NELSON MULLINS

Memorandum

To: File

From: Daniel B. Nunn, Jr.
Lee D. Wedekind III

Date: December 26, 2019

Re: JEA Due Diligence

Our law firm recently interviewed to serve as special legislative counsel for the Jacksonville City Council in connection with its evaluation of JEA's long-term strategic plan. In preparation for that interview, we conducted extensive due diligence and solicited the input of our energy team on the challenges facing government-owned utilities.

We began with an analysis of JEA's current condition and ability to adapt to disruptive changes in the energy and utilities markets. While we concluded that JEA is not in a "death spiral" and should continue to experience modest growth in energy sales over the next 10 years, there are compelling reasons to consider a sale:

- Scale and territorial growth will be critical for adapting to a new regulatory and competitive environment for utilities. As a municipally-owned utility, JEA is inherently limited in its ability to scale up by expanding its territory. On the other hand, the importance of scale will motivate investor-owned utilities to pay a premium price for JEA;

- JEA's financial value may have peaked, as only modest growth is expected over the next 10 years. Population growth will be largely offset by improvements in energy efficiency and distributed generation;

- JEA's debt burden and Plant Vogtle commitment, coupled with JEA's customer mix, modest growth projections and fundamental changes in the energy and utilities markets, creates a higher level of enterprise risk;

- Carbon tax legislation, which continues to gain industry and bipartisan political support, will drive further adaptations by utilities. A $50 per ton carbon tax would triple the cost of coal and result in a 28% increase in natural gas prices.[1] JEA appears to be less prepared than many other Florida utilities for this eventuality -- among Florida's 11 utilities required to file a Ten-Year Site Plan ("TYSP"), JEA projects the third largest energy production from coal in 2028.

[1] Source: Energy and Environmental Implications of a Carbon Tax in the United States, an independent study prepared by Rhodium Group for Columbia SIPA Center on Global Energy Policy, July 2018

- JEA has significant value, and a sale could provide a transformative opportunity for the City to achieve other goals.

At the same time, our due diligence left us deeply concerned about the quality of information management provided to the JEA board in connection with its consideration of the strategic plan, particularly with respect to four critical areas:

- The 8% decline in unit sales (MWh) over the past 12 years;
- The 8% projected decline in unit sales over the next 12 years;
- The performance unit plan that created powerful incentives for management to push for a sale; and
- The strategic planning process, including management's interactions with advisors during the period leading up to the July 23rd board meeting, and management's intentions regarding the new downtown headquarters.

This memorandum is intended to memorialize those concerns and is not intended to present all due diligence findings regarding the financial condition, industry outlook or future of JEA.

Historical and Projected Unit Sales Information

In March 2019, management deviated from prior practice[2] by not presenting the JEA board with a TYSP. This document is prepared annually and filed with the Florida Public Service Commission (PSC). Historically, JEA has used this document for both budget planning and resource planning. Management prepares the document using a sophisticated methodology to project future demand (MWh sales) so that the PSC can be sure that JEA has adequate resources to meet future demand. These forecasts consider several factors, including historical demand, population growth, energy efficiency and weather projections.

Instead, Mr. Zahn reported that management would be preparing a "management case" forecast as part of the strategic planning process.[3] This was unprecedented and startling in that it implied that the publicly filed forecasts which are used in the budget process,

[2] The board materials for the JEA March or April meetings from 2014-2017 contain the TYSP that was presented to the board. The April 17, 2018 board materials contain references to the TYSP and explain its role in budget planning.

[3] Mr. Zahn's remarks were preceded by a dramatic video of a showdown between a Navy ship and a lighthouse.

reviewed by the PSC, and presumably reviewed by ratings agencies and bondholders, were somehow flawed.

Management provided the board with the following chart in the May, June and July board packages that shows an 8% decline in Unit Sales (MWh) from 2006 to 2018:

Impact of the Last Decade of Business Disruption

	2006 Actual	2018 Actual	Change	Change %
Rates ($ yield per MWh)	36	62	26	71%
Unit Sales (MWh)	13,440,900	12,364,340	(1,076,560)	(8)%
# of Energy Customers	402,142	466,411	64,269	16%
Rates ($ yield per kgal)	3.74	6.45	2.71	72%
Unit Sales (kgal)	57,463,877	65,646,920	8,183,043	14%
# of Water Customers	293,689	348,159	54,470	19%
Annual City Contribution	88,688	116,620	27,932	31%
Total JEA Headcount	2,598[1]	2,191	(407)	(16)%
Total Long-term Debt ('000)[2]	$6,386,000	$3,335,000	($3,051,628)	(48)%
Total Maintenance and Other Operating Exp.	$282,282	$445,953	$163,671	58%

[1] Reflects headcount from 2008 [2]Peak JEA Long-term debt in 2010 compared to October 2019 balances.

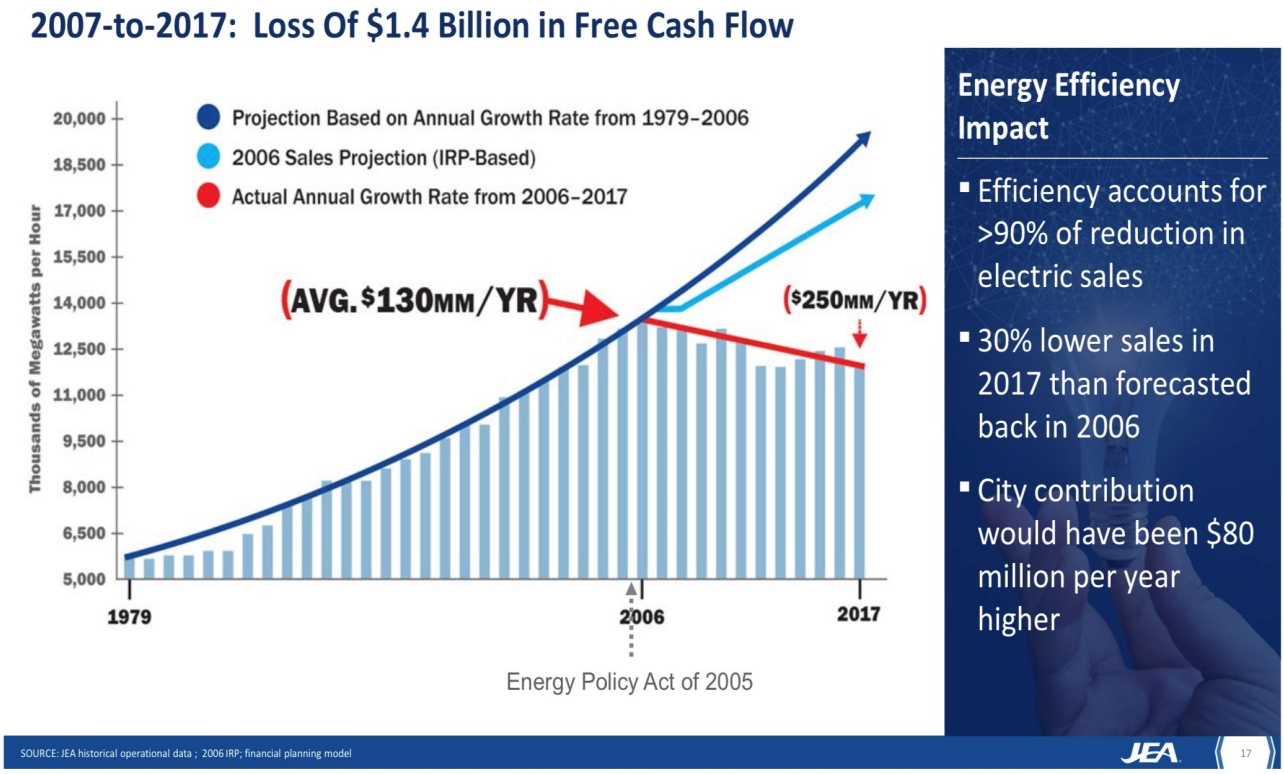
- Customer rates increased 71% in the electric system *(went from lowest in the state to median)* and 72% in the water system
- 407 jobs eliminated since 2008
- ~$3 billion of debt repaid from 2010-2019

SOURCE: JEA historical operational data and financial statements JEA 20

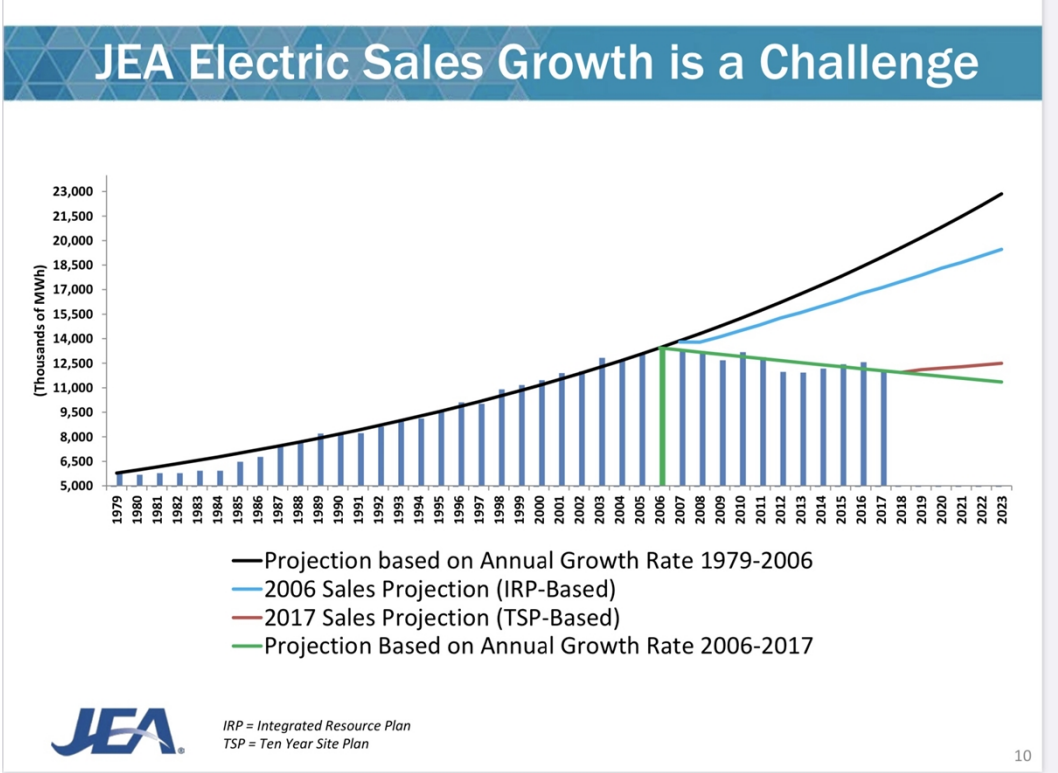
The Unit Sales metric presented is Territorial Sales, which consists of sales to residential, commercial and industrial customers, public street lighting and territorial sales for resale.

A separate slide in the May 28 board materials[4] stated that "efficiency accounts for >90% of reduction in electric sales."

[4] A similar slide was included in the board materials for the January 2019 meeting.



The slide above is very similar to a slide presented at the April 2018 JEA Board Workshop on Privatization (below), with two notable differences: (i) the April 2018 slide included a line showing the growth in MWh sales projected in the TYSP (the red line in the slide depicted below); and (ii) the April 2018 slide does not attribute 90% of the decline to energy efficiency.



Any analysis of trends over a period of years is highly dependent on the years chosen for comparison, as individual years may be impacted by aberrations such as weather events and general economic trends. A better approach is to review trends over time. Although technically accurate, the lack of context around the 2006 to 2018 comparison makes the presentation superficial at best and misleading at worst, as shown by the following analysis:[5]

Sales (MWh)	2006	2018	% Change	% of Total Decline
Residential	5,650,986	5,414,721	(4.2%)	22%
Commercial and Industrial	7,157,602	6,851,803	(4.3%)	28%
Street Lighting	110,178	59,176	(46.3%)	5%
Territorial Sales for Resale	522,134	38,640	(92.6%)	45%
Total	13,440,900	12,364,340	(8%)	

[5] Source: JEA 2006 and 2018 Annual Reports

The territorial sales for resale in 2006 are sales by JEA to Florida Public Utilities, the electric utility provider for Fernandina/Amelia Island.[6] This contract was terminated on December 31, 2017, and FPL now sells electricity to Florida Public Utilities. This accounts for 45% of the reduction in Unit Sales from 2006 to 2018,[7] a fact that management fails to identify.

Given this change in Territorial Sales of Resale, Retail Sales (i.e., MWh sales to residential, commercial and industrial customers) are a better measure of the impact of energy efficiency (net of population growth and weather impacts[8]) over this 12-year period. Retail Sales declined by only 4.2% over this period. In fact, Retail Sales grew in 7 of the last 8 years as customer growth and increased degree days[9] have outpaced energy efficiency gains:[10]

Fiscal Year	Residential MWh Sales	Commercial/Industrial	Total Retail Sales
2012	4,806,144	6,670,200	11,476,344
2013	4,877,264	6,599,249	11,476,513
2014	5,086,866	6,636,445	11,723,311
2015	5,243,002	6,767,836	12,010,838
2016	5,328,245	6,847,583	12,175,828
2017	5,108,945	6,725,201	11,834,146
2018	5,414,721	6,851,803	12,266,524
2019	5,515,428	6,793,603	12,308,985

At the May board meeting, management projected that by 2030 JEA's customers "may likely" increase 16% and energy sales "may likely" fall by 8%, as shown on the following slide:

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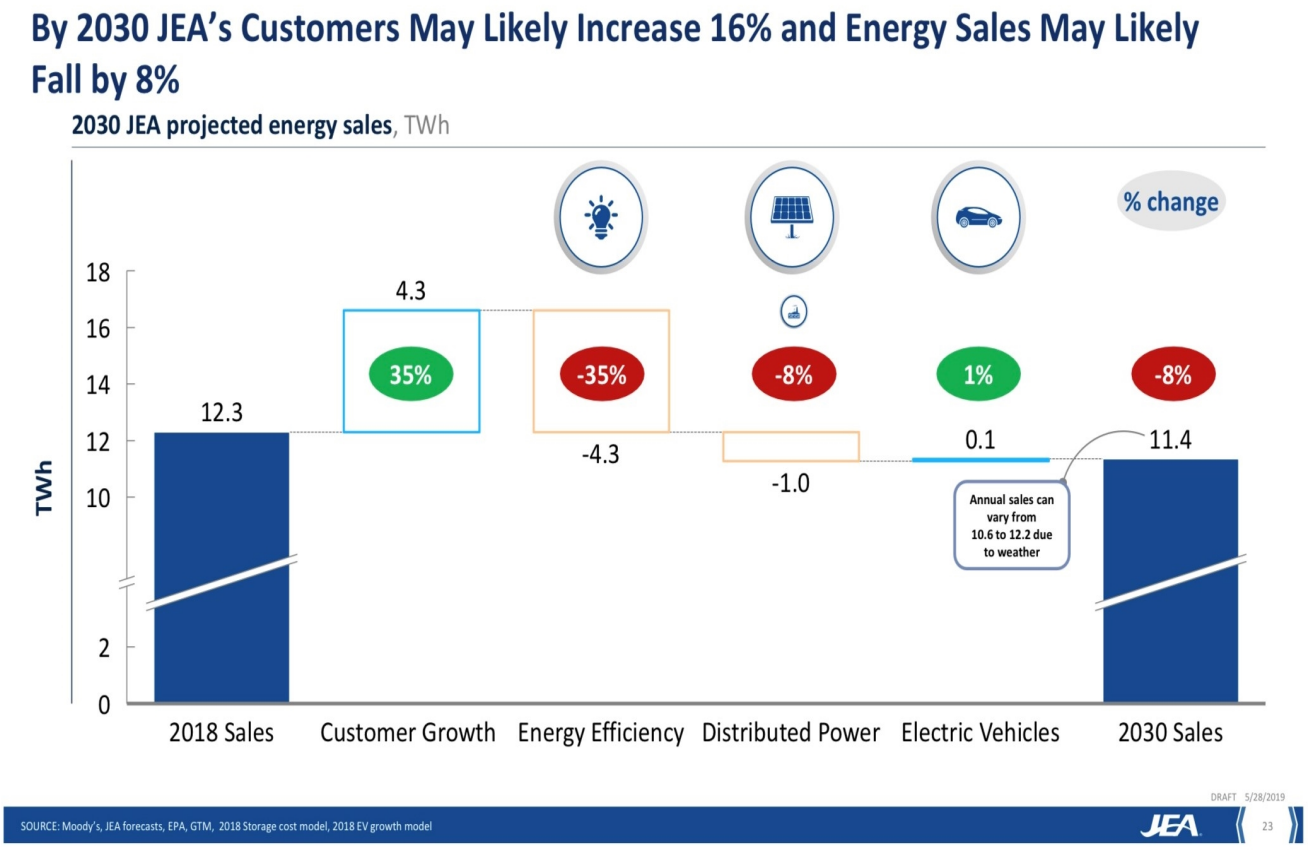
[6] Source: Section 2.1.3 of 2007 JEA 10 Year Site Plan.

[7] Sales to Florida Public Utilities declined over this period due to the construction of cogeneration facilities at the paper mill and energy efficiency.

[8] For residential users, improvements in energy efficiency have been somewhat offset by increases in cooling degree days due to climate change. From 2006 to 2017, degree days for Jacksonville increased by 6%, while degree days for Tampa (TECO) increased by nearly 15%.

[9] Degree days are a measure of how hot or cold a location is in relation to a standard temperature of 65 degrees. A higher number of degree days results in higher energy use.

[10] Source: JEA Annual Reports



This same information was presented again at the June board meeting, along with a specific slide projecting the actual numerical decline in unit sales. Presumably, this represents the "management case" forecast that Mr. Zahn referenced in the March meeting.

PROJECTED IMPACT OF THE NEXT DECADE OF BUSINESS DISRUPTION

	2018 Actual	2030 Projection	Change	Change %
Rates ($ yield per MWh)	62	94	32	52%
Unit Sales (MWh)	12,364,340	11,382,447	(981,893)	(8)%
# of Customers - Energy	466,411	542,502	76,091	16%
Rates ($ yield per kgal)	6.45	7.42	0.97	15%
Unit Sales (kgal)	65,646,920	73,695,324	8,048,404	12%
# of Customers – Water	348,159	416,470	68,311	20%
Total Annual City Contribution	116,620	131,256	14,636	13%
Total JEA Headcount	2,191	2,191	0	0%
Total Long-Term Debt plus Contract Debt ('000)[1]	$5,110,000	$4,834,000	($276,000)	(5)%
Total Maintenance and Other Operating Exp.	$393,657[2]	$737,376	$343,719	87%

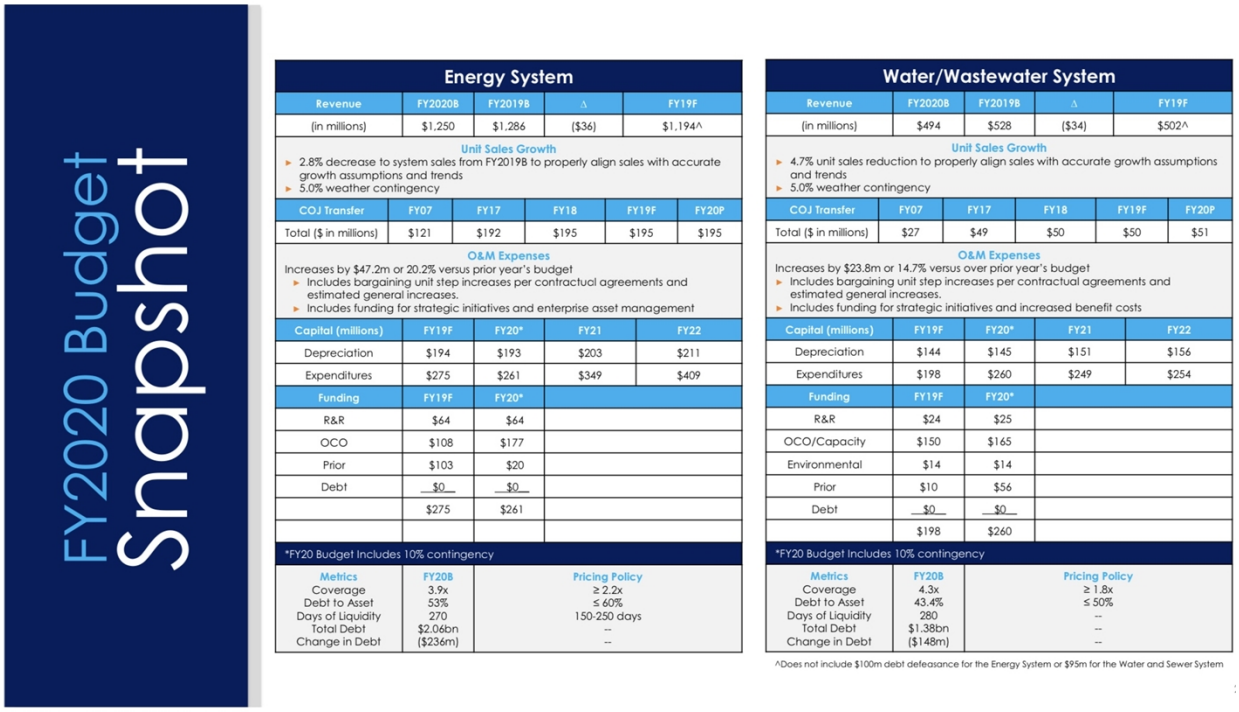
[1] JEA Long-term debt in October 2019 2018 [2] Actual Maintenance and Other Operating Exp adjusted to exclude SJRPP

- Customer rates increase 52% in the electric system
- Customer rates increase 15% in the water system
- $276 million of debt repaid, leaving $4.8 billion of direct + contract debt outstanding
  - Contract debt amortizes through 2062, JEA obligation to pay debt service for all contract debt through 2043

SOURCE: JEA Financial planning and forecasting model

JEA 11

At the same June board meeting, management presented a fiscal 2020 budget that assumed a 2.8% decline in territorial unit sales.



This was surprising, given that retail sales had been increasing and sales for resale were no longer material.

At the July 23rd board meeting, the “may likely” qualifiers were eliminated and the threats from distributed generation were outlined.

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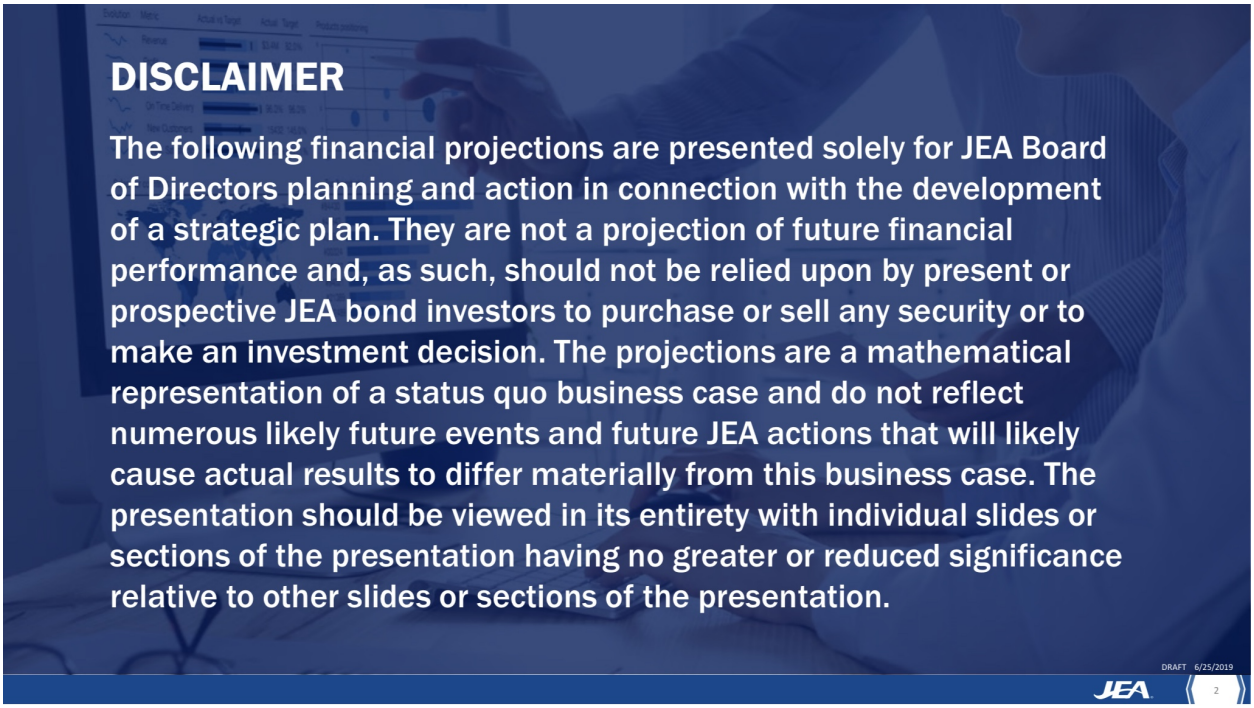
SOURCE: JEA financial planning and forecasting model

JEA 30

Cognizant of the securities law implications of providing management case forecasts that deviated from the publicly filed TYSP, management included a slide in the board materials with the following disclaimer:



It is impossible to determine whether this management case forecast is realistic or a "black swan" forecast because management did not provide information on its methodology for creating this projection or how the assumptions differed from those used in the creation of the 2019 TYSP that was publicly filed with the PSC. The only variable offered by the board was the expected loss of commercial customers that had made renewable energy commitments, creating a risk from distributed generation. However, there was no explanation of the process used to quantify the impact (e.g., customer adoption modeling for distributed generation) and no analysis of whether JEA could have retained the customers by serving as the renewable energy provider to these customers. This variable should have been factored into the TYSP[11].

We further note that the management case's projected 8% decline is directly contradicted by, or incongruous with:

- the projections contained in JEA's TYSP filed with the PSC on March 29, 2019, which shows continued growth;

- the amended projections filed by JEA with the PSC just 6 days prior to the July 23rd board meeting, which project 5% growth from 2018 to 2028;

[11] See page 23 of the PSC Review of the 2019 Ten-Year Site Plans of Florida's Electric Utilities.

- PSC's November 2019 Review of the 2019 Ten-Year Site Plans of Florida's Electric Utilities, which notes that Florida's retail energy sales are projected to grow at 0.83% per year compared to the 0.43% actual growth increase from 2009-2018;

- Every other TYSP filed by Florida electric utilities in 2019, all of which contain more positive projections;

- JEA's retail electricity sales over the past 8 years, which show customer growth and increased degree days more than offsetting energy efficiency gains;

- Evaluations by PFM (and presumably JP Morgan and Morgan Stanley) of the value of JEA;

- The U.S. Energy Information Administration Annual Energy Outlook 2019;

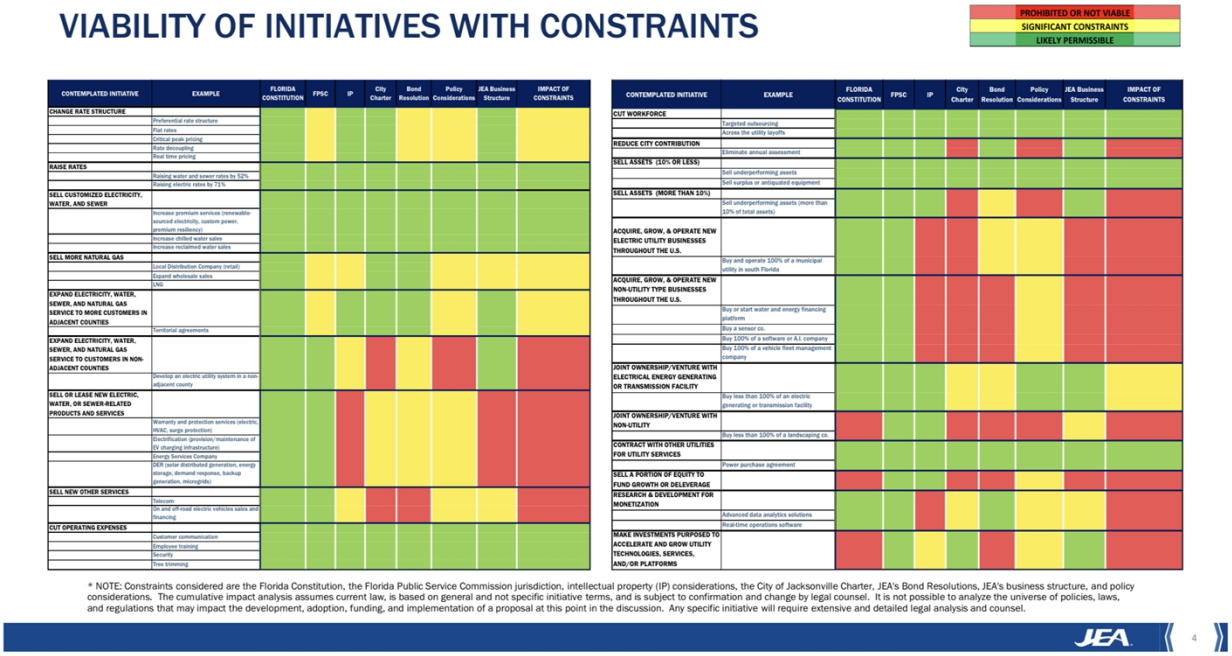
- Ratings of JEA's bonds by the ratings agencies; and

- The bids received from bidders.

Absent other explanation, our conclusion was that management presented selective historical information without proper context and "management case" projections that provide a contrived negative narrative regarding the future of JEA to drive the board to explore a sale.

Overview of Legal and Public Policy Constraints

At the July 23rd board meeting, management presented to the board an analysis of the legal and public policy constraints that prevented JEA from adapting to the evolving utilities market in the same manner as other utilities.



VIABILITY OF INITIATIVES WITH CONSTRAINTS

PROHIBITED OR NOT VIABLE
SIGNIFICANT CONSTRAINTS
LIKELY PERMISSIBLE

CONTEMPLATED INITIATIVE	EXAMPLE	FLORIDA CONSTITUTION	FPSC	IP	City Charter	Bond Resolution	Policy Considerations	JEA Business Structure	IMPACT OF CONSTRAINTS
CHANGE RATE STRUCTURE									
	Preferential rate structure								
	Flat rates								
	Critical peak pricing								
	Rate decoupling								
	Real time pricing								
RAISE RATES									
	Raising water and sewer rates by 52%								
	Raising electric rates by 71%								
SELL CUSTOMIZED ELECTRICITY, WATER, AND SEWER									
	Increase premium services (renewable-sourced electricity, custom power, premium resiliency)								
	Increase chilled water sales								
	Increase reclaimed water sales								
SELL MORE NATURAL GAS									
	Local Distribution Company (retail)								
	Expand wholesale sales								
	LNG								
EXPAND ELECTRICITY, WATER, SEWER, AND NATURAL GAS SERVICE TO MORE CUSTOMERS IN ADJACENT COUNTIES									
	Territorial agreements								
EXPAND ELECTRICITY, WATER, SEWER, AND NATURAL GAS SERVICE TO CUSTOMERS IN NON-ADJACENT COUNTIES									
	Develop an electric utility system in a non-adjacent county								
SELL OR LEASE NEW ELECTRIC, WATER, OR SEWER-RELATED PRODUCTS AND SERVICES									
	Warranty and protection services (electric, HVAC, surge protection)								
	Electrification (provision/maintenance of EV charging infrastructure)								
	Energy Services Company								
	DER (solar distributed generation, energy storage, demand response, backup generation, microgrids)								
SELL NEW OTHER SERVICES									
	Telecom								
	On and off-road electric vehicles sales and financing								
CUT OPERATING EXPENSES									
	Customer communication								
	Employee training								
	Security								
	Tree trimming								

CONTEMPLATED INITIATIVE	EXAMPLE	FLORIDA CONSTITUTION	FPSC	IP	City Charter	Bond Resolution	Policy Considerations	JEA Business Structure	IMPACT OF CONSTRAINTS
CUT WORKFORCE									
	Targeted outsourcing								
	Across the utility layoffs								
REDUCE CITY CONTRIBUTION									
	Eliminate annual assessment								
SELL ASSETS (10% OR LESS)									
	Sell underperforming assets								
	Sell surplus or antiquated equipment								
SELL ASSETS (MORE THAN 10%)									
	Sell underperforming assets (more than 10% of total assets)								
ACQUIRE, GROW, & OPERATE NEW ELECTRIC UTILITY BUSINESSES THROUGHOUT THE U.S.									
	Buy and operate 100% of a municipal utility in south Florida								
ACQUIRE, GROW, & OPERATE NEW NON-UTILITY TYPE BUSINESSES THROUGHOUT THE U.S.									
	Buy or start water and energy financing platform								
	Buy a sensor co.								
	Buy 100% of a software or A.I. company								
	Buy 100% of a vehicle fleet management company								
JOINT OWNERSHIP/VENTURE WITH ELECTRICAL ENERGY GENERATING OR TRANSMISSION FACILITY									
	Buy less than 100% of an electric generating or transmission facility								
JOINT OWNERSHIP/VENTURE WITH NON-UTILITY									
	Buy less than 100% of a landscaping co.								
CONTRACT WITH OTHER UTILITIES FOR UTILITY SERVICES									
	Power purchase agreement								
SELL A PORTION OF EQUITY TO FUND GROWTH OR DELEVERAGE									
RESEARCH & DEVELOPMENT FOR MONETIZATION									
	Advanced data analytics solutions								
	Real-time operations software								
MAKE INVESTMENTS PURPOSED TO ACCELERATE AND GROW UTILITY TECHNOLOGIES, SERVICES, AND/OR PLATFORMS									

* NOTE: Constraints considered are the Florida Constitution, the Florida Public Service Commission jurisdiction, intellectual property (IP) considerations, the City of Jacksonville Charter, JEA's Bond Resolutions, JEA's business structure, and policy considerations. The cumulative impact analysis assumes current law, is based on general and not specific initiative terms, and is subject to confirmation and change by legal counsel. It is not possible to analyze the universe of policies, laws, and regulations that may impact the development, adoption, funding, and implementation of a proposal at this point in the discussion. Any specific initiative will require extensive and detailed legal analysis and counsel.

JEA 4

In this presentation, management gave short shrift to two key alternative strategies for addressing the decline in MWh sales in the management case projections — revenue decoupling (also known as rate decoupling) and distributed generation sales. Revenue decoupling removes the link between MWh sales and profitability by modifying traditional ratemaking practices to adjust rates frequently to ensure that utility revenue is neither more nor less than what is needed to cover costs and a fair return. This removes incentives to maximize electricity sales and promotes implementation of customer energy efficiency programs. As a municipal utility, JEA has more flexibility in adjusting rates, subject to PSC approval of rate structure.[12]

Likewise, the growth of distributed energy resources provides both risk and opportunity. The opportunity here is to be the provider of renewable energy to large customers through industrial scale solar as well as solar panel and battery storage provider to homeowners.

These are important adaptation strategies and the analysis of the legal barriers to these strategies presented to the board at the July 23rd board meeting (page 109 of the board package) is superficial at best.

[12] Revenue decoupling is authorized in approximately 30 states at present.

Performance Unit Plan

The performance unit plan (PUP) was designed to pay out to plan participants upon a sale an amount calculated to be about 10% of the amount by which the sale price exceeded $7.5 billion.[13] The formula is described in detail below, but the basic concept is that PUP units were to be purchased at $10 per unit and increase by $100.00 per unit for each Value Change Percentage (Current Year Value divided by Base Year Value) in excess of 110% of the Base Year Value. On a sale, this equates to paying out 10% of (i) the total purchase price paid by the buyer in a sale (not the net amount received by JEA after payment of debt), plus (ii) customer rebates paid in connection with a sale, less (iii) approximately $7.5 billion.

Here is the math, based on September 30 financial statements, along with a payout calculation based on a $9 billion sale price.

Current Year Value Calculation
Base Year Value (9/30)

JEA Net Position as of 9/30/19	2,964,336,000
Plus, Amounts Paid to COJ in Past 12 months	132,802,000
Plus, Customer Rebates Paid in Last 12 months	0
	3,097,138,000

Redemption Price will increase by $100.00 per unit for each Value Change Percentage (Current Year Value divided by Base Year Value) in excess of 110% of the Base Year Value.

Base Year Value of $3,097,138 x 110% = $3,406,851 (the Challenge Valve Target)

This Challenge Value Target implies an enterprise value of JEA at $7.2 to $7.7 billion, meaning that in a sale scenario 10% of any sale price above that is paid out under the PUP. The calculations are shown below:

	$3,406,851
Plus, Estimated Liabilities per ITN	3.8 to $4.3 billion
	7.2 to 7.7 billion

Calculation of Per Unit Value

[13] The threshold for the payout could vary between $7.2 billion and $7.7 billion, depending on the amount required to defease the debt.

Based on $9 Billion Sale Price[14]

Sale Price	$9 billion
Less Debt	$4.3 billion (high estimate)
Plus $400 million Customer rebate payable on sale	400 million
	5.1 billion

(calculation ignores value of any retained cash or assets and any contributions made to COJ between now and closing, all of which would increase the number)

Value Change Percentage = 5.1 billion ÷ 3.4 billion = 50%,
so, units increase in value from $10 by $100 x 50.

Original Unit Value	$10
Plus, Increase	$5000
	$5010

With the issuance of initial 30,000 units previously approved, this would be $150 million.

Background and Timeline

The JEA board's compensation committee began discussing a long-term incentive plan in January 2019. The revised employment agreement for Mr. Zahn, included in the meeting materials, references the creation of a compensation plan to "drive the measures set forth in the Strategic Framework". According to the City Council auditor's memo on law firms, the engagement of Pillsbury is retroactive to January 1, 2019, which suggests that management had already begun to work with Pillsbury at the time of this meeting.

On June 17, 2019, the OGC issued a memo to JEA's Chief Legal Officer Lynne Rhode describing the restrictions on long-term incentive/bonus programs. The memo discussed Fla. Stat. § 215.425(3), which provides that a bonus scheme must (i) base the award of a bonus on work performance, (ii) describe the performance standards and evaluation process by which a bonus will be awarded, and (iii) consider all employees for the bonus. The memo also notes that:

- Article II, Section 8 of the Florida Constitution prohibits public officials from acting in a manner in breach of public trust.

[14] The Future and Opportunities for JEA report from 2018 estimated an enterprise value of $7.5 to $11 billion.

- Fla. Stat. § 112.313(6) and Section 602.631 of the City Ordinance Code prohibit public employees from using their position or otherwise acting in a manner inconsistent with his official duties to obtain a special privilege, financial or otherwise.

The PUP was created by outside counsel and modeled on a phantom stock plan used in the corporate sector. The PUP was specifically designed to circumvent the above legal restrictions by requiring participants to purchase the units for a nominal price.

At the June 18 Compensation Committee meeting, the Committee authorized JEA management to start the process of finalizing the long-term compensation framework. The meeting materials describe a performance unit plan with the following features:

- performance units tied to book value of JEA;
- 3-year performance period;
- performance measures consisting of (i) net book value - used to determine performance unit value; and (ii) customer rates-used to determine the number of performance units earned;
- a payout range of 50-150% of target;
- an estimated annual cost of *$3.4 million*.
- a proposed long-term incentive award percentage for Zahn of 40% salary and 5% for other directors.

The board materials for the July 23 board meeting (352 pages) included the same JEA and Willis Towers PowerPoint presentations outlining a program with the features outlined above. The Long-Term Performance Plan (PUP) summary attached as the last 6 pages of the 352-page board book significantly deviates from the PUP features presented to the Compensation Committee in several critical respects.

The PUP summary provides for the value of the performance units to increase by a formula based on the increase in book value of JEA at the close of business on the date of the sale over the book value of JEA at December 31, 2019 (meaning the net proceeds from the sale are included in the calculation). The effect of the plan is to pay out 10% of the increase in book value of JEA over $300 million, giving credit in the calculation for customer rebates and contributions to the City.

Summary of Concerns regarding the modified PUP

There are numerous issues with the design of the revised plan, including the following:

1. Public Policy Concerns. As a threshold matter, no consideration was given to the public policy concerns underlying the restriction on payments of performance bonuses to public officials. Instead, the lawyers designed a plan to circumvent those restrictions based on a model used to reward employees of private companies. Section 215.425, Florida Statutes, restricts payment of extra compensation to public employees for services already provided. This restriction is based on the public policy that public funds may only be used for a public purpose and it is contrary to this policy to give extra compensation for work that has already been performed for an agreed upon wage.

2. Compliance with Law. Despite a contrary legal analysis issued by Foley & Lardner, the OGC determined that the plan does not comply with Florida law, including Fla. Stat. § 215.425(3).

3. The Plan Design Incentivizes Management to Push for a Sale. The terms of the plan provide for either a modest payout for continuing to operate as a municipal owned utility for the next three years or a huge financial windfall to plan participants if JEA were sold. The plan was designed to incentivize management to pursue a sale over any other alternative.

4. Uncapped Payment Upon Sale. It is typical, as this plan does, for the performance period to be shortened by a sale. Often, the benefits (*i.e.*, the $3.4 million intended by the initial Compensation Committee presentation) are deemed earned upon a sale, but it is *extraordinarily unusual* for such a plan to be adopted in contemplation of a pending sale without including a cap on the payout or using a fair market value threshold for a payout. Worse, doing so was inconsistent with the JEA compensation presentation and the Willis Towers report provided to the compensation committee and the board. When former CFO Ryan Wannemacher was specifically asked about this during the July 23 board meeting, he did not provide a complete answer that would have explained the impact of the sale on the PUP.

5. Use of Book Value. Although book value is readily ascertainable, it does not reflect the true value (fair market value) of a business, because GAAP requires that asset values be recorded based on historical costs (less applicable depreciation) and excludes the value of intangible assets such as goodwill.

As a result, changes in book value can be used to measure profitability for purposes of management incentives provided that proper adjustments are made for transactions that impact the company's book value but not its fair market value.

A prominent example is real estate sales. Under the real estate optimization program presented to the board, management plans the sale for up to $62.5 million of properties with a book value of only $32 million. These sales would increase book value (or JEA's Net Position as it is described in the Plan) by $33 million while not increasing JEA's market

value at all. The effect of such sales would simply be the conversion of asset classes ($65 million in land for $65 million in cash). The optimization plan also contemplates possible real estate sales of an additional $100 million in sales. These sales would goose the PUP payout without any change in JEA's value.

Likewise, a payment on recapitalization (*i.e.,* a sale on January 1, 2020) would lead to a greater PUP payout because JEA would have the net sales proceeds based on fair value in the bank, so its book value would be increased to that amount. Again, this would happen despite no action by management leading to an increase in JEA's actual value. The payment of a bonus is triggered by a Current Year Value of $3,403,551 (based on JEA's 9/30/19 financial statements) (see above calculations). This implies a total value for JEA of $7.2 to $7.7 million. The 2018 report The Future of JEA: Opportunities and Considerations estimates a value range of $7.5 to $11 billion.

6. Customer Rates. The plan puts management at odds with ratepayers, because it incentivizes rate increases simply to increase book value.

7. Calculation of Recapitalization Payment. Beyond the issues described above, the PUP payment includes in the calculation of current year value the $400 million in customer rebates described in the ITN, none of which benefits the City.

Although we did not pick up on this point during our review, the Council Auditor correctly observed that even without a sale the Challenge Target is too easy to achieve and is not a stretch target (which therefore essentially guarantees a PUP payout).

Disclosure Concerns regarding the PUP

As a threshold matter, management and its outside counsel prepared and presented a plan specifically designed to circumvent Florida law's restrictions on performance bonuses to public officials without ever advising the board about those restrictions or the policy reasons underlying them. Thus, the board was never given proper information to inform a decision as to whether this type of plan was a good idea in the first place.

Second, the plan differed in significant respects from the Willis Towers and management presentations included in compensation committee and board packages which showed a total $3.4 million cost and capped payout ranges.

Third, the plan summary was presented as the last 6 pages of a 352-page board book.

Fourth, Mr. Zahn failed to make full disclosure that he apparently had been working with Pillsbury since January.

Fifth, Ms. Rhode, who under the terms of the plan summary was eligible to participate in the plan as part of a special carve-out designed specifically for her, failed to take adequate

steps to ensure that the board understood the terms of the plan and may have made affirmative misrepresentations.

Sixth, based on publicly available information, it appears that outside counsel, who stood to gain millions in fees from a sale, failed to take adequate steps to ensure that the board understood the terms of the plan, the policy reasons behind the Florida restrictions on performance bonuses or to ensure that the plan complied with Florida law. These lawyers were present at board meetings and permitted management's insufficient disclosures to go unexplained.

These incomplete disclosures made by management at the July 23 board meeting include the following:

a. (2:53:24 of video) Board chair Mr. Howard notes that there is accelerated vesting upon a recapitalization event. In response, management fails to point out the impact of the sale on the amount of the PUP payment.

b. (2:54:18 of video) Mr. Howard asks whether the plan has been approved by the OGC and Ms. Rhode replies in the affirmative (based on footnote 2 to an OCG memo to file and the subsequent OGC letter, this was not accurate).

c. (2:54:40 of video) Board member Ms. Flanagan asks Mr. Wannamacher to walk the board through how the value of the units is determined. He answers the question but fails to describe the impact of a sale on the value.

d. (2:55:49 of video) Ms. Flanagan asks about the implications of scenario 3 (a recapitalization) on the plan. Mr. Wannamacher responds that the only implication is that a recapitalization ends the performance period and that the calculation would be done at that time. He fails to explain the impact of the sale on the value calculation. Mr. Zahn and outside counsel also were present and failed to provide this information to the board.

Process Concerns

As a general observation, watching the 2019 board meetings back-to-back leads to the conclusion that there was a carefully orchestrated process under the guise of strategic planning to convince the board that JEA had to be sold, while simultaneously creating a PUP under which management would reap huge financial rewards from such a sale. Our due diligence led to the following process concerns:

Strawman Alternatives.

The strategic planning process seems to have been designed to create and tear down strawmen, leaving a sale as the only viable option:

- According to management, continuing the *status quo* is not an option because JEA's electric sales will decline by 8% over the next 12 years (based on a contrived metric discussed above);

- JEA cannot adapt as the industry can adapt because of legal constraints that are unlikely to be changed.

The final two strawmen are the initial public offering and the electric cooperative. The analysis on these two options should be straightforward. The cooperative alternative would by necessity involve a sale of assets by the City to the cooperative.[15] It is possible that a consortium of electric cooperatives could band together to bid in the sale process. In terms of a newly formed cooperative, there is a simple financial analysis – how much could the cooperative leverage JEA's assets to finance a purchase? Our conclusion was that financing limitations (*i.e*. loan-to-value requirements imposed by a lender) and the strategic value of JEA to existing competitor utilities meant that a cooperative was never a truly viable alternative.

The initial public offering process also should be a relatively straightforward conversation among JEA management, lawyers and bankers. As a threshold question, it is not clear that this option is available to JEA due to constitutional restrictions unless it sold its entire ownership interest in the IPO. An IPO resulting in a sale of JEA's entire interest likely would not be feasible. Moreover, our conclusion was that JEA would have more value to strategic buyers than the public markets. It is notable that no municipal utility has ever attempted an IPO approach.

Summary of Concerns regarding the Bid Conditions in the ITN

Bid Requirement	**Issues/Concerns**
Greater than $3 billion to City of Jacksonville	This prices JEA at the low end of the value range of $7.5 to $11 billion. The City Council and voters may be willing to approve a sale only at a higher price. Based on 9/30/19 numbers, the Challenge Vale Target was $3.4 billion. The net amount to the City and the $400 million customer rebates are counted toward the target, so under the PUP, 10% of anything above this $3 billion threshold would be paid to PUP plan participants.

[15] A concession model is possible where JEA retained its assets but that would have reduced the proceeds available to the City.

$400 million in Customer Rebates	This rebate may make the sale more popular with voters, but it diverts $400 million from the City's coffers to ratepayers, including ratepayers living outside Duval County that are serviced by JEA. That is a policy decision that the City Council should have decided prior to initiating the ITN process. Also, the $400 million rebate is credited toward the payout under the PUP even though the City gets no value.
3 Years of Contractually Guaranteed Rate Stability	Same issue – it may make the sale more popular with voters, but it will impact the purchase price received by the City. Any bidder would simply reduce its purchase price by the amount it calculates this concession would cost.
Commitment to fund and provide 100% renewable energy to COJ and DCPS by 2030	This requirement merits further study before including it in the ITN in terms of its impact on purchase price, future rates and the environment. It also highlights an issue that seems absent from the strategic planning process – carbon tax scenario planning and its impact on rates and future capital investments.
Commitment to fund and provide 40MM gallons of alternative water capacity by 2035	This condition makes sense but merits further study in terms of its impact on purchase price.
Protection of certain employee retirement benefits	This is an admirable objective, though it should be noted that it will impact the purchase price. Also, the increase in years of service credit could result in significantly reduces bids.
Guarantee of employee compensation and benefits for 3 years	Again, this will impact the purchase price.
Retention payments to employees of 100% current base compensation	Same comment. The entire package should be reviewed by a compensation consultant. The overall package seems a bit out of market based on the term sheet examples provided to

	the JEA board at the April 2018 meeting (even when you exclude the PUP).
Commitment to headquarters in Downtown	Same comment regarding reduced purchase price. Based on the information provided by management, if JEA does not proceed with Scenario 3 (recapitalization) then it will not proceed with the new Downtown headquarters. Accordingly, Exhibit F to the lease approved at the June 2019 board meeting allows JEA until 9/30/19 to terminate the lease for the new headquarters, provided it reimburses the landlord up to $2.9MM in costs. If management believes that JEA's corporate campus should be moved to a cheaper location under a status quo scenario then the decision to approve the lease with this limited termination right is imprudent for two reasons: (1) It's a $2.9 million gamble on a decision that the JEA board will make the following month; and (2) if a recapitalization is not approved by the City Council or the voters, JEA is stuck with the lease. It appears that management was simply using the Downtown lease issue to drive a JEA board decision to pursue a sale.

Summary of Concerns regarding Management's Advisors

Management had been working with Pillsbury since January 2019 but had not disclosed this to the board and has not disclosed what advice they were receiving. These same advisors created the financially lucrative PUP.

Further, it is customary for investment bankers to provide to the board their views on strategic alternatives and initial thoughts regarding valuation at the outset of a process. This did not occur.

As noted above, counsel remained silent instead of providing the board with an adequate explanation of the effect of a sale on the PUP payout calculation.

Addendum

After this memorandum was drafted, JEA posted on its website the bidder due diligence questions and JEA responses. We reviewed these materials and noted that certain bidders raised some of the same issues that are discussed above. Accordingly, we updated this memorandum with the following analysis.

Bidder	Q. #	Question/Request	Date	JEA Response
NextEra	24	Please explain the variance (by load class) between the forecasted load in the CIP and Financial model and the forecasted load provided in JEA's 10 Year Site Plan	11/12/19	TYSP is not a financial forecast. It is intended to ensure sufficient system capacity. *Comment: TYSP is not a financial forecast, but it is a load forecast prepared using a sophisticated methodology. It is a publicly filed document available for review by ratings agencies and bondholders and in the past has served as the basis for the revenue projections in JEA's budget.*
IFM	5	Please provide a detailed breakdown of residential, commercial and industrial load forecasts, including assumptions on population growth, total connections and efficiency measures. Please provide a reconciliation of these forecasts to JEA's latest submitted site		As the negotiation process continues, JEA anticipates providing Respondents access to additional information and documents, some of which may include information addressing this question. *Question: Does this information exist?*

		plan, including an explanation of key differences.		
IFM	33	Please provide a reconciliation between the management forecasts under the Current Pro Forma Scenario and management's latest Board approved budget and business plan.	11/8/19	As the negotiation process continues, JEA anticipates providing Respondents access to additional information and documents, some of which may include information addressing this question. *Question: Does this information exist?*
Mira	53	Can you please explain how electric load was forecast?	11/11/19	The load-growth forecasts were developed by JEA, with input from 3rd party consultants. As the negotiation process continues, JEA anticipates providing Respondents access to additional information and documents, some of which may include information addressing this question. *Comment: This explanation lacks any detail.*
API	9	"Management Case"- Has the management case (capex and load-growth forecasts) been cross-examined by a 3rd party consultant and if yes, please	11/1/19	The load-growth forecasts were developed by JEA, with input from 3rd party consultants. The capex projections were developed by JEA, based on available visibility into capital needs over the 10-year period. *Comment: This explanation lacks any detail.*

		provide details/findings of such examination? If not, has it been informed by any 3rd party consultant projections, if yes, please provide details around such projects/reports?		
Duke		Please discuss why EE has impacted Jacksonville more so than other parts of the state, especially considering that >40% of the residential population is noted as being low-income. For reference, we note that the FTI report states the following; "JEA's load outlook differs considerably from the state as a whole as strong EE penetration has caused load to drop, a trend that is expected to continue	12/13/19	No JEA response *Comment: The FTI report is not yet publicly available, but it seems to base its analysis on JEA management's assertion to the JEA board that energy efficiency accounts for 90% of the reduction in electric sales from 2006-2018. In fact, 45% of this decline is due to the loss of the contract to sell electricity to Florida Public Utilities.* *Over the past 3 years, the decline in electricity usage by residential customers is similar for JEA, FPL, Duke Energy, TECO and FMPA. Arguably, JEA may be more vulnerable to energy efficiency in the longer term because its customer mix includes a smaller percentage of residential customers and a higher percentage of industrial customers and a large portion of its residential customers are low income. Also, JEA's service area has experienced an increased number of degree-days but not to the extent of South Florida service areas.*

		moving forward – and which is a significant driver of the sale. The plot below is from the "status quo" scenario provided by JEA. In this scenario, 90% of the reduction in load is attributable to EE penetration, which implies that JEA is well ahead of EE programs elsewhere in the state."		
Emera	13	FTI Regulatory Report to JEA – Page 19 - please provide the data that Electric System supports the concept that Jacksonville has stronger EE penetration than the rest of the state and provide any associated analysis/evidence as to the reasons why Jacksonville is well ahead of EE programs elsewhere in the state.	11/1/19	FTI reviewed data from the Load and Resource Plan published by the Florida Reliability Coordinating Council which shows that load for the state of Florida as a whole has been trending upward for roughly the last 10 years. Figure 3 of our report, which utilizes data provided by JEA, shows that JEA's load has been falling over the same period. From these data, we conclude that demand-side management, including EE as well as distributed generation, are causes of the difference between the trend in JEA's load and that of the state as a whole. *Comment: JEA's load growth declined over the past 10 years due to the decline in sales for resale. Retail sales for this period declined by only 0.17%, and retail sales have grown 7 of the last 8 years.*

Emera	241	Please provide additional detail on efficiencies that are expected to cause the load decline between 2022 and 2023 (beyond the detail provided in document 8.4.1 of the data room)	12/13/19	Additional detail on efficiencies are included in the document Management Case Demand Forecasts in Electric System folder 31.3 in the VDR. *Comment: This should be analyzed further.*
IFM	54	Please describe in detail the energy efficiency measures being adopted by C&I customers - do these relate to reduced total power consumption or moves to Electric System source power outside of the grid entirely? Which customers have active plans to source a substantial amount of their power off grid? What pricing strategies do management intend to deploy with respect to these customers?	11/8/19	JEA offers three different energy efficiency incentive programs for its commercial customers. The programs are: Prescriptive, Small Business/Direct Install and Custom Commercial. Adoption of high efficiency lighting systems is by far the most popular which contributes to reduced power consumption. JEA does not have any specific details of any customers active plans to source a substantial amount of power off-grid. For customers who do look to outsource, JEA Pricing Strategy has established its Distributed Generation (DG) Policy [link omitted]and Standby Service (SS-1) rate [link omitted] which addresses rate stabilization regarding DG.

IFM	55	Why are energy efficiency (EE) adoption rates higher within JEA's service Electric System area compared to the rest of Florida, which has a strong outlook for electric load growth?	11/8/19	Energy savings related to the adoption of Energy Efficiency within the JEA service territory has averaged 0.3% of sales over the past 5 years per data submitted to the U.S. Energy Information Administration, Annual Electric Power Industry Report, Form EIA-861 (https://www.eia.gov/electricity/data/eia861). JEA's load growth as shown in its Ten Year Site Plan (TYSP) is consistent with other Florida utilities, please see [link to FPSC Ten-Year Site Plans]. *Comment: These statements are accurate, and they contradict the assertions made by management that the load will decline. Population growth and increased degree days are expected to continue to outpace energy efficiency.*
Mira	36	CIM - page 94 General Operations Can you please provide rationale for including DG under regulated business activities? Is there precedence that FPSC would treat such activities as regulated?	11/11/19	There is regulatory precedent in the United States for regulated DG storage. A detailed assessment of potential FPSC regulation was not conducted. *Comment: How can management not have conducted a detailed assessment of FPSC regulation of direct generation for the "Legal Obstacles" presentation that it made at the July 23rd board meeting? Notably, that presentation does not cite specific obstacles to JEA's pursuit of this business line.*
Resp. A	1	Are there any known plans for JEA's large commercial, industrial or military General	10/25/19	Several large customers have corporate sustainability goals that may include the installation of onsite generation. JEA does not have an exhaustive list of these projects or the associated impacts on revenues.

		Operations customers to build onsite generation? If so, what are the associated impacts		*Comment: Why wouldn't JEA have done this analysis?*