

LAZARD

May 2, 2018

Lisa Atkins
CAWCD Board President
PO Box 43020
Phoenix, AZ 85080-3020

Dear Ms. Atkins:

RE: Navajo Generating Station

As described in the letters dated February 1, 2018 and April 4, 2018, Lazard has been engaged by Peabody, with the broad support of multiple key stakeholders, to facilitate ownership transition alternatives for the Navajo Generating Station (“NGS”) that would enable the plant to remain in long-term operation.

This process, which began in 2017, was initiated to transfer ownership in NGS to new owners that would continue plant operations beyond 2019. As previously described, interest in NGS has primarily come from well-respected financial investors with strong track records in the power generation sector, all of which understand that NGS will need to be competitive with the current power price environment in order to operate post-2019. As part of the process to transfer ownership in NGS, Lazard received interest from over 15 highly reputable and experienced power plant operators and private equity firms.

There are a number of positive factors that we understand are driving a strong interest in NGS from potential investors. First, Peabody is actively studying ways in which the Kayenta mine can adjust its mining operations in order to reduce the cost of coal, which would more favorably position NGS vis-à-vis natural gas generation—notably, Peabody has made significant progress on this front (i.e., it has identified ways to significantly reduce mining costs and the recent passage of Arizona House Bill 2003 (i.e., the Navajo coal tax exemption) has improved the coal cost equation even further (~\$2.00 per ton). Additionally, reputable and experienced power plant operators and private equity firms that have expressed interest in NGS believe that the plant could operate more efficiently from a fixed cost basis, further increasing the cost competitiveness of NGS—for example, it is the point of view of the potential investors that a significant portion of the “catch-up” capital expenditures at the plant (i.e., over \$100 million) can be avoided under a different operating construct, the avoidance of which would make the plant even more competitive. Finally, a provision in the EPA rule relating to NGS (i.e., 40 CFR Part 49, alternatively known as “Alternative B”), adopted during the administration of President Obama, would allow the entire 2,250 megawatts of power generation capacity at NGS to operate over the long-term without the need for certain environmental retrofit capital expenditures. This provision is not available to the current owners of NGS.

Given the significant complexities surrounding NGS, we believed that selecting a credible and experienced potential investor to perform detailed diligence and engage with key stakeholders would result in the highest probability of success. Therefore, in January 2018, based on these qualifications and our assessment, Peabody and Lazard selected, from the pool of interested counterparties, a reputable and experienced investor (and that investor’s power plant operating company, together the “Potential Investor”), to perform detailed due diligence of NGS.

GEORGE W. BILICIC

Lazard Frères & Co. LLC
300 North LaSalle Street
Chicago, IL 60654

Over the course of the past three months, Lazard, alongside Peabody and the Potential Investor, have performed a significant amount of work to identify a solution for NGS that would allow the plant to supply power at market competitive prices.

While the Potential Investor has not yet put forward an indicative proposal, they have been performing intensive due diligence and have been working at the fastest possible rate. This has included a visit to Phoenix, Page and Kayenta between March 12 – 14, a subsequent visit to Phoenix and Tucson on April 2 – 3 to meet with selected current owners of NGS and CAP (i.e., Ted Cooke and Tom McCann), a trip to Las Vegas to meet with NV Energy on April 11, a subsequent trip to Phoenix on April 16 to meet with the NTUA, a subsequent due diligence trip to Page between April 24 – 25 to perform an intense due diligence session at NGS, and countless hours of operational due diligence and follow-up discussions with key stakeholders. Given the significant complexities surrounding NGS, the Potential Investor is working at the highest speed possible to evaluate the opportunity to operate NGS post-2019.

Based on the Potential Investor's discussions and due diligence efforts to date, NGS can deliver power at rates that are more competitive than those indicated in the proposals recently received from third parties during the CAWCD's baseload RFP process, and can compete against newly-built natural gas-fired power generation facilities. While we appreciate you deferring further action on the RFP by one month, we ask you and the Board of CAWCD to further delay the RFP process so that the Potential Investor can process the findings of its recent due diligence visit to NGS and put forward its best indicative proposal, one that we believe will be highly attractive and beneficial to CAP and its ratepayers.

The ownership transition process is moving at the fastest rate possible and remains on track with the timeframe outlined by operating agent Salt River Project, who has agreed to help facilitate an ownership transition subject to negotiation of definitive agreements.

Based on the current due diligence efforts conducted by the Potential Investor and the significant potential cost savings in electricity that can be generated by a new owner for the reasons noted above, we believe it is prudent to further delay the RFP process for a short period of time to determine if the plant will continue to operate and if it can deliver power at a more stable and lower cost than that which was recently offered under the RFP process. If you have any questions regarding this information, please contact me at 312-407-6673.

Sincerely,



George W. Bilic
Vice Chairman of Investment Banking
Global Head of Power, Energy & Infrastructure
Head of Midwest Investment Banking

CC: Members of the CAWCD Board

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OVERVIEW OF LAZARD

Lazard, one of the world's preeminent financial advisory and asset management firms, operates from 43 cities across 27 countries in North America, Europe, Asia, Australia, Central and South America. With origins dating to 1848, the firm provides advice on mergers and acquisitions, strategic matters, restructuring and capital structure, capital raising and corporate finance, as well as asset management services to corporations, partnerships, institutions, governments and individuals.

Lazard's commitment to the Global Power, Energy & Infrastructure Industry is of the highest priority. In that regard, we believe that we have the greatest allocation of resources and effort among any investment bank. Further, we have an ongoing and intense focus on strategic issues that require long-term commitment and planning.

Selected Recent Transactions in the Power, Energy & Infrastructure Industry

- Advisor to Sempra on its pending acquisition of EFH's 80% ownership interest in Oncor
- Advisor to Calpine on its pending sale to Energy Capital Partners
- Advisor to FirstEnergy Solutions on its ongoing strategic review
- Advisor to Great Plains on its pending merger with Westar
- Advisor to WGL on its pending sale to AltaGas
- Advisor to Invenergy on the capital raise for Lackawanna Energy Center
- Advisor to Dynegy on its restructuring of Illinois Power Generating Company (Genco)
- Advisor to BlackRock on its take private of Gas Natural
- Advisor to the Special Committee of the Board of Directors of SolarCity on its sale to Tesla
- Advisor to the Official Committee of Unsecured Creditors in the Chapter 11 cases of SunEdison
- Advisor to China Three Gorges on the acquisition of wind portfolios in Poland and Italy from EDP
- Advisor to Clean Line Energy Partners on a range of strategic advisory matters
- Advisor to Columbia Pipeline Group on its sale to TransCanada
- Advisor to Dynegy on its acquisition of Engie's U.S. fossil portfolio
- Advisor to SDIC Power on its acquisition of Repsol's UK wind assets
- Advisor to the Board of ITC Holdings on its sale to Fortis
- Advisor to Enel Green Power on its integration into Enel
- Advisor to Williams on its proposed combination with Energy Transfer Equity (terminated)
- Advisor to TerraForm Power on its proposed acquisition of the operating assets of Vivint Solar (terminated)
- Advisor to Iberdrola on the merger of Iberdrola USA and UIL and the formation of AVANGRID
- Advisor to TerraForm Power on its acquisition of the operating assets of First Wind
- Advisor to NiSource on the spin-off of Columbia Pipeline Group and formation of an MLP
- Advisor to Dynegy on its acquisition of the Duke Ohio and EquiPower generation portfolios
- Advisor to Integrys on its sale of Integrys Energy Services to Exelon
- Advisor to Acciona on its sale of one-third of its renewable generation business to KKR
- Advisor to Integrys on its sale to Wisconsin Energy
- Advisor to the Unsecured Creditors' Committee of Energy Future Holdings
- Advisor to Pepco on its sale to Exelon
- Much more significantly, Lazard continues to advise a large number of Industry participants on ongoing strategic and ordinary course matters on a strictly confidential basis