PREPA: A deadweight on Puerto Rico's economy

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Opinion

In August of 2005, the Center for the New Economy (CNE) published a research paper entitled "Restructuring the Puerto Rico Electricity Sector". In that report we noted that the Puerto Rico Electric Power Authority (PREPA) suffered from various financial and operating inefficiencies that should be corrected as soon as possible. In our recently published update of the 2005 study we find, unfortunately, that most of those deficiencies are still present three years later.

First, PREPA, a vertically-integrated, self-regulated monopoly with the market power and the legal authority to recover all its costs from its customers, reported a net loss, on a GAAP basis, of $39 million during fiscal year 2007. This fact, by itself, speaks volumes about the state of management at PREPA.

In terms of its operations, PREPA is substantially less efficient than its U.S. counterparts and its performance is mediocre or poor in virtually every area of operations. PREPA's workers are less productive than their counterparts in the United States, in terms of customers served per employee, and PREPA also reports higher administrative, accounting, customer service, general and sales expenses per customer when compared with mainland public power producers. These higher ratios seem to be indicative of the existence of a relatively larger administrative and support staff at PREPA.

Just as worrisome, we also found that the company keeps pouring millions of dollars into old technology. According to its most recent five-year capital improvement program, it plans to invest over $900 million in production plant, mostly to retrofit aging oil-based generators.

In terms of financial performance, during fiscal year 2007, PREPA generated less cash, it took longer to actually recover amounts owed to it by its clients, and it also took longer to pay its suppliers than in 2006. Remarkably, accounts receivable from the government and municipalities increased from $265 million in 2006 to $316 million in 2007, an increase of $51 million, or 19%.

Another reason for concern is that the amount of energy lost and unaccounted for has increased by 23% since 2003 and PREPA actually losses 14% of its product along its transmission and distribution system, a rate that is 3.3 times the average loss rate for government-owned utilities in the United States. To put these losses in perspective, PREPA's total energy lost and unaccounted for in 2007 exceeded the total amount of energy consumed (in KWhs) in Bolivia or in Nicaragua during the entire year of 2006.

We also found that consumers are being overcharged for the purchase and generation of electricity due to the way the energy purchase and fuel adjustment charges are calculated by PREPA. In fact, PREPA is charging customers for the purchase and generation of more energy (in KWh terms) than they actually consume during any given month.

To address these deficiencies we propose, among others, the following policy recommendations. First, establish an independent regulatory commission that would: safeguard the best interests of the Puerto Rican consumer; establish, review, and revise electricity tariffs on an annual basis; approve PREPA's capital investment plans; promote the transition to renewable energy technologies at PREPA; and oversee the overall operations of the company.

Second, it is imperative that PREPA be subject to a rigorous set of performance benchmarks in areas such as generation costs per KWh; availability and forced outage rates; and client service (time to process and address complaints).

Third, we need to provide the correct set of incentives. The current regulatory structure, which allows PREPA to pass along all its costs to the consumer, is a recipe for inefficiency and waste. In the alternative, the government of Puerto Rico should try implementing performance-based regulation. The most common form of performance-based regulation in the monopoly context is known as "price cap" regulation. With price caps, the regulator sets an initial price and then specifies in advance how that price would change during a period of years taking into account inflation and expected productivity gains.

Finally, given global developments regarding climate change, it appears to us that PREPA's business model is unsustainable. In the next 10 to 15 years it will face significant pressure to reduce its dependence on oil; cut back on its consumption of other non-renewable fossil fuels, such as coal and natural gas; decrease its overall carbon footprint; and move towards and adopt renewable fuels for the generation of electricity. To the extent the government of Puerto Rico and PREPA start working on this transition now, while they still have time to control the pace of events, the less painful the process will be for all involved.

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