on their securities by exchanging them for bonds repaid with a new customer fee, called a securitization charge.

Recommendations:

Full privatization of the energy production supervised by the Energy Commission as a strong regulatory entity. As in other jurisdiction, like Singapore the commission has to ensure stable and reliable rates to consumers. Also, political control over the corporation needs to be eliminated by legislation. The appointment of the Executive Director and the board of directors must be executed by a non-partisan entity and non-recurrent five-year mandates;

We also recommend, openness to private capital to redevelop PREPA's production infrastructure. We recommend the public partnership model to access top notch know-how and capital.

To that extent, on October 2015, PUMA has presented to PREPA, a comprehensive proposal to develop infrastructure for storing and using Liquid Petroleum Gas (LPG) from PUMA's Bayamon Plant to the San Juan Power Plant and Palo Seco.

Industry analysts estimated that PREPA needs \$3 to \$4 billion in new investment to modernize its generation plants. Since the public corporation is insolvent, we recommend the Private Public

Partnership (PPP) model to achieve this goal. With the right policy framework, PUMA is willing to partner with PREPA to be part of its modernization process.

Maritime transportation Policy (Jones Act)

The Jones Act of 1920 requires all maritime trade between US ports to be done by ships that are US flagged, US manned, US owned and US built. Thus, international trade is not affected which may explain why most states are not even aware of its existence or simply feel it is of no consequence. The initial objective of this Act was to guarantee the US with a merchant marine in case of emergencies and war. But it has failed because the US Merchant Marine has never been lower in numbers after almost a 100 years of the Jones Act and other laws with the same purpose.

The main reason is that higher operating costs and ship construction costs make the US Flagged vessels less competitive than carriers using international flags. The Maritime Administration (MARAD) did a study in 2011 confirming US ship owners and operators prefer to register under international flags.

Furthermore, in January 2015 one of the shipping lines, Horizon Lines, left the market. Horizon had 30% of the market and it was the only carrier operating ships, not barges, from the 3 main connecting ports to PR - NJ, Jacksonville and Houston. This created a huge logistical problem for the Island that has yet to be resolved. There are now 2 companies with over 80% of the US-PR market.

They are geographically concentrating cargo movements in the port of Jacksonville and the once important northeast route is being served only by barges, not ships, and by only one company. Barges take more than twice the time to make the trip as ships and are thus not ideal for transporting perishables. It is important to consider this also hurts US suppliers that now only have limited barge service from the northeast and only service twice a month from Houston.

Jones Act violations by other LPG importers

The Consumer Affairs Department (DACO for its Spanish acronym) in Puerto Rico reported that apparently the LPG product is being imported to Puerto Rico from Houston via Dominican Republic, where it is labeled as a D.R. product, and then sent to Puerto Rico, in violation of the Jones Act.

The government is responsible for investigating if the circumvention of the Jones Act is affecting the current market conditions. Any violation of the federal laws in the LPG market will give unfair competitive advantages to some of the current competitors.

The current economic conditions in PR require a revision of the impact that the Jones Act has in the LPG product cost, since the Cabotage Law is a component that increases the transportation cost for LPG and a revision could end up decreasing product cost impacting positively the private and the public sector in the Island.

Policy recommendation

- Exclude PR from the Jones Act – It is more than justified since all other US territories are totally or partially excluded, even our neighbors the US Virgin Islands. Also, the original reasons for this protectionist measure no longer exist or it has failed in achieving them.

- Temporary partial waiver allowing foreign built ships to enter the market to transport energy derivatives, and oil products. It will provide competition and increased service helping to reduce transportation cost, and finally, allowing competitive prices in energy derivatives.
- While Congressional action is taken, we recommend to increase controls by local and federal agencies of LPG imports that might violate the Jones Act by domestic companies.

Opportunities for the Government in the LPG Market

A multiple selection bidding process allows that all participants could be awarded the contract. As a result, each tender has the opportunity to sign a supply contract for LPG with the General Service Administration. However, as second step each competitor has to compete and negotiate with each entity or agency under the supply contract. In sum, an entity or agency will do business with a tender that submitted higher prices during the bidding process.

Competitors have been participating for many years in both events choosing the regions that each of them is interested in a prior agreement between them to reduce competition. Both licenses (domestic and commercial) are required for tenderers to participate in the bidding; while both services could be managed independently.

Fuel consumption is one of the items with higher impact in government, industrial and commercial operations. Most of the agencies and companies are looking for opportunities to reduce their expenses converting industrial equipment and vehicles to propane gas. The LPG industry in Puerto Rico has suffered important changes during the last 2 years.

The LPG supply chain in Puerto Rico had been controlled by two main importers during more than 30 years until 2014. Since 2014, the Puerto Rican market has a new LPG importer. As a result, LPG prices (in segments where the new importer has the permits to operate) have shown a reduction of 70% approximately. The LPG market price adjustment is a benefit that government agencies should capitalize on favor of the government's financial stability. Also, the LPG industry needs active monitoring from the government agencies to take action to stop and prevent unfair business practices that are likely to reduce competition, leading to higher prices and reducing quality.

Policy recommendation

Competitive bidding aims at obtaining goods and services at the lowest price by stimulating competition, and by preventing favoritism. There are two main bidding processes for LPG acquisition by the Puerto Rico Government Agencies:

- General Service Administration
 - A multiple selection bidding process for the LPG supply and services contract, regarding government agencies and entities in Puerto Rico. However, each agency can hold an individual bid.
- Public Schools' Cafeterias – Department of Education, the LPG acquisition is funded by Federal assignments.

Government agencies have the opportunity to revise the following LPG market factors that are affecting a healthy competition in the LPG bidding processes. A revision of these factors will increase

competition resulting in lower prices for the government and improving transparency in the whole process.

LPG distribution permits

LPG licenses are issued by the Public Service Commission, and there are two licenses available for LPG distributors:

- Commercial for bulk distribution, it allows the LPG distributors to serve the whole Island.
- Domestic for cylinders (20 pounds and 100 pounds) distribution, it limits the LPG distributors to sell their cylinders to some region(s).

LPG distribution regions

In the domestic segment the Public Service Commission divides the Island in 10 different regions. Distributors can get the domestic license for a particular region depending on the area where they have their cylinder's filling plants or business offices. The original purpose of these regions was to ensure that all distributors had enough market for their business.

LPG Multiple Selection Contract with Government Agencies

A multiple selection bidding process allows that all participants could be awarded the contract. As a result, each tender has the opportunity to sign a supply contract for LPG with the General Service Administration. However, as second step each competitor has to compete and negotiate with each entity or agency under the supply contract. In sum, an entity or agency will do business with a tender that submitted higher prices during the bidding process.

For both bidding processes the Island is divided in small regions: 10 regions for the General Service Administration and 7 regions for the Public School Cafeterias. Competitors have been participating for many years in both events choosing the regions that each of them is interested in a prior agreement between them to reduce competition. Some regions only have one tender and it is awarded without competition offering higher prices than market.

Both licenses (domestic and commercial) are required for tenderers to participate in the bidding; while both services could be managed independently. Also, for domestic services it is required for the distributor to have the license to sell cylinders in a particular zone or region. This restriction should not apply to Government Agencies and Public School Cafeterias in order to increase competition.

Permitting and environmental regulations

As part of the investment process and development opportunities in Puerto Rico a review of the Permit Process Reform Law is crucial. The permit process needs to effectively improve the quality and efficiency in the management of the processes regarding the evaluation of applications for the approval of denial of final determination and permits. The permit process needs to be integrated and the Autonomous Municipalities must adhere to the same to have uniformity across the Island.

Another important area of improvement and directly involved in the permit and development process are the Environmental Agencies. The US Environmental Protection Agency (EPA) is charged with

managing and enforcing federal environmental programs in PR, although it has delegated certain of these responsibilities to the Puerto Rico Environmental Quality Board (EQB). The EQB is Puerto Rico's primarily environmental policy-making body. EQB issues regulation establishing standards designed to minimized environmental harm and control activities that cause pollution.

As part of any development and permit process the EQB is the lead governmental agency needs evaluate the environmental impacts and issue an endorsement letter as a precondition to obtain other permits. Actually the lacks of technical resources and in some instances experience or technical expertise at the EQB delay the permit process and eliminate opportunities for innovated development projects. In addition, the effectiveness of the Agency to prevent and undo environmental degradation while balancing environmental protection with economic development may have been compromised.

Another example of the effects of lack of technical resources is the current EQB reluctance to implement Risk-Based Property clean-ups. The current economic conditions at PR required the effective property redevelopment and jobs creation.

The Risk-Based Corrective Action (RBCA) is based on sound science that determines site-specific clean-up levels that ensure the protection of human health and the environment. In simple terms, RBCA is a set of corrective action strategies that categorize sites according to risk and move all sites toward environmental clean-up completion using appropriate levels of action and oversight based upon the intended use of the property. With the RBCA process, regulators can make sound, quick, consistent management decisions for a variety of sites, instead of requiring inefficient clean-up approaches that require the same level of results for all sites.

The United States Environmental Protection Agency (USEPA) Office of Solid Waste and Emergency Response (OSWER) Directive 9610.17 (1995), has clearly supported and encouraged states, including the EQB, to use the RBCA process for the management of petroleum-contaminated UST sites for the past 20 years. Over 30 US States and various countries have successfully implemented risk-based programs, which result in timely redevelopment and productive use of appropriate sites that meet certain parameters.

The EQB has been reluctant to implement a risk-based program, despite having received specific training on a number of occasions in the past 20 years and having a set of draft guidelines for 10 years. Instead, EQB has adopted clean-up levels that apply indiscriminately to general categories, regardless of a site's specific use.

This approach consumes substantial governmental and private resources even when there is no risk to human health or the environment. Moreover, it means that the EQB itself cannot focus its energies on sites that are more pressing and require more immediate attention.

EQB's current approach is even more impactful if one considers that investors are hesitant to finance redevelopment of properties until a formal EQB closure is received. As a result, numerous properties in Puerto Rico remain underutilized, regardless of whether the site's conditions are suitable given the intended use of the property.

A site-specific clean-up program would improve EQB's efficiency, facilitate investment, and create jobs that will revitalize the Puerto Rico economy. Correct and judicious implementation of RBCA has several advantages, including:

1. The process will ensure the protection of human health and the environment under current and reasonable future land use conditions.
2. This process is consistent with the state of the practice related to the investigation and remediation of contamination at petroleum tank sites. Implementation of this process will, therefore, make the EQB program able to manage contaminated sites consistent with the prevailing practices across the US.
3. This process will streamline the process of site investigation, cleanup and closure, and provide a scientifically defensible and consistent process to make decisions related to site characterization, risk assessment, and risk management necessary for site cleanup with the objective of ensuring the protection of human health and the environment.
4. It will also provide a reliable process for property owners, developers and other entities that are involved in the evaluation, development, and management of contaminated sites. Although the framework promotes cost-effective site activities, it does not allow cost considerations to compromise human health, safety or the environment.

Further Support to RBCA Adoption and Benefits are the following:

- The most recent LUST list available from the EQB is dated 2010, and includes more than 550 projects. In more recent discussions with the EQB, we understand that this number has expanded to more than 700 projects; which is compounding the delays in work plan and permit approvals.
- It is estimated that if RBCA were implemented, approximately 40% of the existing LUST projects would be closed. If this percentage is indicative of other LUST projects (beyond the Energy Sector), it could be extrapolated that upwards of 300 projects could be expeditiously closed with RBCA implementation.
- The attached statistics were gleaned from the EPA OUST Semi-Annual State Clean-up Backlog Update. Puerto Rico is included with Region 2 states. Note that the Region 2 Average for percentage of UST cleanups remaining is 16%, but Puerto Rico has the highest at 67% which is more than 4 times the Region 2 average. This data further supports and underscores the necessity of adopting a RBCA program as part of the solution to EQB delays:

State	Cleanups Initiated	Cleanups Remaining	% Remaining
CT	3159	911	29%
MA	6354	308	5%
ME	2781	24	1%
NH	2641	601	23%
RI	1397	154	11%
VT	2160	661	31%
NJ	14173	4357	31%
NY	29611	1102	4%
PR	839	560	67%
VI	32	5	16%
DC	929	97	10%
DE	2761	86	3%
MD	12090	218	2%
PA	16913	1845	11%
VA	12452	312	3%
WV	3520	617	18%
Region 2 Average			16%

Puma as the leading company in the energy industry in Puerto Rico, reaffirms its commitment to collaborate with Congress and the Task Force in any initiative to support the Island's economic development. Please, feel free to contact us; we are available to participate in any meeting to discuss our proposals.

Regards,

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