Holland & Knight

1180 West Peachtree Street, Suite 1800 | Atlanta, GA 30309 | T 404.817.8500 | F 404.881.0470
Holland & Knight LLP | www.hklaw.com

J. Allen Maines
(404) 817-8525
allen.maines@hklaw.com

To: Jody Brooks, Esquire
Melissa Dykes, CFO

From: J. Allen Maines, Esquire
Woody Vaughan, Esquire

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Re: Expedited Analysis of Options Under PPA Agreement

Contents Covered by Attorney-Client Privilege and Work Product Doctrine

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I. Abbreviated Factual Background.

Jacksonville Electric Authority ("JEA") entered into an Amended and Restated Power Purchase Agreement ("PPA") with Municipal Electric Authority of Georgia ("MEAG") dated December 31, 2014, to purchase power output from two nuclear plants being constructed at Plant Vogtle (partially owned by MEAG) in exchange for sharing the construction risk, among other things. The PPA is governed by Georgia law, and contains a choice of forum clause designating either the Superior Court of Fulton County, Georgia, or the United States District Court for the Northern District of Georgia, as the exclusive forums for resolution of disputes.

The relationship created under the Agreement is unsatisfactory to JEA among other reasons because the economics have changed. Construction cost over runs currently exceed $11 Billion. Nuclear power now is more expensive than alternatives in part due to technological advances making fracking and natural gas much more affordable, and many operating nuclear plants are only able to continue operations because of state subsidies granted in order to save the jobs associated with those plants. Additional debt service payments required from JEA were unexpected and currently approximate $948,000 per month or about $11,400,000 annually.

On Monday August 28, 2017, JEA's CEO is scheduled to meet with Jacksonville's mayor. By August 31, Georgia Power is required to advise the Georgia Public Service Commission whether it plans to proceed with construction of Plant Vogtle. Georgia Power is widely expected to recommend that construction continue.

For a variety of reasons, it appears that circumstances potentially enabling JEA to escape from its financial obligations under the PPA arguably are as good as they will ever be.

II. Summary Analysis of Alternatives Available to JEA.

JEA is evaluating various possible goals including (a) to end the Agreement, (b) to sue to end the PPA and possibly for damages, (c) to negotiate a new Agreement with MEAG, (d) to locate a purchaser for its position and assign the PPA to the purchaser in exchange for the purchaser assuming all of JEA's future obligations under the PPA. JEA has asked HK to preliminarily[1] comment on the pros and cons associated with its options including consequences if JEA were to breach the Agreement.

A. Financial Consequences of Either Party Breaching the Agreement.

Unless otherwise specified in the PPA, the PPA generally limits recoverable damages against either party to "direct actual damages only." Section 504(c). Consequential damages are disclaimed except where one party is liable to a third party, and is entitled to be indemnified from the other party to the PPA (presumably primarily designed for tort claims). Section 504(d). Where the PPA establishes the damages or remedy for breach of a particular provision, the contractual remedy shall be the "sole and exclusive remedy" for breach of that provision. Section 504(b). Such "sole remedy" provisions generally are enforceable. In addition, section 1012 of the PPA provides that each party bears its own fees and expenses arising from litigation,

[1] HK's preliminary observations are based on review of only four documents: the PPA, part of the Owner's Agreement, the Loan Guarantee Agreement, and selected MEAG bond offering documents.

meaning that MEAG will not be able to seek its legal fees from JEA if it attempts to enforce the PPA.

Based on this limitation of liability, and general case law interpreting direct damages as a result of a breach of contract, strong arguments exist to significantly minimize the dollar amount of JEA's exposure to MEAG for breach of contract. As more fully addressed in the analysis hereinafter, if JEA elects to breach the PPA by ceasing making payments thereunder, it is unlikely that MEAG could recover anything more than the delinquent payments plus interest as "direct actual damages" based on information available to us at this point.[2]

III. Summary of Proposed Action Items for JEA's Consideration.

A. Georgia PSC Deadline on August 31, 2017. File a "low-key" submission with the PSC briefly advising it that JEA does not believe Plant Vogtle remains an economically viable project and does not believe that construction of Plant Vogtle should continue. JEA should inform the Georgia PSC that it may supplement its submission once JEA has an opportunity to review and to consider the Owner's submission. This "starts the clock" with respect to MEAG and Georgia Power, signaling that they need to collaborate to devise an exit strategy for JEA quickly in order to obviate the necessity for JEA to elaborate publically on all of the reasons Plant Vogtle should be scuttled, which will result in a "feeding frenzy" for the press and likely embolden others to voice skepticism about the economic viability of the last nuclear plant under construction in the United States.

B. Engage with MEAG to terminate JEA's continued obligations under the PPA.

1. Cease making the monthly payments required under the PPA.
2. Establish a deadline by which MEAG locates a party willing to step into JEA's position under the PPA.
3. Schedule a meeting with MEAG to underscore urgency and to explore options.
4. Demand to review MEAG's books and records pursuant to the PPA (§1015).

C. Coordinate Strategies with Jacksonville's mayor and city council.

1. The PPA made economic sense when JEA entered into it.
2. The PPA and Plant Vogtle are no longer economically feasible. Nuclear-generated power is no longer cost effective or even competitive in light of new fracking technologies, and the ability to store and distribute solar and wind-

[2] A possible exception would be if JEA's breach resulted in MEAG being obligated to indemnify some third party in a manner contemplated by the agreement, but HK currently is not aware of any such circumstance.

generated power.

3. Construction cost over runs at Plant Vogtle exceed $11 Billion, and delays continue.

4. Although the PPA purports to require JEA to continue its payment obligations in virtually every circumstance, JEA cannot simply increase the burden on its constituents unilaterally and forever, and in unlimited amounts. The various entities overseeing JEA can reach their own conclusions about whether continuing with the PPA is consistent with "Prudent Utility Practice" unbridled by the broad definition of such in the PPA. In assessing whether to continue with Plant Vogtle, Georgia's PSC considers its economic impact and the jobs it creates in Georgia. Such reasons to continue are unrelated to the city council's and JEA's obligations to protect JEA's rate payers.

IV. Abbreviated Legal Analysis.

A. Sensitive Discovery That Could Create Greater Problems.

JEA's leverage is less grounded in the strength of its legal arguments than in what "facts" likely will surface during discovery pursuant to litigation. None of the Owner's want anybody sifting through years of records that will jeopardize the prospect of Plant Vogtle being built, and may result in additional legal troubles for the Owners including MEAG. The Plant Vogtle project is and has been controversial, with skeptics eager to pounce on what they characterize as a lack of candor and transparency. Likely areas of uncomfortable discovery for the Owners include:

1. Internal discussions and views on the economic viability of nuclear power and Plant Vogtle.

2. Whether the Owners and MEAG, and MEAG's members, have followed and are following "Prudent Utility Practices." How can it be a good utility practice to continue to pour money into this project when it likely will have to be subsidized by the state for years to come in order to continue operating, as is the case with many other nuclear plants (e.g., IL, TX and NY), although the Owners will argue that other markets are bi-lateral, organized markets where the risks are greater due to pooled capacity auctions.

3. The burden on both Florida and Georgia rate payers.

4. Safety Audit Records identifying risks and concerns, and lapses, identified by the NRC.

5. Analysis of constant change orders and corrections resulting in expense. Similar plants such as Shoreham in New York never operated after being constructed due to expense analyses that will be largely applicable here. Use the Navigant study on economic viability.

6. NRC licensing glitches.

7. The Westinghouse insolvency. What did the Owners know, when did they know it, and when did they disclose it? What potential liabilities exist to third parties (e.g., bond holders) that could increase JEA's obligations yet again.

8. Discovery from the NRC.

B. Potential Claims and Defenses.

Although beyond the scope of this preliminary analysis, one alternative to simply ceasing to perform and breaching the Agreement is for JEA to bring affirmative claims against MEAG. There are viable potential claims that JEA could assert against MEAG including (a) breach of the covenant of good faith and fair dealing ("GFFD"), (b) constructive, and possibly actual, fraud, or mistake, and (c) breach of standards within the PPA (e.g., "Prudent Utility Practices"). Of course, the limitation on recoverable damages discussed above also applies to constrain the amount of any recovery by JEA against MEAG, unless the PPA were rescinded due to fraud in the inducement. However, one incentive for MEAG to accept JEA's offer to "walk away" is that in the event of litigation JEA is not precluded from seeking to recover all of the monies that it has expended from inception as damages under certain legal theories.

The GFFD claim does merit brief discussion. New York law, for example, like Georgia, implies a covenant of good faith and fair dealing "pursuant to which neither party to a contract shall do anything which has the effect of destroying or injuring the right of the other party to receive the fruits of the contract." Thyroff v. Nationwide Mut. Ins. Co., 460 F.3d 400, 407 (2d Cir. 2006) (citation omitted). The covenant "can only impose an obligation consistent with other mutually agreed upon terms in the contract. It does not add to the contract a substantive provision not included by the parties." Broder v. Cablevision Sys. Corp., 418 F.3d 187, 198–99 (2d Cir. 2005) (citation omitted). Under New York law, a claim for breach of an implied covenant of good faith and fair dealing does not provide a cause of action separate from a breach of contract claim. "[P]arties to an express contract are bound by an implied duty of good faith, but breach of that duty is merely a breach of the underlying contract." Harris v. Provident Life & Accident Ins. Co., 310 F.3d 73, 80 (2d Cir. 2002); see also L–7 Designs, Inc. v. Old Navy, LLC, 647 F.3d 419, 433 n. 17 (2d Cir. 2011) ("[B]reach of [the duty of good faith and fair dealing] is merely a breach of the underlying contract.").

A claim for breach of the covenant of good faith and fair dealing must be based on different facts than a breach of the underlying contract. It will be disallowed as duplicative of a breach of contract claim where both claims are based upon the same allegations or where the same conduct is the predicate for both claims.

In Best v. U.S. National Bank of Oregon, 739 P.2d 554 (Or. 1987), the Supreme Court of Oregon explained how a court should assess a claim that a party breached the implied duty of good faith and fair dealing when the contract provided that party with discretion in acting under the

contract. In Best, two depositors brought a class action, arguing that the defendant bank violated its duty to set fees in good faith when it increased the fee it charged depositors for processing nonsufficient fund checks from three to five dollars per check over a six-year period. Id. at 555. The lower court granted the defendant's motion for summary judgment, and the plaintiffs appealed. The Oregon Supreme Court found it was unfair to assume that the depositors knew about and agreed to the fee because bank employees did not inform customers about the fee unless the customers asked, and the bank did not notify depositors when it increased the fee. Id. at 557. Because the defendant did not establish that the plaintiffs agreed to the fees, the court proceeded with the good faith and fair dealing analysis. The court stated:

"When one party to a contract is given discretion in the performance of some aspect of the contract, the parties ordinarily contemplate that that discretion will be exercised for particular purposes. If the discretion is exercised for purposes not contemplated by the parties, the party exercising discretion has performed in bad faith."

Id. at 558. Thus, although the bank had the contractual discretion to set its fees, it was required to exercise that discretion within the confines of the depositors' reasonable expectations. The court reversed the grant of summary judgment because there was a genuine issue of material fact with respect to whether the bank set the fees in accordance with the parties' reasonable expectations. Id. at 559.

C. High Level Legal Analysis if JEA Were Sued for Breach of Contract.

Damages for breach of contract include general (or direct) damages, which compensate for the value of the promised performance, and consequential damages, which are indirect and compensate for additional losses incurred as a result of the breach. Direct damages are typically expectation damages, measured by what it would take to put the non-breaching party in the same position that it would be in had the breaching party performed as promised under the contract. Direct damages are also defined as "the natural and probable consequence of the breach." Special, or consequential damages, on the other hand, are "extraordinary" in that they do not so directly flow from the breach and are recoverable only upon a showing that they were foreseeable and within the contemplation of the parties at the time the contract was made.

The PPA excludes consequential damages and limits recovery to "direct actual damages." If a court were to determine that JEA's breach is unexcused, the most likely measure of MEAG's direct damages would be the payments not made by JEA plus interest thereon.

JEA's further performance under the PPA might be excused in certain circumstances. For example, if a court were to find that the essential purposes of the contract has been frustrated, . Frustration of purpose is both a defense to a breach of contract claims and a basis for declaratory judgment. There is authority that JEA would be relieved from its obligations.

"[F]rustration of purpose refers to a situation where an unforeseen event has occurred, which, in the context of the entire transaction, destroys the underlying reasons for performing the contract, even though performance is possible, thus operating to discharge a party's duties of performance." *Sage Realty Corp. v. Omnicom Group, Inc*., 705 N.Y.S.2d 500, 504 (N.Y. Supp. 2000). "The doctrine applies when a change in circumstances makes one party's performance virtually worthless to the other, frustrating his purpose in making the contract." *Id*. For frustration of purpose to excuse performance, the frustrated purpose must be so completely the basis of the contract that, as both parties understood, without it, the transaction would have made little sense. *See A&E TV Networks, LLC v. Wish Factory*, 2016 U.S. Dist. LEXIS 33361 (S.D.N.Y. Mar. 11, 2016).