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Dear Ms. Jaresko and members of the Financial Oversight and Management Board:

Last week, I testified before the Puerto Rico House of Representatives Committee on Economic Development, Planning, Telecommunications, Public-Private Partnerships and Energy as part of its investigation of the LUMA Energy contract.

I write to bring the principal new findings of my testimony (available here) to the board's attention. These findings raise new questions about the procurement process for this contract and the purported savings that have been promised by LUMA Energy. These findings lead me to question the board's recent assertions that any amendment or delay in the LUMA contract would be inconsistent with the PREPA and Commonwealth Fiscal Plans.

I reviewed documents related to the procurement process produced by the Puerto Rico Public-Private Partnerships (P3) Authority as part of a public records request by Cambio, a Puerto Rican non-profit. As you know, the evaluation of bids and negotiation of the LUMA Energy contract was conducted by a five-member Partnership Committee. The committee was responsible for reviewing bids and scoring them according to various technical, operational and financial criteria. The final scores were used to select the winning bidder.

The individual committee member evaluation documents, provided in an exhibit to my testimony, show that four of its five members arrived at identical numerical scores in 37 of the 38 categories. Three of the members even made the same numerical error in summing their scores. A report by FTI Consulting provides the basis for the financial metrics (which accounted for 50% of the total scoring); FTI Consulting's recommended scores appear to have been copied directly onto the scoring sheets. It is unclear how the four Partnership Committee members also arrived at identical scores on the technical metrics (which accounted for 45% of the total scoring).[1]

[1] The evaluation of the proponent's presentation to the committee accounted for the remaining 5%.

The scoring sheets were then tabulated by the P3 Authority, and the tabulated scores were used by the executive director of the P3 Authority as the basis for a recommendation to vote in favor of LUMA Energy as the winning bidder. This vote was conducted as a unanimous, up-or-down vote by email. There was no further discussion of the evaluation documents in the procurement record.

While Puerto Rico law permits consultants to advise the Partnership Committee and the P3 Authority, the consultant-driven process that occurred here is, in my view, a completely inappropriate way to conduct a procurement process. It shows a disturbing lack of independence on the part of the committee members who were chosen based on their professional expertise to represent the interests of Puerto Rico. In my experience reviewing dozens of procurement processes for the state and city of New York, I would never have signed off on this agreement had I been aware that committee members had not exercised independent judgment in recommending the award of the contract.

Second, my testimony addressed recent information that calls into question the savings that will be achieved from this contract. LUMA Energy's proposed initial three-year budgets are vague on savings, and there is little consequence to LUMA if savings are not achieved. The budgets appear to be back-engineered to meet LUMA's promise of not raising base electric rates for the next three years.[2] The result is that LUMA has budgeted $110 million in savings for FY 2024 with little explanation of how it will achieve these savings other than "loss reduction." If LUMA fails to stay within its budget, it foregoes an incentive payment of less than $1 million in FY 2024.

Moreover, LUMA's budgets fail to account for repaying the $894 million Commonwealth loan that the board has stated is necessary to execute the transition to LUMA Energy by June 1. No additional public information has been made available about the terms or conditions of the loan.

The contract's poorly thought-out approach to workforce management is likely to lead to additional costs to the Commonwealth that haven't been included in any discussions of savings from the contract. The contract does not provide for the automatic transfer of employees from PREPA to LUMA, nor does it recognize the collective bargaining agreements of the PREPA unions and other important employee benefits. It is my understanding that as a result of these poor management choices in negotiating the contract, LUMA Energy by late March had received only 1,300 applications from PREPA employees (some of whom may have submitted multiple applications).[3] PREPA has approximately 4,500 employees in transmission and distribution. Under Law 120-2018, PREPA employees who do not take a position with LUMA will be relocated to other positions within the government of Puerto Rico, potentially increasing the commonwealth's labor budget by more than $200 million annually. Again, this is more than enough to offset any potential savings of the LUMA contract.

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[2] As described in a dissenting opinion of PREB Commissioner Angel Rivera, "[W]hen using a true bottom-up approach, utilities calculate the expected costs of providing service and then add them together to compute the actual revenue requirement. LUMA instead fixed its expected revenue and used it as a constraint throughout its budget development process." (Dissenting Opinion of Commissioner Angel Rivera. April 5, 2021, p. 7.)

[3] El Nuevo Dia. Presidente de LUMA dice que el contrato de privatización de la red eléctrica "no necesita enmiendas." March 25, 2021.

IEEFA has read the board's April 6 letter to Gov. Pierluisi, Sen. Dalmau and Rep. Hernandez that relies heavily on the assertions that the LUMA contract is in line with PREPA and Commonwealth Fiscal Plans and that any attempt to amend the contract or delay its implementation would be contrary to the Fiscal Plans. We do not understand how the board arrived at its conclusion that the LUMA contract is consistent with the most recent Fiscal Plans for PREPA and the Commonwealth:

- As noted above, the implementation of the LUMA contract is likely to create a significant increase in the labor budget of the Commonwealth. This additional cost is not contemplated in the Commonwealth Fiscal Plan. In this instance, mismanagement has a real, immediate and substantial negative impact on the budget of the Commonwealth and the services provided by PREPA.

- The FOMB asserts that the LUMA contract is "critical" to "reducing costs."[4] As described above, we do not find it credible that LUMA will achieve the level of savings that it projects. We are not encouraged by the fact that LUMA is already more than 11% over budget in the front-end transition period of the contract.[5] The FOMB has provided no analysis to substantiate why it believes that the LUMA contract will lead to "reducing costs." Indeed, the only publicly available document in the procurement record that points to potential savings is a study by FTI Consulting that notes that if a private operator "hypothetically" were able to reduce operating costs by 10% and "hypothetically" were able to improve system efficiency by 10%, the result would be $294 million in annual savings.[6] There is no analysis of how such savings would actually be achieved.

  IEEFA has asked on several occasions for the standards and measures used by the FOMB to ensure that savings promises are kept. We raised the issue in our first report on PREPA's budget;[7] IEEFA and Cambio's report on New Fortress Energy;[8] and in various other public reports made to the Legislature and the courts. Our concerns have been dismissed by the FOMB.

- The board notes that eroding and limiting the powers and independence of the Puerto Rico Energy Bureau (PREB) would be contrary to the Fiscal Plans.[9] Yet the board did not raise this objection previously when the Puerto Rico Legislature passed Law 120-2018. The law (as amended by Law 17-2019) dramatically limited PREB's powers by giving full authority to negotiate privatization contracts to the P3 Authority. It provided PREB only with a 30-day window to approve such contracts, even though

[4] Financial Oversight and Management Board. Letter to Governor Pierluisi, Senator Dalmau and Representative Hernandez. April 6, 2021, p. 5.
[5] LUMA Energy. Monthly Report for the Period Ending February 2021. March 13, 2021, p. 16.
[6] Puerto Rico Public-Private Partnerships Authority. Partnership Committee Report: Puerto Rico Public-Private Partnership for the Electric Power Transmission and Distribution System. May 15, 2020, Exhibit B.
[7] IEEFA. IEEFA Puerto Rico: PREPA's Approved Budget Faces Five Years of Shortfalls. May 2018.
[8] IEEFA. IEEFA Puerto Rico: Utility PREPA gave unfair advantage to NFE in awarding $1.5 billion power plant contract. June 10, 2020.
[9] Financial Oversight and Management Board, *op. cit.*, p. 3.

these contracts have the potential to significantly impact rates and quality of service.[10] The LUMA contract itself further erodes the powers of the PREB by granting additional powers to the P3 Authority and creating a lack of clarity around certain contract oversight provisions. The contract establishes the P3 Authority as the primary oversight entity.[11] The contract allows PREB to only audit LUMA's use of federal funds,[12] while PREB's statutory authority gives it full auditing rights.[13] The contract also gives the P3 Authority the responsibility of reviewing LUMA's performance and determining the incentive fee to award to LUMA.[14] Thus, although PREB initially approves the performance metrics, it has no authority to enforce them. PREB also cannot propose amendments to LUMA's performance metrics that "reduce the likelihood of Operator's earning the Incentive Fee."[15] This is despite the fact that PREB was previously granted broad statutory authority to "oversee quality and reliability" of electric service in Puerto Rico.[16]

The combination of the contract's incentive provisions and erosion of PREB authority provides precisely the wrong incentives to improve management and achieve fiscal balance. A major contributing factor to PREPA's fiscal distress is that there were no penalties when it spent money inefficiently. The cost of the mismanagement was passed along to the ratepayers or PREPA was forced to forego necessary operational expenditures. Privatization was supposed to bring order and discipline to the process, but these steps have dramatically weakened the potential for real accountability.

- The PREPA Fiscal Plan, as well as Commonwealth law (Law 17-2019), makes a rapid transition to renewable energy a cornerstone of PREPA's transformation.[17] As you know, the priority assigned renewable energy offers clear cost savings, improved system reliability and resiliency and compliance with federal environmental law. Yet, despite transferring significant responsibilities for generation planning and prioritization of new generation projects to LUMA,[18] the contract has no incentives or penalties related to achieving renewable energy goals. IEEFA fails to understand how this failure to provide any accountability for a central goal of the PREPA transformation is consistent with the Fiscal Plan.

- Puerto Rico House Joint Resolution 88 makes several criticisms of the contract, including questioning the repayment of the $894 million Commonwealth loan and how the Commonwealth will afford increased labor and pension expenses under the

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[10] Commonwealth of Puerto Rico. Law 17-2019. 2019, Section 6.2.
[11] Puerto Rico Public-Private Partnerships Authority. Puerto Rico Transmission and Distribution System Operation and Maintenance Agreement. June 22, 2020, Section 6.2.
[12] Puerto Rico Public-Private Partnerships Authority, *op. cit.*, Section 6.3.
[13] Commonwealth of Puerto Rico. Law 57-2014. 2014, Section 6.24(a)
[14] Puerto Rico Public-Private Partnerships Authority, *op. cit.*, Section 7.1(c).
[15] Puerto Rico Public-Private Partnerships Authority, *op. cit.*, Section 7.1(d).
[16] Puerto Rico Energy Bureau, *op. cit.*, Section 6.3(d).
[17] Financial Oversight and Management Board. 2020 Fiscal Plan for the Puerto Rico Electric Power Authority. June 29, 2020, p. 84.
[18] Puerto Rico Public-Private Partnerships Authority, *op. cit.*, Sections 5.6(f) and 5.13(d).

contract (due to the transfer of PREPA workers to the Commonwealth and early retirements).[19] These issues are never addressed by the Fiscal Plans.

- The board states that the contract achieves the Fiscal Plan's goal of depoliticizing the electrical system.[20] Yet the planning process leading up to the issuance of the transmission and distribution request for proposals (RFP) failed to offer any cost/benefit analysis of the transaction. The contracting process itself was highly political, as evidenced by the lack of independence shown by Partnership Committee members in the award of the contract. And by deliberately excluding key stakeholders—PREPA workers—from the process, the parties that pushed this contract (P3 Authority and the board) left those workers little choice but to revert to the political process that the board now finds offensive.

Finally, the board accuses the Puerto Rico Legislature of seeking to defeat the PROMESA legislation's goals of "promoting market competition, making government contracting more effective [and] increasing the public's confidence in the government contracting process."[21] Instead, the LUMA Energy contracting process has drawn the opposition of both houses of the Puerto Rico Legislature; failed to prioritize or incentivize key renewable energy or savings targets; and deliberately wrote off PREPA's workforce, leading to an entirely predictable clash with organized labor. This is not effective management. The irregularities in the procurement process are not likely to increase public confidence in government contracting.

In its defense of the LUMA Energy contract, the board is turning a blind eye to some of the same fiscal practices that led PREPA and the Commonwealth into bankruptcy: Politically-driven contracting processes; poorly documented cash transfers between Commonwealth entities; lack of clarity and accountability for budgetary savings initiatives; failure to prioritize renewables; and costly and shortsighted labor management.

At its best, the PROMESA statute could have been a tool for bringing together stakeholders to work out real solutions to Puerto Rico's serious fiscal problems. What is still needed to resolve many of these issues going forward is openness and transparency. I hope that in the board's answer to this letter, you will address these concerns in that spirit.

Sincerely,

Tom Sanzillo
Director of Financial Analysis

[19] Legislative Services Office. HJR 88. March 15, 2021, pp. 2 and 5.
[20] Financial Oversight and Management Board, *op. cit.*, p. 3.
[21] Financial Oversight and Management Board, *op. cit.*, p. 6.