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MEMORANDUM

TO: Honorable Mayor Lenny Curry
Honorable Members of the Jacksonville City Council
JEA Board of Directors

CC: Chief Administrative Officer, Sam Mousa
Chief of Staff, Brian Hughes
Chief Financial Officer, Mike Weinstein

FROM: Jason Gabriel, General Counsel
Jody Brooks, Chief Legal Officer, JEA
Gayle Petrie, Chief Financial Officer for OGC

RE: Process for the evaluation of a potential JEA privatization

DATE: February 13, 2018

I. Background and Purpose

In November 2017, former JEA Board Chair Mr. Tom Petway posed questions to the JEA Board which included whether the services and financial benefits derived from the privatization of JEA would better serve the customers of the JEA and the citizens of Jacksonville and the region at large.

In an effort to respond to these inquiries, the current JEA Board Chair, Mr. Alan Howard, requested that JEA management engage a qualified firm "to appraise the value of JEA's constituent utilities: electric, water/wastewater, and district cooling." Public Financial Management (PFM) was engaged by JEA to prepare such a report and is working to finalize and deliver the report to the JEA Board, City Council and members of the Administration on or around February 14, 2018. A draft of the PFM report dated February 2, 2018 was provided to City Council members, JEA Board members, and members of the Administration.

The JEA and City Council members have inquired as to the process for exploring and considering the potential privatization of JEA utility operations which include water and

sewer, chilled water, and electric systems. The purpose of this memo is to provide the basic process for such exploration and consideration, including, without limitation to identify local, state and federal regulatory processes that would be necessary to complete.

Please note that this memo provides basic procedural information on a comprehensively large first-of-its-kind transaction and accordingly is subject to further modification, amendment, elaboration and analysis as the evaluation, exploration and consideration process is undertaken.

II. Authority and Responsibilities of JEA

JEA is the largest municipally-owned electric, water and sewer utility in Florida and the 8th largest in the nation. JEA serves Duval County and portions of three adjacent counties including St. Johns County, Nassau County and Clay County. In 1967 upon consolidation, Jacksonville Electric Authority became an independent authority of the City of Jacksonville authorized to own, manage and operate an electric utility system. In 1997, the City amended the Charter to expand this authority to include water, sewer and natural gas, and the City transferred the water and wastewater responsibilities from a City department to Jacksonville Electric Authority and renamed the independent authority to simply JEA.

A. JEA Charter

Article 21 of the City of Jacksonville Charter creates the JEA, defining its responsibilities, authority and power. JEA is authorized to own, manage and operate utility systems within and without the City of Jacksonville and was created for the express purpose of acquiring, constructing, operating, financing and otherwise having plenary authority with respect to electric, water, sewer, natural gas and such other utility systems as may be under its control now or in the future. Such utilities may be owned, operated or managed by JEA separately or in such combined or consolidated manner as JEA may determine. Section 21.01, City Charter.

The JEA's powers are listed in Section 21.04 of the Charter. Specifically, Section 21.04(p), in part, limits JEA's ability to "transfer any function or operation which comprises more than ten percent of the total of the utilities system by sale, lease or otherwise to any other utility, public or private without approval of the council."

Any transaction that comprises more than ten percent of the total utilities system would require approval of City Council. Upon receipt of the PFM final report, the JEA Board could make a recommendation to City Council on pursuing a potential privatization opportunity and exploring the market to do so, however the JEA ultimately does not have the power to complete such a transaction without City Council approval.

B. JEA Charter Amendment Process

Any transaction that would modify the authority or powers of JEA would require an amendment to or repeal of Article 21. Section 21.11 provides the following legislative authority of City Council:

Notwithstanding any provision of this charter to the contrary, the council may repeal or amend any portion of this article, by two-thirds vote of the membership of the council. A public hearing on the adoption of the ordinance shall be advertised in substantially the same manner as the council is required to advertise its intention pursuant to s. 200.065, Florida Statutes, and held not earlier than 30 days after the introduction of the ordinance into the council. The council shall take final action on the ordinance only after the expiration of 60 days after the advertised public hearing, and no ordinance shall be enacted except by a two-thirds vote of the entire council. If the mayor disapproves the ordinance, the council may enact it notwithstanding such disapproval only by a four-fifths vote of the entire council.

Section 21.11 authorizes the City Council to repeal or amend any portion of the JEA Charter. Because this amendment and repeal section (coupled with the sale/transfer provision set forth in Section 21.04(p)) was specifically authorized by the State Legislature, no referendum would be required to amend or repeal the JEA Charter to affect a privatization transaction. Furthermore, any effort to require such a transaction to be subject to a voter referendum would require an amendment to Article 21 of the City Charter.

C. Interlocal and Franchise Agreements

JEA provides utility services to surrounding communities under certain interlocal or franchise agreements. The electric system provides service to the Town of Orange Park, Town of Baldwin, Atlantic Beach and a portion of St. Johns County. The water/wastewater system provides service to parts of Nassau and St. Johns Counties. Each of these agreements will need to be reviewed for the provision of service to these surrounding communities and the transferability of the agreements.

Those agreements are referenced as provided below:

1. Electric:

a. Ordinance No. 305 (Town of Orange Park) Franchise Fee Agreement effective September 1, 1969, between JEA and Town of Orange Park

- b. Assignment and Assumption of Franchise Agreement (FPL) dated January 1, 2000, between JEA and Town of Baldwin

Franchise Agreement between JEA and Atlantic Beach

- c. Territorial Agreement (FPL) dated December 14, 1998, between JEA and St. Johns County

2. Water/Wastewater:

- a. Nassau County/JEA Water and Wastewater Interlocal Agreement dated December 17, 2001

- b. St. Johns County/JEA Water and Wastewater Interlocal Agreement dated July 1, 1999

A purchaser would also need to negotiate a franchise agreement with the City of Jacksonville.

3. All Applicable Agreements:

Agreements with governments outside of Jacksonville would need approval for a transfer or will need to be renegotiated with the local governmental units. Those agreements include the agreements listed above. The Office of General Counsel is currently examining all known applicable agreements, and is researching JEA files to ensure that all necessary agreements are identified and reviewed. Accordingly other agreements may be added to the list of agreements that necessitate review.

D. Real Estate / Asset Inventory Review

All governmentally owned, leased, managed, operated or controlled property interests and other assets associated with JEA utilities need to be reviewed, along with the instruments and documents which govern them. The purpose of such examination is to assess the rights, obligations, benefits and burdens contained within them which affect the various utility systems. This is an undertaking conducted by the JEA with assistance from the City, Office of General Counsel, and specialized outside legal counsel.

III. Applicable State and Federal Agencies

A. Regulatory Approvals

As a municipal utility, JEA is exempt from certain federal and state regulatory laws that would be applicable to a non-municipal, investor-owned purchaser. Approval by the Federal Energy Regulatory Commission (FERC) (with respect to the entire transaction of the electric system) and the Florida Public Service Commission (PSC) (with respect to

the approval of utility rates and related matters) of a privatization transaction to a private entity would be required as part of a conversion from a municipal-owned utility to an investor-owned utility.

B. Public Interest Determination for Water/Wastewater System

Pursuant to Florida Statutes, no county, municipality, special district or community development district may sell a water, sewer or wastewater reuse utility or enter into a wastewater facility privatization contract for a wastewater facility until the governing body has held a public hearing and made a determination that the sale or wastewater facility privatization contract is in the public interest (§125.3401 - Purchase, sale, or privatization of water, sewer, or wastewater reuse utility by county, §180.301 - Purchase, sale, or privatization of water, sewer, or wastewater reuse utility by municipality, §189.054 - Purchase, sale, or privatization of water, sewer, or wastewater reuse utility by special district, and §190.0125 - Purchase, privatization, or sale of water, sewer, or wastewater reuse utility by district, Florida Statutes). The public interest determination shall consider at a minimum the specific items required by statute.

IV. Exploration and the Transaction Process

Should the valuation conducted by PFM provide justification for further exploration by the Consolidated Government for examining and considering further action toward privatization, the draft PFM report dated February 2, 2018, outlines a six-phased approach for a utility asset sale:

- Phase 1 – Commitment to the Process
- Phase 2 – Documentation and Disclosure
- Phase 3 – Preparing for the Sale
- Phase 4 – Indications of Interest
- Phase 5 – Due Diligence and Final Bids
- Phase 6 – Regulatory Approvals

Because of the complexity of a multi-faceted privatization transaction of this nature and magnitude and the integral involvement of various parts of the Consolidated Government, the City and JEA will have to craft a process in collaboration with an investment advisor which adequately tests the market, seeks suitable investors and forges a path to evaluating the best value proposition of the asset for the City. The City and JEA have the ability and authority to create a fair and effective process for a privatization transaction that mirrors standard merger and acquisition processes that are tailored for achieving the best result for the City.

Incorporating the six phases from the PFM draft report, the following is an outline of process for the benefit of the City Council and JEA:

A. City Council and JEA evaluate the PFM final report and decide whether to support further exploratory consideration and action. This can be accomplished through a Council resolution. A cohesive, collaborative and cooperative approach by the entire Consolidated Government is highly recommended while the market is tested for such a comprehensive transaction in order to achieve the highest and best potential valuation by interested entities on behalf of the taxpayers.

B. Assuming City Council support is obtained for the exploration of a potential transaction or set of transactions, arrangements are made to retain an investment advisor, merger and acquisition counsel and other necessary professional services including assistance with employee and labor matters and real estate / asset inventory review.

C. In close collaboration with the investment advisor and merger and acquisition counsel, marketing and disclosure documentation and minimum transaction parameters are prepared for potential investors, and discussions commence with such entities.

D. Prospective investors are assisted with their due diligence review / information acquisition, and the parties begin negotiating terms and conditions of associated transaction documents, including any necessary provisions regarding future rates and employee matters. The bid process is narrowed to the potential investor or investors that have provided the favored terms of acquisition.

E. Final proposals are obtained from investors, reviewed and evaluated. The parties then negotiate definitive acquisition documents that are packaged and submitted to City Council for consideration and formal action.

F. If a proposal is accepted and approved by City Council, transaction documents are executed, and work is commenced on satisfaction of closing conditions, including the regulatory approval process with governmental agencies.

V. Conclusion

If pursued, this complex transaction will require extended cooperation between JEA and the City to maximize net proceeds and clear regulatory hurdles which as noted above include FERC and PSC review and approval.

Please let us know of any further questions and if we can be of any further assistance.

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