

FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO



José B. Carrión III
Chair

Members

Andrew G. Biggs
Carlos M. García
Arthur J. González
José R. González
Ana J. Matosantos
David A. Skeel, Jr.

Natalie A. Jaresko
Executive Director

BY ELECTRONIC MAIL

September 5, 2018

Hon. Larry Seilhamer-Rodríguez
Chair
Special Committee on Energy Affairs
El Capitolio
PO Box 9023431
San Juan, Puerto Rico 00902-3431

Dear Senator:

The Oversight Board is pleased to provide its remarks with regards to the Puerto Rico Legislature's efforts to develop a comprehensive regulatory framework for the energy sector.

The goal of PREPA's Fiscal Plan, as certified by the Oversight Board on August 1, 2018, is to support and guide Puerto Rico's energy sector transformation from the current, inefficient vertically-integrated monopoly towards a system that leverages private capital, knowledge and experience to provide reliable service at affordable and competitive prices. This transformation is contingent on a myriad of actions and processes coming to fruition, including the establishment of a strong, independent regulator, the concession of PREPA's transmission and distribution ("T&D") system, the privatization of generation assets, the development of new, efficient, low-cost generation resources, and the successful restructuring of PREPA's debt obligations. Failure to achieve any of these objectives in a timely manner could seriously undermine Puerto Rico's ability to provide its citizens with low-cost, reliable power and drive economic growth and prosperity.

The presence of a strong, independent regulator is a key element for injecting confidence, stability and predictability into Puerto Rico's energy market as it transitions towards a modern energy system. To effectively achieve its goals, the regulator must be fully empowered to make determinations based on generally accepted, industry-based legal, regulatory and evidentiary principles, free of political influences, and consistently with public policy goals. The regulator should be authorized to ensure energy rates are just and reasonable for both service providers and customers, promote compliance with quality service standards, ensure investments towards improving quality of service are undertaken, oversee compliance with environmental policies, and prevent, unfair, fraudulent and discriminatory practices. Equally important is ensuring a regulator

that transcends political cycles by promoting career civil servants and ensuring independent funding sources, such as rate-based funding that the regulator receives directly, without the need for legislative or governmental appropriations or for a disbursement from the central government.

Another key element of Puerto Rico's energy sector transformation is the concession of PREPA's T&D system, the privatization of existing PREPA-owned generation assets, and the development of new, efficient and low-cost generation resources. Under PREPA's management and operation, Puerto Rico's energy system has fallen into disrepair. Basic quality of service indicators show a system that consistently underserves its customers, with above-average outage incidences and longer-than-average duration. The lack of maintenance and upgrades to PREPA's infrastructure has resulted in an inefficient and wasteful system incapable of delivering low-cost, reliable service without significant capital investments.

A concession for the administration, operation and management of PREPA's T&D system and the privatization or private operation of generation assets provides an opportunity to leverage private-sector knowledge and experience to modernize Puerto Rico's grid, access necessary capital to maintain the system and establish a reliable operational structure that promotes continued investment in upgrading and modernizing the grid.

The regulatory framework should also identify the individual objectives that need to occur to achieve the overall goal of low-cost, reliable energy service. As outlined in the Fiscal Plan, to achieve sustainable energy prices, Puerto Rico's energy market must transition from existing fuel-oil generation towards greater reliance on renewable, storage and liquified natural gas (LNG), undertake strategic investments in infrastructure hardening aimed at increasing service reliability and resiliency and promote the development, updating and implementation of macro resource planning standards, such as a regulator approved IRP.

Additionally, other initiatives, including investments in technological advancements such as smart meters and smart grids, the development of energy efficiency and demand side management programs and appropriate oversight of power purchase agreements and other utility level transactions, are key elements of a robust energy regulatory framework.

Some of the tools for achieving these objectives and initiatives include clearly defining targets for Puerto Rico's generation resource mix and the deployment of renewable energy resources through, for example, the establishment of achievable and enforceable renewable portfolio standards. The regulator should also define quality standards, such as reliability and resiliency, that will apply to Puerto Rico's energy sector. Finally, but not less important, the regulatory framework should clearly identify the appropriate role that distributed generation and microgrids will play in Puerto Rico's energy market and how these technologies can be used to support a modern, stable, low-cost energy system for all of Puerto Rico's citizens.

Lastly, the regulatory framework should support the successful restructuring of PREPA's debt obligations. As outlined in PREPA's Fiscal Plan, if none of the transformational measures are undertaken, including the restructuring of PREPA's debt, Puerto Rico's electric service rates would reach unsustainable levels of approximately \$0.30/kWh. In addition to burdening ratepayers

Hon. Seilhamer Rodríguez

September 5, 2018

Page 3 of 3

with unaffordable energy rates, the inability to restructure PREPA's debt may delay the execution of private market investments in Puerto Rico's energy sector in particular—and Puerto Rico's economy in general—given the uncertainties surrounding PREPA's legacy debt and the unfavorable economic conditions resulting from unsustainable energy prices. Accordingly, a framework must appropriately account for ongoing efforts to restructure PREPA's debt when developing energy public policy for Puerto Rico.

The Oversight Board looks forward to working closely with you in moving Puerto Rico forward and achieving economic growth and prosperity.

Sincerely,



Natalie A. Jaresko

CC: Christian Sobrino Vega