CNE
Puerto Rico's Think Tank

Remarks of the Center for a New Economy Before the Commission for Economic Development, Planning, Telecommunications, Public-Private Partnerships and Energy of the Puerto Rico House of Representatives Public Hearing on House Resolution No. 136

Sergio M. Marxuach Colón
Policy Director
Center for a New Economy
April 12, 2021

Good morning, Honorable Representative Luis Raúl Torres Cruz, Chairman of the Commission for Economic Development, Planning, Telecommunications, Public-Private Partnerships and Energy of the Puerto Rico House of Representatives, Honorable Representatives members of this Commission, and everyone that is accompanying us today.

We have received your letter dated March 23, 2021, inviting us to testify at these public hearings to discuss the House of Representatives' Resolution Number 136 ("HR 136"), before your consideration to "hold an exhaustive investigation regarding the contract of the Puerto Rico Electric Power Authority with LUMA Energy to operate, manage, repair and restore the public corporation's network" and for other related purposes.

We appreciate the opportunity to participate in the analysis and discussion of this important public policy measure.

INTRODUCTION

We are at a difficult juncture regarding the future of Puerto Rico's electrical system. On the one hand, we have the Puerto Rico Electric Power Authority ("PREPA"), a bankrupt public corporation with serious administration and execution problems. Its operational failures after Hurricane Maria probably cost hundreds of Puerto Ricans their lives. It would not be an exaggeration to conclude that there is a consensus on the need to radically transform PREPA's operations.

However, the solution that the government of Puerto Rico has proposed, in the form of an operation and maintenance agreement with LUMA Energy, has severe deficiencies that we detailed extensively in a report that we published in August 2020. Puerto Rico, then, is trapped between the immovable object of PREPA and the apparent unstoppable force of LUMA Energy.

Unfortunately, the public debate on this transaction has been skewed and at times acrimonious; dividing Puerto Rican society into two camps, one in favor of the contract and the other against. At CNE we believe that the problem we face is an extremely complicated one that cannot be solved with binary or simplistic solutions "for" or "against" LUMA. The objective reality is that PREPA is a disaster in every sense of the word and the deal with LUMA Energy is flawed. **Both things are true.** It is up to you, the officials elected by the people of Puerto Rico, to determine how to protect the common good in the midst of this complex situation, which, we repeat, does not lend itself to simple solutions.

In order to help the Legislative Assembly with this difficult task, we explain in this presentation the reasons why PREPA ended up bankrupt, we set forth some of the main deficiencies of the agreement with LUMA Energy, and we offer some recommendations on how to address them. We hope our analysis is helpful to you during your decision-making process on this complex matter.

HOW DID WE GET HERE?

For at least two decades business owners, community leaders, NGOs, trade organizations, and consumers have been advocating for a thorough transformation of the Puerto Rico Electric Power Authority ("PREPA"). The service provided by Puerto Rico's state-owned utility is unreliable and expensive. Its generation fleet is old and disproportionately dependent on fossil fuels, mostly bunker fuel and diesel.

In addition, PREPA is an organization that has lied to the public for decades; it has voluntarily and recklessly breached both Puerto Rican and federal environmental laws and regulations for years; it has traditionally operated with little transparency and less accountability; and it has constituted a dead weight on the economy of the country with its high and arbitrary rates. The transmission and distribution grid, for its part, has been neglected for years and suffered widespread damage as a result of hurricanes Irma and Maria in 2017.

Furthermore, PREPA has traditionally been a source of private and public corruption on the island. Appointment to senior management positions depends more on partisan politics than on personal merit. Technical and managerial decisions, in turn, were subordinated to short-term political interests for years.

PREPA survived largely by postponing capital expenditures, delaying payment to suppliers, using accounting gimmicks that muddled its true financial condition, and by borrowing billions at relatively low, tax-exempt rates in the U.S. municipal bond markets, even when it was on the brink of insolvency. That all these shenanigans eventually ended in a bankruptcy filing should not be surprising. Nonetheless, it is still difficult to think of other monopolies that have managed to bankrupt themselves, with the exception, perhaps, of the state-owned enterprises in the former Soviet Union.

To be fair, it wasn't always this way. PREPA was created almost eighty years ago with the mission of bringing electricity to every corner of the island and the consensus is that it executed that mission with excellence. The problem is that after

fulfilling this mission, PREPA was left adrift, without a clear mission, objectives, or goals. This is something that eventually happens to all organizations, public or private, for profit or not for profit. So much so that this phenomenon is studied in depth in business schools.

As we have expressed on other occasions, in the case of PREPA the problem is that it became what the economist Albert O. Hirschman called a "lazy monopolist". Economic theory has traditionally focused on the monopolist who uses his power in the market to exploit the consumer and maximize his profit through restrictions on the production of goods or services. But Hirschman pointed out that:

> But what if we have to worry, not only about the profit-maximizing exertions and exactions of the monopolist, but about his proneness to inefficiency, decay, and flabbiness? This may be, in the end the more frequent danger: the monopolist sets a high price for his product not to amass super-profits, but because he is unable to keep his costs down; or, more typically, he allows the quality of the product or service he sells to deteriorate without gaining any pecuniary advantage in the process...as a result one can define an important and too little noticed type of monopoly-tyranny: a limited type, an oppression of the weak by the incompetent and an exploitation of the poor by the lazy which is the more durable and stifling as it is both *unambitious and escapable*.[1]

"Oppression of the weak by the incompetent and of the poor by the lazy."

I don't think there is a more succinct, yet accurate way to describe PREPA's performance after Hurricane Maria. This oppressive dynamic leads the most demanding consumers, those most sensitive to the quality of the products or services they buy, to exit the system, in Hirschman's terminology. This exit has an adverse effect as it allows the lazy monopolist to:

> …to persist in his comfortable mediocrity. This applies for example, to the small city or "ghetto" stores which lose their quality-conscious patrons to better stores elsewhere, as well as to sluggish electric power utilities in developing countries whose more demanding customers will decide at some point that they can no longer afford the periodic breakdowns and will move out or install their own independent power supply.[2]

---

[1] Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Harvard University Press: Cambridge, 1970), pp. 57-59, [italics in the original].
[2] Id., p. 59.

In Puerto Rico, we have seen how the most demanding consumers seek to exit or disconnect from PREPA's system every day.[3] The departure of these consumers, in turn, allows PREPA to continue operating quietly in the comfort of its mediocrity.

In addition, the business model of electricity generation companies, including PREPA, traditionally known as "build and grow", based on (1) the construction of increasingly large and efficient centralized generation plants using cheap fossil fuels and (2) a continuous increase in the consumption of electricity, began to fail in the 1970s due to limitations in the achievable efficiency in the generation of electricity, the increase in the price of fossil fuels, new environmental regulations, the reduction in the demand for electricity, and the introduction of new generation technologies using renewable sources. [4] Simply put, the world changed almost 50 years ago, but PREPA continued to do things as it had always done them.

Given all of the above, the inescapable conclusion is that PREPA simply cannot continue operating the way it has up until now. We concur with the government of Puerto Rico, as well as several other organizations, that the time has come to take drastic action with respect to PREPA, as it has proven incapable of reforming itself and been immune to the efforts of several administrations to modernize and improve its operations.

That said, however, we believe it is imperative to meticulously analyze the political and economic context in which PREPA has operated and carefully study the options proposed for transforming the Puerto Rico electric system.

POLITICAL-ECONOMIC CONTEXT

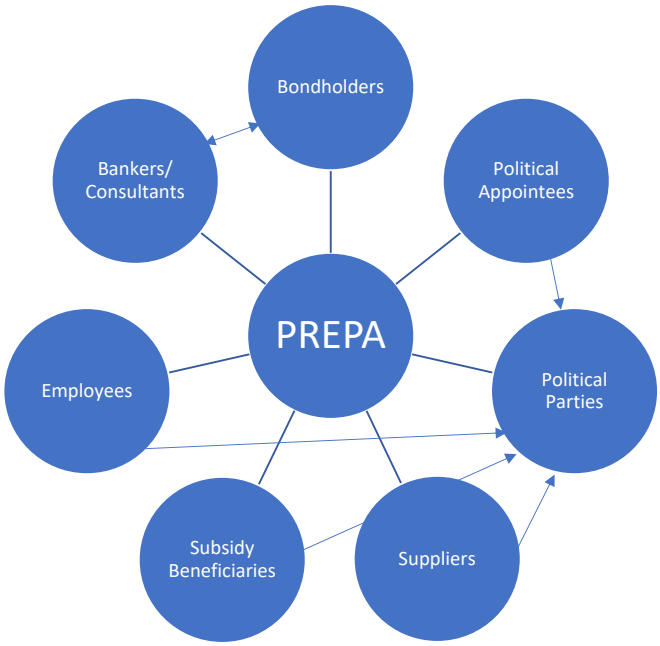
First, it is important to understand that no one at PREPA exercises the legal powers that shareholders — in this case all the residents of Puerto Rico — would exercise in a private company. This situation has allowed diverse interest groups, such as suppliers, political parties, beneficiaries of subsidies, unions, bondholders, bankers and consultants, and the politically connected, to organize in order to extract undeserved benefits from PREPA at the expense of the rest of the population of Puerto Rico.

---

[3] It is important to point out that this phenomenon in Puerto Rico has occurred not only regarding PREPA, but also in education, health and even public safety all to the detriment of Puerto Rican democracy. See Dr. Francisco A. Catalá Oliveras, *Recursos Extraviados: lecciones de Hirschman para el desarrollo de Puerto Rico*, Lección Magistral, University of Puerto Rico in Cayey, September 10, 2013.

[4] Gretchen Bakke, *The Grid: The Fraying Wires Between Americans and Our Energy Future*, (Bloomsbury: New York, 2017), pp. 72-93.

Economists call this behavior "rent-seeking", which the International Monetary Fund defines as "the pursuit of uncompensated value from other economic agents, in contrast with profit-seeking, where entities seek to create value through mutually beneficial economic activity."[5]



Source: CNE Analysis

Paul Teske, a professor at the University of Colorado, offers further insight into this behavior:

> Rent seeking is a complex phenomenon, especially where multiple interest groups, each with different organization costs, interests, and power, interact with each other. The usual result is that, like vectors in a physics model, the interest group pressure will act on politicians from different directions and with differential force.[6]

These rent-seeking groups created obstacles that hindered previous efforts to transform PREPA, since each of the groups that benefited from the status quo was well organized and had a strong interest in protecting its benefits, while consumers were disorganized and the costs of acting collectively exceeded the individual benefit each consumer would receive.

The logical implication of this analysis is that PREPA went bankrupt due to the slow but steady extraction of rents by these well-organized groups, which gradually sucked the lifeblood out of the government-owned corporation. This is why we find

[5] International Monetary Fund, *Building Institutions*, World Economic Outlook 2005, p. 126.
[6] Paul Teske, *Regulation in the States,* (Brookings Institution Press: Washington, DC, 2004), p. 38.

it difficult to understand how organizations and individuals who stand outside the *cercle sacré* of the beneficiaries of this legally-sanctioned, but nonetheless morally corrupt scheme, can *possibly* advocate against the thorough transformation of PREPA.

Rent-seeking also explains why PREPA went bankrupt in the way most other businesses do: "gradually, then suddenly."[7] For PREPA that moment arrived in July 2017 when the Financial Oversight and Management Board for Puerto Rico ("FOMB"), acting as agent for the government of Puerto Rico, "in the interest of ensuring PREPA's future financial sustainability…filed a voluntary petition on behalf of PREPA for protection under Title III of PROMESA in the US District Court."[8]

Therefore, PREPA's fundamental problem is not merely technological or financial, but as we have shown, it is also a problem of Puerto Rico's political economy, and specifically of reducing the economic and political power of those special interests who unduly benefit from the existing system and increasing the power of those who are adversely affected by it.

Any effort to transform Puerto Rico's electric system needs to take into account the predatory behavior of PREPA's internal and external interest groups that benefit from the current situation and *provide mechanisms for limiting or eliminating that behavior.*

If the currently-favored privatization process is limited simply to transferring the assets or operation of a corrupt company in the public sector to a group of investors in the private sector, without disrupting or dismantling the rent-seeking network we have described above, then we will have achieved absolutely nothing.

In other words, privatization, in and by itself, **will not solve Puerto Rico's electricity problems,** if all it does is substitute a group of rent-seekers for another.

PREPA AND LUMA ENERGY CONTRACT

On June 22, 2020 PREPA and the Puerto Rico Public-Private Partnerships Authority (the "P3A" or "Administrator") entered into an agreement for the Operation and Maintenance ("O&M" Agreement") of PREPA's Transmission and Distribution

[7] Ernest Hemingway, *The Sun Also Rises*, (Charles Scribner's Sons: New York, 1926).

[8] *2020 Fiscal Plan for the Puerto Rico Electric Authority*, certified by the Financial Oversight and Management Board for Puerto Rico, June 29, 2020, p. 72.

System ("T&D System") with LUMA Energy, LLC, ("ManagementCo") and LUMA Energy Servco, LLC ("ServCo", and together with ManagementCo, the "Operator").[9]

The Operator, in turn, is a consortium formed by ATCO Ltd., a Canadian operator of electric systems and Quanta Services, Inc., a Texas-based provider of "infrastructure solutions" for the electric power industry.

In August 2020, CNE published an extensive report that analyzes important aspects of this transaction and offers specific recommendations to improve it. This report has been submitted to the Commission to be included in the legislative record.

The O&M Agreement grants the Operator the right to operate and manage PREPA's T&D System for fifteen years, while PREPA retains the ownership of the T&D System. In consideration for managing the T&D System in accordance with O&M Agreement, the Operator is entitled to receive a Service Fee consisting of:

(1) A Fixed Fee starts at $70 million on year 1 and increases to $105 million for each of years 4 through 15; and

(2) An Incentive Fee, which is payable upon the Operator achieving certain performance benchmarks. This fee starts at $13 million on year 1 and increases up to $20 million for each of years 4 through 15.

In both cases, the amounts payable on account of the Fixed Fee and the Incentive Fee, if any, will be adjusted for inflation. The agreement also includes a "Front-End Transition Period" and a "Back-End Transition Period" for which the fees are different to the Service Fee indicated above.

ANALYSIS

In general terms, we are concerned that Puerto Rico's government may lack the required capacity to successfully manage this complex multilayered process, with several dimensions that intersect and reinforce each other.

[9] To be clear, according to the P3 Committee Report: "Operator consists of both ServCo and ManagementCo. ManagementCo consists of the senior management personnel of Operator. ServCo is a subsidiary service company of ManagementCo. ManagementCo is not responsible for providing the O&M Services but is responsible solely for providing the Front End Transition Services. ServCo is responsible for providing the O&M Service, including employing the workforce that will provide the O&M Services, and is otherwise responsible for the T&D System."

Furthermore, it is apparent from our analysis of the O&M Agreement that it does not equitably allocate risks between the parties. In our opinion, the government of Puerto Rico needs to develop a greater capacity to clearly establish the public policy objectives to be achieved and to successfully negotiate this type of agreement, if it wants to continue implementing public-private partnerships in the future.

Below we summarize specific aspects of the O&M Agreement that are cause for concern and CNE's recommendations on how to address them.

PERFORMANCE BENCHMARKS

The Operator, in order to collect the annual Incentive Fee, has to achieve certain performance benchmarks as set forth in Annex IX to the O&M Agreement. Annex X, in turn sets forth the methodology for calculating the amount of the Incentive Fee that is due, if any. The concern here is that a significant number of the benchmarks has not been determined yet and are subject to further negotiation among the parties.

The issue is, as our friend Roy Torbert from the Rocky Mountain Institute put it, that "on almost every one of the benchmarks they have to beat PREPA's prior performance" but that is really a low bar as PREPA "has a really bad history with data and consistency", not to mention a long record of deficient performance. [10]

This is a key issue for determining the success or failure of the transaction. We understand that it may be necessary to set benchmarks against PREPA's prior performance during the initial years of the contract period as the T&D System needs significant remediation in order to perform at reasonable standards. But at some point, the performance benchmarks should be set against similar utilities in the United States.

Risk/Concern: The payment of the Incentive Fee depends on the Operator achieving certain performance benchmarks that have not been determined yet. Using PREPA's prior performance to measure progress could set a standard that is too low to justify the transaction.

Recommendation: Performance metrics should be developed in consultation with the Puerto Rico Energy Bureau ("PREB") and the P3A using best practices and

[10] Robert Walton, "PREPA CEO sees bright future for embattled utility, but funding, grid mod challenges remain", *Utility Dive*, July 20, 2020.

benchmarks from similarly situated utilities. It is our understanding that this process is currently ongoing between the PREB and LUMA.

AUDITING AND TRACKING PROJECTED SAVINGS

The P3A Committee Report states that the present value of the Fixed Fee and the Incentive Fee over the 15-year term of the O&M Agreement is approximately $1.35 billion. This means that entering into the O&M Agreement would be rational, from a purely financial perspective, if, and only if, the present value of the future savings to be generated by the Operator exceeds $1.35 billion.

According to a P3A presentation that took place when the transaction was announced, annual savings are forecast to reach $288 million by the fifth year that the O&M Agreement is in effect, compared to an annual fee payable that year of $138 million, for net savings of $150 million.

Similarly, Exhibit B to the *P3A Committee Report: Advantages of Third-Party T&D Operator of the Puerto Rico T&D System* sets forth a similar savings analysis by FTI Consulting. FTI estimated cost savings according to two scenarios. First, they assume "a 10% reduction in base revenue operating costs (non-variable costs such as labor costs and maintenance expense) due to new work methods and improved management practices implemented by the T&D Operator", which they estimate will generate $117 million in savings.

And, second, they present "a higher efficiency scenario [that] evaluates the impact of a reduction in the amount of fuel and purchased power required due to improved operations leading to reducing line losses", and which they estimate will generate $177 million in savings.[11]

Both analyses fall well short of the full cost/benefit analysis we would like to see, but at first glance it appears that the O&M Agreement, if executed in accordance with its terms, would pay for itself. **The problem is that PREPA is notorious for overestimating savings from various reform efforts undertaken in the past.**

Risk/Concern: The forecast of cost reductions to be generated by the Operator could be significantly overestimated.

[11] Exhibit B to the P3 Committee Report, *Advantages of Third-Party T&D Operator of the Puerto Rico T&D System*, p. 101-102.

Recommendation: The P3A should hire an independent auditing firm to perform yearly audits and keep track of cost reductions allegedly generated by the Operator. The PREB should also be allowed to review and analyze those findings. The O&M Agreement should be adjusted as necessary if the Operator fails to deliver the requisite cost reductions.

TRANSACTIONS BETWEEN GRIDCO AND GENCO

One of the conditions precedent to the Service Commencement Date is that a final plan for the reorganization of PREPA be in effect. This reorganization consists of splitting PREPA into two operating companies: (1) GridCo, which will retain ownership of the T&D System, and (2) GenCo, which will retain ownership of PREPA's generation assets until they are retired or otherwise disposed of.[12]

The O&M Agreement requires that GridCo and GenCo enter into a power purchase and operating agreement (the "GridCo-GenCo PPOA"), with the Operator acting as agent of GridCo, providing for expense reimbursement, power delivery and other services related to the generation, and the sale and purchase of power and electricity from PREPA's generation assets, in accordance with the terms and conditions of the term sheet set forth in Exhibit H to the O&M Agreement.

Now, the notion that two PREPA subsidiaries will enter into a bona-fide, arm's length agreement is frankly naïve, not to say outright preposterous, and in our opinion the Term Sheet set forth in Exhibit H raises some serious concerns.

First, under the proposed terms for the GridCo-GenCo PPOA, GenCo will be responsible for procuring fuel for GenCo,'s generation units but it will be GridCo who "shall pay for all fuel purchases after GenCo certifies receipt and quality, and authorizes payment." Furthermore, pursuant to Section 2.5 of Exhibit H to the O&M Agreement, **"GridCo shall have no obligation to verify any invoice submitted by GenCo."** The failure to require even a minimum amount of due diligence from GridCo's part prior to paying any invoice, **including fuel invoices**, is baffling to us, given the nefarious history of PREPA's fuel procurement practices.[13]

---

[12] O&M Agreement, Section 4.5(q).

[13] See, Beatriz de la Torre, "AEE pasa con fichas", *El Vocero,* March 21, 2013; "Nebuloso financiamiento de 'mareducto'", *El Vocero*, May 23, 2013; "Denuncian 'chanchullo' en AEE", *El Vocero*, July 22, 2013; Mary Williams Walsh, "At Puerto Rico's Power Company, A Recipe for Toxic Air, and Debt", *New York Times*, February 15, 2016; and "In Scandal at Puerto Rico Utility, Ex-Fuel Buyer Insists He Took No Bribes", *New York Times*, March 2, 2016.

Second, the terms and conditions of the proposed PPOA will govern GridCo's purchases of energy generated by GenCo. And while Section 3.1 of Exhibit H states that "if the cost of the Energy from the Generating Facilities becomes more costly on an incremental basis than other sources available to GridCo, the output from the Generating Facilities shall be reduced to zero, if GridCo so requests…", the concept of "cost" is very fluid in the energy world.

In fact, electricity regulators around the world spend most of their time arguing over and defining which "costs" should be included in rate cases. It is important then that the final PPOA include a detailed definition of "costs" attributable to the generation of electricity so as to minimize consumer rates and avoid the cross-subsidization of GenCo's inefficient generation units by GridCo.

Finally, the Operator is required to enter into an agreement to provide certain services to GenCo (the "GenCo Shared Services Agreement") in accordance with the terms and conditions set forth in Annex VI to the O&M Agreement. According to Annex VI, "GenCo shall pay a shared service fee (without markup for profit) to be determined in, and in accordance with, the allocation methodology of the Shared Services Agreement". Again, the term "cost" is not defined and presumably it is up to the parties to determine somehow that the amounts charged by GridCo for services provided to GenCo are "without markup or profit."

Risk/Concern: The O&M Agreement requires the execution of several other agreements that, in essence, constitute related-party transactions and which could provide opportunities for rent-seeking or outright malfeasance by the Operator or PREPA.

Recommendation: With respect to the GridCo-GenCo PPOA we recommend that (1) the agreement be subject to close scrutiny, review, and prior approval by the PREB; and (2) that GridCo be required to exercise reasonable and prudent due diligence prior to paying any invoice submitted by GenCo. With respect to the GenCo Shared Services Agreement and any other related-party transactions or agreements not expressly covered by the terms and conditions of the O&M Agreement we recommend that they be submitted to the PREB for its prior approval, taking into account the impact on rates, as well as any other appropriate benchmark.

CAPITAL IMPROVEMENTS BY THE OPERATOR OR ITS AFFILIATES

The Operator does not have an obligation to make any capital improvements to Puerto Rico's T&D System. However, the Operator does have the option, pursuant to

Section 5.5(d) of the O&M Agreement, to propose Operator-owned capital improvements to the PREB. The PREB, in turn, shall evaluate any such proposal on its merits and allow for the Operator "to earn a reasonable rate of return thereon consistent with the returns permitted to be earned by companies operating in the United States electric transmission and distribution business on similar investments."

Indeed, it appears that at least one of the partners in LUMA, Quanta Services, Inc. ("Quanta"), believes there is significant upside in making those investments. According to Quanta's press release announcing the transaction on June 22:

> Quanta believes there is opportunity for it to compete for work associated with Puerto Rico's electric T&D system modernization efforts that are separate from its ownership interest in LUMA. Puerto Rico's electric T&D system is at a critical juncture after the destruction caused by Hurricanes Maria and Irma. As a result, the government of Puerto Rico, through the P3 and in collaboration with PREPA, have embarked on a plan to rebuild, modernize, harden and "green" its power grid, a majority of which is expected to be funded by U.S. federal disaster relief agencies and managed by LUMA. The P3 estimates that more than $18 billion of electric T&D capital investment could be required through 2028 for this initiative.[14]

While the O&M Agreement mandates the PREB to review these transactions, we believe related-party transactions are particularly vulnerable to rent-seeking and shall be subject to additional review by the P3A as Administrator of the O&M Agreement.

Risk/Concern: Bidding on capital improvements by the Operator, or any of its affiliates, would be a related-party transaction and such transactions are prone to generate rent-seeking opportunities.

Recommendation: First, the PREB should develop a special administrative process to conduct a strict scrutiny of any such proposed transactions. Second, those transactions should also be subject to review and approval by the P3A, as Administrator of the O&M Agreement.

COORDINATION WITH OTHER REFORMS

As of the date of these remarks, there are at least five ongoing processes that will affect PREPA's operations in the near future:

---

[14] Quanta Services, Inc., *Quanta Services and ATCO-Led Consortium Selected by the Puerto Rico Public-Private Partnership Authority for the Operation and Maintenance of Puerto Rico's Electric Power Transmission and Distribution System,* June 22, 2020.

- First, the PREB has reviewed and approved an Integrated Resource Plan ("IRP") for PREPA that, in theory at least, should guide the operations of the utility for the next twenty years.
- Second, the FOMB has already certified a Fiscal Plan for PREPA, which should serve as the basis for a Plan of Adjustment ("POA") to restructure all its obligations with its creditors.
- Third, the FOMB has negotiated an Agreement to Support PREPA's Debt Restructuring with a subset of PREPA's creditors, but that process has paused at least in the short term, due to the impact of the pandemic of COVID-19 on the economy of Puerto Rico.
- Fourth, PREPA, with the assistance of the federal Department of Energy ("DOE"), has prepared a plan to modernize and decentralize the transmission and distribution grid in Puerto Rico, as part of a larger effort to rebuild the electrical system.
- Finally, PREPA and several other entities have executed the O&M Agreement for the operation and administration of the transmission and distribution system for the next fifteen years, which we have analyzed in this presentation.

That is an ambitious agenda for any electric company, but especially challenging in the case of PREPA, which has a long record of failed attempts at strategic change. The FOMB appears to acknowledge this when it states that "to successfully execute on the Fiscal Plan and ensure progress toward the transformation, PREPA must effectively manage several contingencies and risks."[15]

In theory, all the processes described above should follow a logical sequence based on the long-term Integrated Resource Plan. However, PREPA has decided to go ahead with some "predetermined decisions" regarding new capital investments (for example, the gas terminal for San Juan Units 5 and 6) outside the context of the approved IRP. In addition, PREPA has submitted to FEMA an Infrastructure Improvement Plan ("IMP") for the investment of approximately $10 billion of federal funds that appears to be in conflict with the IRP and the O&M Agreement, since both plans seek to use the same allocation of federal funds to modernize Puerto Rico's transmission and distribution system.

This is cause for concern as there appears to be no coordination between the implementation of the IRP and certain actions PREPA is taking, apparently on its own. This situation is particularly worrisome given the limited capacity of the government of Puerto Rico to manage and execute complicated processes.

---

[15] *2020 Fiscal Plan for the Puerto Rico Electric Authority*, as certified by the Financial Management and Oversight Board for Puerto Rico on June 29, 2020, p. 10.

It appears to us that these initiatives are running on parallel tracks and there is no real coordination among and between the parties in charge of watching over all of these moving parts, which could potentially lead to the failure of the attempt to modernize and transform Puerto Rico's electricity system. It appears to us that all these initiatives should be coordinated from the PREB, as it is the only government agency with the legal authority and jurisdiction to oversee Puerto Rico's power system as a whole.

Risk/Concern: Failure to coordinate the multiple actions required to modernize Puerto Rico power system could lead to a catastrophic failure of the entire transformation process.

Recommendation: The processes to transform PREPA should be coordinated by the PREB pursuant to the duly adopted Integrated Resource Plan that sets forth a logical sequence for PREPA's modernization and transformation. The PREB should exercise its legal authority to compel PREPA to comply with this requirement.

With respect to the PREB, we recommend that the administration restore its legal standing and powers as a truly independent regulator. Regardless of the ideological preferences of the interested parties, the fact is that a strong, independent regulator is going to be the key to the successful execution of PREPA's transformation process. In addition, both the Legislative Assembly and the FOMB should ensure that the PREB has the human resources and the adequate budgetary resources to effectively execute its mission.

CONCLUSION

We are not here to curse the darkness, but to light the candle that can guide us through that darkness…
—Senator John F. Kennedy, July 15, 1960

It should be obvious to any objective observer of the Puerto Rican economy that PREPA cannot continue to operate as presently constituted. The economic, environmental, financial, and social costs are unsustainable, given Puerto Rico's current situation. Thus, the transformation of PREPA is imperative for the future development of the island's economy.

The O&M Agreement is a first step in this transformation, but it is far from perfect. We have highlighted some critical flaws in the O&M Agreement and proposed specific recommendations to address them. Therefore, in our opinion, the most

prudent course of action at this time is to renegotiate the O&M Agreement with LUMA to better allocate and balance risks between the parties. If it is concluded that the deficiencies of the O&M Agreement cannot be corrected, then its cancellation should be considered and a new process to improve and transform Puerto Rico's electrical transmission and distribution system shall begin.

Again, we welcome the opportunity to participate in this important public debate. Critical analysis by citizens, representatives of the private sector, and non-governmental entities of the actions proposed by the government is essential for the healthy exercise of democracy. Paraphrasing then Senator John F. Kennedy, we do not come with the intention of cursing the darkness, although some prefer it to hide their actions, but to light a candle that guides us through that darkness.

We remain at your disposal to answer any questions that you or the members of the honorable Commission on Economic Development, Planning, Telecommunications, Public-Private Partnerships and Energy may have regarding this important matter.

Respectfully submitted,

Sergio M. Marxuach Colón
Policy Director
Center for a New Economy