

Hon. Luis Raúl Torres Cruz

Presidente

Comisión de Desarrollo Económico, Planificación,
Telecomunicaciones, Alianzas Público Privadas y Energía
Comisión para el Desarrollo y la Fiscalización de Fondos
Públicos de la Ciudad Capital, Aguas Buenas, Bayamón,
Cataño y Guaynabo



Representante Distrito Núm. 2

San Juan

**CÁMARA DE
REPRESENTANTES**
DECIMONOVENA ASAMBLEA LEGISLATIVA

September 30, 2021

Vía email: nrdems@mail.house.gov

Hon. Raúl M. Grijalva
Chairman
Natural Resources Committee
U.S. House of Representatives
1324 Longworth House Office Building
Washington, DC 20515

RE: Transformation of the Electric System of Puerto Rico

Introduction

After more than four years of PREPA's bankruptcy, under the advice of the Financial Oversight and Management Board for Puerto Rico (FOMB), and the implementation of a privatization strategy promoted by the Commonwealth Government, the electric system of Puerto Rico has become more unreliable and costly than ever. The entities in charge of the reconstruction of the electric system, including the Public Private Partnerships Authority (P3A) and the Puerto Rico Energy Bureau (PREB), do not have the necessary expertise to guide the system through its transformation. Moreover, the recovery process after the hurricanes was shrouded by obscure processes, such as the contracts with Whitefish and Cobra, one of them resulting in criminal prosecution of former FEMA officers and Cobra executives by the federal justice system. All of these constitute good reasons for searching for a different approach to achieve the transformation of Puerto Rico's electrical system.

Based on all the above, we respectfully come before you to request your assistance in finding a sound alternative to achieve the transformation of our electrical system. Notwithstanding, our concern is whether Puerto Rico's needs can be addressed in a timely fashion before the federal funds assigned for the reconstruction are used contrary to the wellbeing of all residents of Puerto Rico. As we will discuss, PREPA has signed a Transmission and Distribution System Operation and Maintenance Agreement (The Agreement) with LUMA Energy, LLC and LUMA ServCo, LLC. (Together known as LUMA.) that became effective on June 1, 2021. The first three months of the contract have

shown that LUMA is ill prepared to operate the electric system and, furthermore, it has the potential to hinder the economic growth in Puerto Rico. We are confident that your commitment to the people of Puerto Rico will move you to intervene in this matter.

It appears that a few months from now, any intervention from Congress could be moot, since Puerto Rico is on the verge of executing a great number of projects to reconstruct the electrical system, under the present guidance of the FOMB, and maybe still influenced by exogenous political influence that could result in arbitrary and non-effective spending of federal funds. Even worse, LUMA will manage all the projects and federal funds, through the Agreement.

We urge Congress to act immediately and take action to designate an entity to oversee the transformation of Puerto Rico's electric system as a project under its supervision, assuring that federal funds are used efficiently and revisiting the laws and contracts, including the Agreement, executed by PREPA and the Government of Puerto Rico to prescribe the path to this transformation.

PREPA under PROMESA, FOMB, FEMA, and Related Others

On August 14, 2014, the Puerto Rico Electric Power Authority (PREPA) entered into a debt strategy agreement, the Forbearance Agreement for PREPA, with owners and insurers of more than 60% of PREPA's bonds and banks that have loaned PREPA monies to operate, since it had failed to make required Bond Service and Redemption Accounts deposits on July 25, 2014.

On July 2, 2017, the Puerto Rico Fiscal Agency and Financial Advisory Authority (AAFAF) said PREPA had filed in the United States District Court of Puerto Rico for protection under Title III of the 2016 Puerto Rico rescue law known as PROMESA, which gave the Government of Puerto Rico, its agencies and instrumentalities, access to a workout process akin to U.S. bankruptcy.

As we are writing, an unfair Restructuring Support Agreement (RSA) is being questioned as filed, by other creditors, congressional members and interested parties. Some parties are arguing for the appointment of a trustee under Puerto Rico law or an independent, private sector firm (IPSIG). In the past, the Financial Oversight and Management Board for Puerto Rico (FOMB) tried to appoint a CEO, but this attempt to control PREPA by the FOMB was rejected by the Title III Court.

Since PREPA first defaulted on July 25, 2014, it has paid more than an estimated one billion dollars in consultants, legal representation for both itself and the bondholders, as required by the agreements reached between both parties.

Notwithstanding, PREPA's finances have not improved, even after receiving millions of dollars from the federal government to rebuild the electric system of the island. The costs

related to the Agreement, together with LUMA's incompetency, have caused PREPA's finances to weaken to the point that the cost of energy will have risen to a 35% during the last nine months if the latest submission for reconciliation of the fuel and power purchase adjustments are approved by the PREB. At this point, it is relevant to mention that a member of PREPA's Governing Board and a former Executive Director have publicly questioned the claims made by LUMA regarding this latest submission, which if approved would represent an increase of 16.4% in the cost of the kilowatt-hour.

We argue that PREPA's top management purposely delayed¹ the much-needed maintenance and reconstruction of the Transmission and Distribution System and Energy Production System, in order to justify the privatization of the public corporation and to fulfill a promise made during the political campaign of 2016, reaffirmed by former governor Ricardo Rosselló on January of 2018, later implemented by former governor Wanda Vázquez, and vehemently defended by governor Pedro Pierluisi, without apparent support of the actual facts.

A similar situation is occurring at the present time with the generation system. Over half of the installed generation is not available or limited, while the rest of the fleet is under-maintained. This becomes obvious by looking at how the maintenance budget for the generation system has been diminished consistently during the last years. Moreover, this lack of compliance with the required conservation of the generating units has caused several forced outages during the past months, on top of outages due to failures in the transmission and distribution system, which some say are a direct result of LUMA's lack of ability and knowledge about Puerto Rico's electric system.

The non-compliance with the proper conservation of the generating units is not a result of incompetence or lack of interest on the part of PREPA's employees. Up to a few years ago, PREPA counted on highly educated, skilled, and experienced professionals devoted to the public corporation, but the **interference of some politicians, going after their political and personal benefit, ultimately ruined PREPA. This is the primary root cause of PREPA's demise**, as concluded by some restructuring experts that were contracted for PREPA's restructuring process.

The Puerto Rico Integrated Resource Plan (IRP) 2018-2019, prepared by Siemens Industry, Inc. on February 12, 2019 (final draft submitted for the approval of Puerto Rico Energy Bureau), contemplates (Section 8.3.1) 2,716 MW generation capacity additions

¹ An example of this can be found on page 10 of the 2020 PREPA Fiscal Plan (the Fiscal Plan) certified on June 29, 2020 by the Financial Oversight and Management Board for Puerto Rico (FOMB), on which it is stated that: "At the end of FY2020, PREPA expects a \$153 million surplus, driven by underspending in vegetation management and necessary maintenance expenses."

from now until 2029. Not even a 1 MW capacity has been added since 2019. Also, this IRP includes the retirement of 2,905 MW capacity between now and 2028.

All of these happened under the supervision of the FOMB. Sadly, after spending an estimated one billion dollars, there are no results to show.

Under the advice of the FOMB, PREPA discarded several contracts for utility scale renewable energy generation projects that were being renegotiated and could have been ready to provide clean, economic, and reliable energy to the island. Moreover, this would allow for the definite retirement and decommission of the oil fueled generating plants, some of which have been declared as Limited Use Units under the Mercury and Air Toxics Standards (MATS) regulation.

As it is widespread known, in September 2017, the island was hit by two major hurricanes, causing devastation, and causing a blackout island wide. It took over a year for the electric system to be restored, but not necessarily up to code, and definitely including no improvements to the system. At the time of these hurricanes, PREPA was working on implementing an Integrated Resource Plan (IRP), which had to be rethought after the effects of the hurricanes.

Recently, the Puerto Rico Energy Bureau (PREB) approved a new IRP, redefining the electric system of the island after considering the impacts of the 2017 hurricanes. Nevertheless, this IRP was based on unlikely scenarios not including a proper sensitivity analysis. This could lead the island into investing the limited resources available, on the wrong projects. This is why the intervention of Congress is needed on a timely fashion.

LUMA Contract

As a result of the unlikely scenarios adopted by the Government of Puerto Rico for the formulation of the IRP, a Transmission and Distribution System Operation and Maintenance Agreement was executed between PREPA, the Puerto Rico Public-Private Partnerships Authority (P3A), and LUMA (a new corporation formed by a consortium between QUANTA Services, Inc. and ATCO Group).

As explained by the Institute for Energy Economics and Financial Analysis (IEEFA), "the contract with LUMA is not solely a T&D operation and management agreement. The LUMA contract identifies a scope of services that goes beyond management of PREPA's transmission and distribution assets and gives LUMA responsibility for planning, rate setting, asset management, budgeting, procurement, collections, public relations and other financial matters. It is a full privatization of PREPA's operational functions."²

² See: Contract Between Puerto Rico, LUMA Energy Sets up Full Privatization, Higher Rates for Island Grid, page 10

Considering this analysis, some questions might come to mind. For one, can the shell public corporation that will remain after the reorganization of PREPA and the execution of the LUMA contract be recipient of federal funds for the repair, restoration, and replacement of damaged facilities? This question has not been specifically answered to this day. According to the provisions of the Stafford Act, Sec. 406. Repair, Restoration, and Replacement of Damaged Facilities (42 U.S.C. 5172), only state and local governments, and private non-profit organizations that provide critical services are allowed to receive contributions from the federal government for the repair, restoration, reconstruction, or replacement of a facility damaged or destroyed by a major disaster and for associated expenses.

This contract has several provisions that are contrary to the legal framework and against the best interest of the people of Puerto Rico³. Some of those provisions are:

- According to publicly available documents, the projections of the variables used to justify the Contract are overly optimistic and fail to include a sensitivity analysis to handle the uncertainty of important variables. PREB should require the PREPA and P3A to perform a more complete analysis to validate projections. Even with these optimistic projections, LUMA has already requested an increase in the electricity cost. This is proof that the contract does not provide for a reduction in the cost of electricity in Puerto Rico.
- The Contract provides more protection to LUMA's interests than to the public interest. It establishes conditions that could lead to a conflict of interest, as LUMA could hire its parent companies to carry out rehabilitation or construction works for both transmission and distribution, and generation.
- The Contract stripped employees and PREPA retirees of the rights acquired and earned over many years and jeopardizes the subsistence of the retirement funding for pensions.
- The Contract provides for the payment to LUMA of an Incentive Fee in case the expected performance metrics are exceeded for a particular year. However, it does not establish penalties in the event that the expected metrics are not reached. The metrics, as set out in Annex IX of the Contract, are non-binding and are still under revision by the PREB. Currently there are no metrics to adequately supervise the performance of LUMA.
- The Contract includes no adequate provisions as to guarantee that the reconstruction projects performed by LUMA will be carried out in such a way that

<https://ieefa.org/wp-content/uploads/2020/10/Contract-with-LUMA-Energy-Sets-up-Full-Privatization-Higher-Rates-October-2020.pdf>

³ Idem

the Federal Emergency Management Agency (FEMA) will reimburse the money invested.

- LUMA is a newly created, limited liability corporation, so the public interest must be protected through a Parent Company Guarantee. We understand that the maximum warranty amount of \$105 million for the entire term of the Contract is not sufficient when compared to other electricity industry contracts that have been awarded in Puerto Rico. Also, QUANTA Services reports to the Security and Exchange Commission (SEC) reveal some red flags regarding the financial stability of this parent company.
- The process of drafting, awarding, and finalizing the Contract was carried out without transparency. Nor was the public interest, customers, employees, let alone retirees, defended. This Agreement was treated as one of adhesion. Today, after several court processes, LUMA still refuses to comply with a court order mandating LUMA to provide the information requested under a legislative investigation being carried out by the House of Representatives of the Commonwealth of Puerto Rico.
- The Contract is potentially bad for PREPA's customers, employees, and retirees, and could hinder the goal of providing a customer-centric system, with financial viability, reliable and resilient, that is a sustainability model, and that becomes the engine of Puerto Rico's economic development.
- The Contract, as proposed, takes away from the Government, its main role in establishing social justice, promoting programs to eliminate poverty, creating an adequate environment of economic development and growth, and establishing and implementing a sound public policy on energy resources, given the geography of the island.

Conclusion

FEMA assigned approximately, \$10.7 billion for the renovation and restoration of the PREPA's Transmission and Distribution System (T&DS). Management of these funds has been assigned to LUMA Energy, LLC under the Agreement. This contract is not good for PREPA, nor for the people of Puerto Rico. For example, the contract provides for LUMA's parent companies, affiliates, and subsidiaries to be among the contractors selected to perform the works for reconstructing the Transmission and Distribution System. This would give LUMA, its parent companies, and affiliates an undue advantage due to the access to privileged inside information, casting doubt and possible conflict of interests on the management of the federal funds.

The above cited defects of the IRP and the LUMA contract, will negatively impact and will constitute an obstacle to the economic development of the island. This, in turn, will

delay ending the bankruptcy of the Government of the Commonwealth of Puerto Rico. Also, the IRP and the 10-Year Infrastructure Plan, which provides an overview of PREPA's infrastructure investment strategy, must be revised under the provisions of President Joseph R. Biden, Executive Order 14008 of January 27, 2021 for Tackling the Climate Crisis at Home and Abroad.

Therefore, **LUMA contract must be annulled or substantially modified** to provide the right tools for the much-needed transformation of the electrical system of Puerto Rico, in compliance with the Energy Public Policy Law of Puerto Rico, requiring that 100 percent of the energy demand on the island be generated from renewable energy sources, and to promote the economic development needed to put an end to the bankruptcy. Also, Congress should take action to **appoint an administrator or trustee** to oversee the reconstruction of the electric system.

The Commission I preside has conducted a thorough investigation of the awarding, execution, and implementation of the LUMA contract. Attached is a copy of the final report of this investigation.

My goal in writing this letter is to shed light upon the path chosen by the Government of Puerto Rico and the FOMB for the transformation of Puerto Rico's electric system, since this transformation is vital to the livelihood of all Puerto Ricans.

Respectfully,



Luis Raúl Torres Cruz