



October 29, 2019

The Honorable Thomas Rivera Schatz, President of the Senate
The Honorable Carlos Johnny Méndez, Speaker of the House
Legislative Assembly of Puerto Rico
Capitol of Puerto Rico
605-607 Calle Cuevillas
San Juan, 00907, Puerto Rico

Letter to the Legislative Assembly Regarding Restructuring Agreement for PREPA

Dear President Rivera Schatz, Speaker Méndez, and members of the Legislative Assembly of Puerto Rico:

The Legislative Assembly of Puerto Rico will be asked to help write and approve a bill that will enable the Puerto Rico Electric Power Authority (PREPA) to close on its Restructuring Agreement (RSA).¹ The RSA, if approved, will have grave consequences, including immediate and long-term electric power rate increases and dire consequences on the Puerto Rico economy.

We want to bring to your attention fundamental information that has been omitted or excluded in the discussion of this RSA that dramatically alters the viability of this RSA as a means to enable PREPA to access financial markets and rebuild the electric power grid.

An alternative path to debt restructuring is available and the Legislature could step up as an active leader in this discussion. The PROMESA law requires that the Puerto Rico Legislature act as a democratic check and balance when, as in this instance, the oversight board uses a faulty and deficient process to lead PREPA and the Commonwealth into a financial disaster.

It is not too late to make an alternative debt plan for PREPA—one that is affordable to the public, fair to investors, sustainable for the economy, allows the electricity grid to be effectively rebuilt, and calls to account many of those who must share responsibility for loading PREPA with debt.

I. Introduction

What follows is a quick summary of our principal points, each of which we explain in more detail in the remainder of this letter:

- **ELECTRIC POWER RATES WILL BE UNAFFORDABLY HIGH.** Rates are already projected to rise under the RSA and we anticipate they will be even higher than projected, well above the 20 cent per kilowatt hour (kWh) goal established by the Legislature in Law 17-2019. Recently, Filsinger Energy Partners, PREPA's financial advisor, and PREPA increased the

¹ Financial Oversight and Management Board. [Definitive Restructuring Agreement](#). May 3, 2019.

estimated rate for FY 2024 to 27 cents/kWh, 35% more than the legislative goal. The Legislature should not approve an unnecessary debt deal with an unaffordable price for Puerto Rico's consumers and small businesses.

- **THE COST OF LEGACY DEBT WILL PREVENT ECONOMIC GROWTH.** The proposed Transition Charge rate increase to pay for legacy debt will grow rapidly, much faster than the slow-growing Puerto Rico economy. Will that growth be used to pay past debts rather than to invest in jobs, businesses and a healthy government? That is the choice being made by the Legislature if it approves this deal. The RSA will impede Puerto Rico's plans to invest in Puerto Rico and rebuild the grid. The Legislature should not approve another economically unsustainable debt deal.
- **THE DEAL WILL INCREASE PUERTO RICO'S BORROWING COSTS.** The RSA creates problems for PREPA and the Commonwealth for decades. PREPA and its advisors have not released any analysis that shows this deal can be rated by credit rating agencies using current rules, let alone that it will receive an investment grade rating. PREPA and its advisors are being negligent about the fragile economic state of the Commonwealth, reckless about its ability to pay back money and borderline fraudulent in their presentation of PREPA's current fiscal condition. The Legislature should not pass a bill supporting a debt deal that may not achieve an investment grade rating, which would increase Puerto Rico's borrowing costs, and represents another attempt to mislead the bond market.
- **THE DEAL UNNECESSARILY PAYS ILLEGAL DEBTS.** Some of PREPA's debt may have been illegally issued. Recently, the Financial Oversight and Management Board (FOMB) stated that PREPA was insolvent in 2011. Two debt issuances occurred after 2011, suggesting a substantial likelihood that the market was misled. A recent lawsuit brought by two bond insurers challenges the legality of an additional \$3.7 billion in PREPA debt issued between 2002 and 2007. It would be irresponsible for the Legislature and its advisors to ask the people of Puerto Rico to pay back debt that may not be legally owed.
- **FINANCIAL DISCLOSURE IS FATALLY FLAWED.** PREPA must have a clean set of books in order to proceed. It doesn't. At this point, the Legislature's approval of the RSA supports a 47-year debt deal when several years of PREPA's financial statements are tainted, the governor who signs the bond deal is unelected and in temporary status, and there is no review by Puerto Rico's electricity regulator. In addition, due to the loss of a key senior advisor to former Governor Ricardo Rosselló, neither PREPA nor the Commonwealth have any employee with the knowledge, experience and competence to testify in favor of the transaction before the bankruptcy court. Only outside consultants who will not live with the results of this deal are the principal advocates before the bankruptcy court.
- **THERE IS A MORE WORKABLE APPROACH.** A reworking of the proposed debt deal can help ratepayers and bondholders. The plan contains four principles: 1) PREPA's rate payers do not bear the full burden of the past debt repayment; 2) Bondholders are compensated fairly; 3) Those who made bad investments or were negligent when advising PREPA should pay a reasonable share of costs; 4) On-island residents with small bond holdings should be fully compensated. They are the people who have been harmed most by this bond fraud.
- **PERMANENT CHANGE TO CLEAN UP PREPA:** The imposition of an independent inspector general (IPSIG) will assist PREPA under any plan going forward. The inspector general would work with the governor and PREPA officials to put the agency back on track and to offer a sustained attack on corruption. PREPA's practices of political hiring, unqualified board and management, unscrupulous contracting, poor budgeting, weak performance, unreliable financial disclosures and hostility to oversight must come to an end. Unlike past, ineffective oversight by the Financial Oversight and Management Board for Puerto Rico (FOMB), Commonwealth Comptroller, Puerto Rico Energy Bureau (PERB), Legislature,

bankruptcy court and governor, the IPSIG would be empowered through the courts to use the findings of these entities to enforce change through management techniques, and if that fails, to move forward with specific, prosecutable cases to law enforcement.

The damage to Puerto Rico from PREPA's failure to supply one of life's basic necessities is an incalculable human tragedy. The damage to Puerto Rico's economy and the global markets has resulted from a series of unconscionable actions of historic dimensions carried out by the largely self-policing guardians of the bond market. And, with this RSA, all the worst aspects of this sordid history are being repeated.

PREPA or its successor cannot rebuild if ratepayers must also support a substantial debt load from the past. Puerto Rico's people and its economy cannot afford the RSA. The Legislature would be approving a substantial long-term rate increase, an unnecessary drain on Puerto Rico's economy, a demand on the public to pay debt that they may not owe and to enter into a deal with vague and complicated terms that can only hinder economic growth and recreate the worst practices that brought the Commonwealth to its current state of financial ruin.

In August of this year, we prepared a report that outlines in detail the problems with the RSA.² This letter updates the information, condenses some parts of the report and adds more material related to alternatives to the bond deal and greater oversight.

II. ELECTRIC POWER RATES WILL BE UNAFFORDABLY HIGH

Rates are already projected to rise under the RSA and we anticipate they will be even higher than projected. The Legislature should not approve this unnecessary debt deal that imposes undue financial burdens on Puerto Rico's consumers and small businesses.

The Transition Charge to support the debt raises rates by at least 13%. Several additional costs identified in the RSA ensure that the rate increase will be even higher. In the weeks following the announcement of the debt deal, then-Governor Rosselló and PREPA Executive Director José Ortiz argued that the cost of the deal would be offset by savings from converting the electrical system to natural gas, resulting in ultimately lower rates. These statements have been inconsistent, lacking in credibility and incompatible with PREPA's published Fiscal Plan.

The initial increase of 2.768 cents/kWh represents a 13.2% increase over the current rate of 21 cents/kWh (fiscal year to date August 2019).³ IEEFA estimates the rate will be at least 23.77 cents/kWh, almost 20% higher than the rate of 20 cents/kWh contained in Law 17-2019. The Legislature passed that law to establish the rate deemed necessary to provide affordable power so the Island economy can recover.

The FOMB and PREPA estimate that, with the Transition Charge in place, rates will increase to 25.6 cents/kWh by FY 2024, with a risk of exceeding 30 cents/kWh if federal funding does not materialize as planned and if PREPA is unable to improve the efficiency of its power generating plants.⁴ Recently Filsinger, PREPA's financial advisors, in order to provide sufficient revenue to pay for the Transition Charge adjusted the PREPA and FOMB rate increase higher for FY 2024 to 27.1

² IEEFA. [Puerto Rico Electric Power Authority Debt Restructuring: A Weak Deal Plagued by Scandal](#). August 2019.

³ PREPA. [PREPA August Monthly Report 2019](#). August 2019, p. 28. The initial rate estimate takes the most recent published rate of 21 cents/kWh and adds the initial rate increase from the RSA of 2.768 cents/kWh.

⁴ PREPA. [2019 Fiscal Plan for the Puerto Rico Electric Power Authority](#). June 27, 2019. p. 62 and p. 66

cents/kWh, which is 35% higher than the legislative goal.⁵

After careful analysis of the deal we have identified several other provisions that are likely to drive prices higher. Namely: additional administrative fees to service the debt, ongoing finance costs, more payments to bond insurers, various unspecified payments and rising subsidy levels. In all, we see the initial Transition Charge driving the overall rate well above 24 cents/kWh.

III. THE COST OF LEGACY DEBT WILL PREVENT ECONOMIC GROWTH

The proposed Transition Charge will grow more rapidly than Puerto Rico’s economy. This will impede Puerto Rico’s plans to expand its economy. The Legislature should not approve another economically unsustainable debt deal.

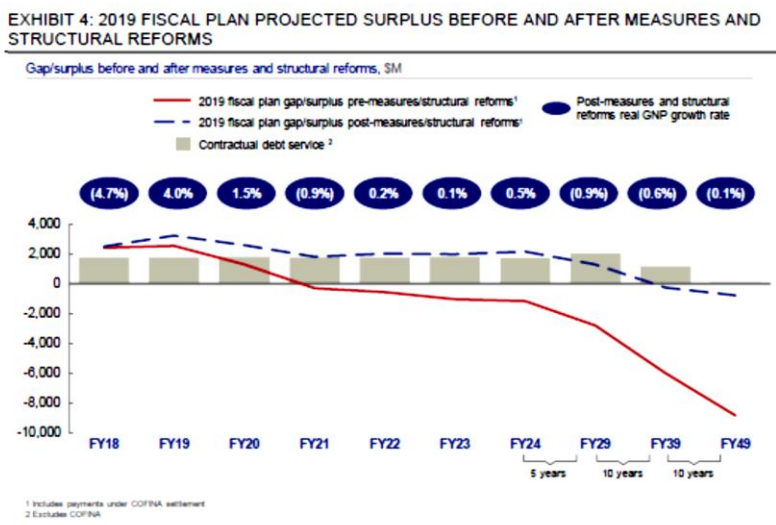
The Transition Charge to pay off the legacy debt, which increases over time, is to be imposed on an economy and a population that are projected to continue declining.

Puerto Rico’s certified Commonwealth Fiscal Plan projects a 32% loss in population by FY 2049 relative to FY 2018, a lower projected population than in last year’s certified fiscal plan.⁶ Population loss translates into lower electricity sales, deterioration in revenues and pressure to raise rates on the remaining customer base.

Alongside the decline in population, the certified Commonwealth Fiscal Plan also projects overall economic decline after a brief period of federal stimulus lasting through FY 2023.

Even if Puerto Rico is able to successfully implement proposed savings and revenue initiatives, the economy will continue to experience flat to declining GDP from FY 2029 to the end of the forecast period.⁷

Figure 1: Projected Fiscal Plan Budget Gaps and GNP Growth Rate



Source: *2019 Fiscal Plan for Puerto Rico*, p. 14, May 9, 2019.

⁵ Filsinger Energy Partners. [PREPA Revenue Allocation Review](#), June 30, 2019. p.8.

⁶ Financial Oversight and Management Board for Puerto Rico. [2019 Fiscal Plan for Puerto Rico](#). May 9, 2019. p. 25.

⁷ Ibid.

Weak economic growth will hinder the ability of the Commonwealth to maintain revenues at a sufficiently robust level to cover expenses, including debt service. Even with the implementation of planned measures and structural reforms, the Fiscal Plan projects annual Commonwealth budget deficits starting in FY 2038, assuming no payment of any Commonwealth legacy debt except for COFINA. The inclusion of other Commonwealth legacy debt service obligations shows fiscal deficits starting in FY 2027.⁸

In testimony supporting the PREPA debt deal, a witness for PREPA and the Puerto Rico Fiscal Agency and Financial Advisory Authority (AAFAF, its Spanish acronym) stated that one of the key economic goals of the debt deal was that “any recovery by PREPA’s creditors had to be secondary to the Commonwealth’s overall economic recovery, for which the recovery of PREPA plays an important role. That meant any agreed repayment of legacy debt could not outpace revitalization of the island’s overall economy, and in particular the ability of PREPA’s customers to pay any increased rates or additional charges required to service restructured PREPA debt.”⁹ This is a worthy goal that recognizes that it is not in the interest even of the creditors to impose an onerous debt deal that would impede the island’s ability to generate the revenues needed to pay the debt.

However, this goal is not achieved by the debt deal. The Transition Charge in fact increases at a faster rate than the projected growth of Puerto Rico’s economy. During the first full year of the Transition Charge, FY 2021, electricity rates will rise by approximately 13% as a result of the Transition Charge. Yet Puerto Rico’s GDP is expected under optimistic projections to *decline* by 0.9% in the same year. The Commonwealth economic assumption shows growth of 4.0% and 1.5% in FY 2019 and 2020 due to an infusion of federal money. (See Figure 1, above). Once that money works its way through the economy, GDP is expected to go flat or negative through the next thirty-four years, even assuming the successful implementation of the revenue and savings initiatives proposed in the Plan. During this period the Transition Charge continues to rise to 4.55 cents/kWh.

The difficulties of establishing a sustainable debt repayment regime under conditions of declining growth and revenues were expressed in a June 2015 monograph by three leading economists summarizing the macroeconomic challenge facing the Commonwealth:

“Few countries have been able to establish debt sustainability with low growth, which limits revenues and raises debt ratios. In Puerto Rico, growth has not just been low but output has actually been contracting for almost a decade now, which is remarkable for an economy suffering neither civil strife nor overt financial crisis.”¹⁰

In July 2017, the FOMB rejected PREPA’s earlier proposed debt restructuring transaction. The Board stated, “Affordable and reliable electricity is central to Puerto Rico’s economic turnaround, without which customers will seek alternative measures to satisfy their needs resulting in

⁸ Ibid., p. 25-26.

⁹ Declaration of David Brownstein in support of the Joint Motion of Puerto Rico Electric Power Authority and AAFAF pursuant to bankruptcy code sections 362, 502, 922, and 928, and bankruptcy rules 3012(A)(1) and 9019 for order approving settlements embodied in the [Restructuring Support Agreement, ECF No. 7819, Case No. 17 BK 4780-LTS](#) in the United States District Court for the District of Puerto Rico, July 2, 2019, paragraph 25.

¹⁰ Anne O. Kruger, Ranjit Teja and Andrew Wolfe. [Puerto Rico: A Way Forward](#), June 29, 2015, p.3. (At p. 1286 of FOMB, [Memo: Labor Reform as a Catalyst for Growth](#), May 2018). Andrew Wolfe, an economist, is currently under contract with the FOMB.

increased pressure to increase the rates to the remaining customer base, thereby inhibiting growth and long-term viability.”¹¹

These criticisms are just as valid for the current PREPA debt deal. The RSA is economically unsustainable.

IV. THE DEAL WILL INCREASE PUERTO RICO’S BORROWING COSTS

The protections provided to bondholders are weak. The Commonwealth and its advisors have not released any analysis that shows this deal can be rated by credit rating agencies using current methodologies. The Legislature should not pass a bill supporting a debt deal that may not achieve an investment-grade rating.

The testimony provided to the Title III court in support of the debt deal is silent on whether the new bonds will be ratable by a credit agency, whether any rating will be investment-grade and what, if any, parts of a credit analysis of the transaction might require additional changes to the debt deal. This is significant because the failure of the bonds to achieve an investment-grade rating would be a further credit negative to PREPA or its successor, impairing its ability to raise capital in the future. This is important because PREPA or its successor will need to borrow to upgrade the grid and its power generating plants.

The bond deal is structured so that the new bonds issued to pay off the legacy debt are issued by a separate corporation, a special purpose vehicle. The new bonds are underwritten by the Transition Charge. The purpose of this structure is to separate the repayment of the bonds from the rest of PREPA’s finances, and to secure the debt with a steady, reliable, dedicated revenue stream. A dedicated revenue stream should improve the creditworthiness of the transaction, and the special purpose vehicle should be expected to have a higher bond rating than PREPA.¹² A dedicated revenue stream should result in a lower interest rate on the debt.

The PREPA debt deal, however, introduces a significant new twist. In this case, the debt deal is structured in such a way that the per/kWh Transition Charge cannot be increased even if electricity demand falls to levels where the Transition Charge revenues are insufficient to cover principal and interest payments. According to the agreement, this is not considered a default, but rather would simply mean that principal and interest payments would accrue into the future. In the case of Puerto Rico, the risk of demand declining further than originally predicted—through outmigration from the island or from customers moving off the grid—is high. The RSA structure is designed to insulate Puerto Rico electricity customers from some of the risk of declining electricity demand, but it also creates an unprecedented financial structure for which there are no clear rating agency guidelines.¹³ This makes it likely that the special purpose vehicle will either be un-ratable by credit rating agencies, or will receive a lower rating than most other utility debt securitization vehicles.

¹¹ Financial Oversight and Management Board for Puerto Rico. [Oversight Board Does Not Approve PREPA’s RSA](#). June 27, 2017.

¹² A successful example of this kind of structure is the Long Island Power Authority, whose securitized legacy debt is held by a special purpose vehicle, the Utility Debt Securitization Authority. LIPA is rated A- by Standard & Poor’s (See: S&P Global. [Ratings Direct Long Island Power Authority, New York; Retail Electric](#). October 8, 2018.), while the UDSA is rated AAA (See: Utility Debt Securitization Authority. [Basic Financial Statements and Required Supplementary Information](#). December 31, 2017 and 2018, p. 7).

¹³ Moody’s, for example, has a specific methodology to assess utility-related special purpose vehicles. The methodology emphasizes the importance of a true-up mechanism to raise rates if necessary to ensure that payments to creditors are made. (See: Moody’s Investor Service. [\(\\$\)](#) [Moody’s Global Approach to Rating Securities](#)

The RSA creates the very real potential for significant levels of delinquent principal and interest payments to accrue on the books of the securitization vehicle, which will also be reported on PREPA or its successors books. This is not likely to engender market confidence in PREPA or its successor, in the special purpose vehicle, or any third party contractor. Non-payment of principal and interest payments by the special purpose vehicle would likely raise interest rates or collateral requirements for PREPA or its successor. This is not a debt solution, but a recipe for constant complications and high fees for the lawyers, financial advisors and accountants involved.

The Legislature is being asked to approve a settlement where the terms of the settlement create real questions about the ratability of the bond. Further information is required regarding a bond rating and perhaps even an opinion of bond counsel¹⁴ attesting to the legality of this bond transaction. The Legislature should be fully informed whether or not its approval is facilitating a bond transaction that meets investment grade standards. As noted above, a failure of the transaction to achieve an investment-grade rating will have a negative impact on PREPA's ability to raise capital for future investment.

V. THE DEAL UNNECESSARILY PAYS ILLEGAL DEBTS

Some of PREPA's debt may have been illegally issued. Recently the FOMB stated that PREPA was insolvent in 2011. Two debt issuances occurred after 2011, suggesting a substantial likelihood that the market was misled. A recent lawsuit brought by two bond insurers challenges the legality of an additional \$3.7 billion in PREPA debt issued between 2002 and 2007. It would be irresponsible for the Legislature and its advisors to ask the people of Puerto Rico to pay back debt that may not be legally owed.

The FOMB and AAFAF (on behalf of PREPA) have negotiated this bond deal without any attempt to investigate or take action on the legality of the debt that is being restructured. This, despite the fact that multiple entities, including the FOMB itself, have called into question the legality of some of the past debt issuances and the conduct of various parties that participated in those issuances.

According to a recent court filing by the FOMB in a PREPA-related matter, PREPA was insolvent in 2011.¹⁵ PREPA originated two bond issuances totaling \$1.3 billion in 2012 and 2013.¹⁶ Yet the FOMB has made no attempt to argue that those bond issuances, which represented to the capital markets that PREPA was a credit-worthy entity and which represent a substantial fraction of PREPA's \$8.26 billion in outstanding legacy debt, were illegal.

The FOMB and the government of Puerto Rico also failed to take heed of the Puerto Rico Commission for the Comprehensive Audit of the Public Credit's review of PREPA's 2013 debt issuance.¹⁷ (The Commission was subsequently disbanded by ex-Governor Rosselló and its

[by Utility Cost Recovery Charges, PBSF 404798](#), June 22, 2015, section 3.8 Structural Features. Per the quote, "The key structural feature of UCRC transactions is the true-up mechanism.")

¹⁴ For example, an opinion of counsel might address questions of potential breach of tax-exempt rules when a bond transaction is entered into by either or both debtor and creditor based upon the high likelihood that the repayment of principal and interest will not occur.

¹⁵ [Adversary Complaint to Avoid Fraudulent Transfer by the Puerto Rico Electric Power Authority](#), ECF No. 1416, Case No. 17 BK 4780-LTS in the U.S. District Court for the District of Puerto Rico. June 30, 2019, paragraph 6.

¹⁶ Official Statement, [PREPA Power Revenue Bonds Series 2013A](#). August 15, 2013, issued in the amount of \$673.1 million; Official Statement, [PREPA Power Revenue Bonds Series 2012A and 2012B](#), April 12, 2012, issued in the amount of \$650 million.

¹⁷ Puerto Rico Commission for the Comprehensive Audit of the Public Credit. [Pre-audit Survey Report on PREPA Power Revenue Bonds Series 2013A](#).

termination was supported by the Legislature).¹⁸ The Commission's review faulted PREPA's team of consultants for a failure to conduct thorough diligence on the transaction. It offers specific criticisms of PREPA's auditor (Ernst & Young),¹⁹ counsel,²⁰ financial advisors,²¹ and consulting engineer.²² The review noted that PREPA's FY 2012 financial statement, covering the period through June 30, 2012, did not contain a going concern warning despite PREPA's deteriorating financial condition.²³

Recently, two bond insurers sued nine financial advisory firms in the Court of First Instance in San Juan, alleging that the firms provided misleading information to the market when they underwrote the issuance of various Puerto Rican bonds, including eight issuances of PREPA bonds between 2002 and 2007.²⁴ The PREPA bonds in question total \$3.7 billion.²⁵ One of the defendants in the suit is Citi Global Markets, an underwriter of six of the eight PREPA bond issuances named in the complaint. Citi is now the chief financial advisor to the Financial Oversight and Management Board for the restructuring and privatization of PREPA.²⁶ Citi's interest in advising the FOMB to support the current debt deal is clear; Citi would have an obvious conflict of interest if it advised the FOMB to investigate the legality of some of the underlying debt issuances.

No attempt has been made by the FOMB or the government of Puerto Rico to challenge either the legality of the PREPA debt issuances or the conduct of the consultants who participated in those issuances, even though either course of action could result in an alternative source of repayment for bondholders. Instead, the Legislature is being asked to approve a debt deal that the public must pay for even though the debt may not have been validly incurred.

VI. FINANCIAL DISCLOSURE IS FATALY FLAWED.

The Legislature is being asked to approve a 47-year debt deal when PREPA's financial statements are tainted, the governor who signs it is unelected and in temporary status, and there is no review by Puerto Rico's electricity regulator.

PREPA remains plagued by persistent flaws in its financial disclosures. These flaws, after more than three years of Board oversight, suggest the need for more thoroughgoing reforms. Oversight measures have failed to produce change in PREPA's financial reporting. Accurate financial reporting

¹⁸ Caribbean News. [Puerto Rico government repeals commission to audit debt](#). April 19, 2017.

¹⁹ Puerto Rico Commission for the Comprehensive Audit of the Public Credit. [Pre-audit Survey Report on PREPA Power Revenue Bonds Series 2013A](#). p. 33.

²⁰ *Ibid.*, p. 29.

²¹ *Ibid.*, p. 31.

²² *Ibid.*, p. 28.

²³ *Ibid.*, p. 33.

²⁴ [Complaint](#), National Public Finance Guarantee Corporation and MBIA Insurance Corporation v. UBS Financial Services Inc., UBS Securities LLC, Citigroup Global Markets Inc., Goldman Sachs & Co LLC, JP Morgan Securities LLC, Morgan Stanley & Co, Merrill Lynch, Pierce, Fenner & Smith Inc., RBC Capital Markets LLC and Santander Securities LLC, San Juan Court of First Instance, August 8, 2019.

²⁵ Official Statement, [PREPA Power Revenue Refunding Bonds, Series VV](#), May 30, 2007 (\$557.41 million); Official Statement, [PREPA Power Revenue Refunding Bonds, Series UU](#), April 19, 2007 (\$1,300 million); Official Statement, [PREPA Power Revenue Bonds, Series RR and Series SS](#), April 4, 2005 (totaling \$993.45 million); Official Statement, [PREPA Power Revenue Refunding Bonds, Series OO](#), August 26, 2004 (\$136.1 million); Official Statement, [PREPA Power Revenue Bonds, Series NN](#), August 19, 2003 (\$517.3 million); Official Statement, [PREPA Power Revenue Refunding Bonds, Series MM](#), October 3, 2002 (\$105.1 million); Official Statement, [PREPA Power Revenue Bonds, Series LL](#), July 2, 2002 (\$98.1 million).

²⁶ Caribbean Business News. [Citigroup appointed by Puerto Rico fiscal board to lead power utility restructuring](#). February 13, 2018.

is the only tool available to the Legislature and other stakeholders to determine whether or not PREPA's operational and financial condition has improved.

A. Budget and cash flow documents are not reliable.

Most recently Filsinger Partners prepared the Revenue Allocation Overview 2019 and 2020.²⁷ The purpose of the document was to determine if there was sufficient financial headroom under PREPA's current financial condition to afford the RSA. Filsinger is under contract with PREPA to assist it with the RSA. The document illustrates the challenge facing PREPA and the Legislature.

First, PREPA's financial advisor questioned the quality of the budget and causes of underspending. PREPA's own financial advisor is unable to attest to the reliability of PREPA's financial reporting system.²⁸ The financial presentation was prepared by Scott Davis, Director Filsinger Energy Partners, a senior corporate official.²⁹ His document contains certain important observations: 1) PREPA's cash and budget documents may be "misleading" with regard to expenditures;³⁰ 2) recent "underspending" of PREPA's budget is not readily explainable by the cash flow reports and monthly reports provided by PREPA.³¹

Second, despite the flaws in the fundamental presentation of PREPA financials, Filsinger concludes that there is a cash surplus of \$101 million³² likely at the end of June 2019. The projection assumes substantial underspending on maintenance and capital expenditures of approximately \$150 million. Filsinger's cash flow surpluses for 2020 and 2021 assume the same levels of underspending. The failure of PREPA to make regular maintenance and capital expenditures is one of the principal reasons why the system has been allowed to deteriorate.

B. BDO's indictment and past practices at PREPA mean its annual financial statements are tainted.

The recent indictment of PREPA's auditor and the announcement of an investigation by the FOMB only intensify the questions of whether this proposed bond transaction can proceed. Section 206 of the PROMESA³³ statute states that, prior to issuing a debt restructuring certification, the FOMB must determine that: "the entity has adopted procedures necessary to deliver timely audited financial statements, and public draft financial statements and other information sufficient from any interested person to make an informed decision with respect to a possible restructuring."

The investigation into the auditor and presumably into the release of FY 2016 audit and recently released FY 2017 audit³⁴ as prepared by BDO needs to consider the following questions:

²⁷ Filsinger Energy Partners. [PREPA Revenue Allocation Review](#). June 30, 2019.

²⁸ Filsinger Energy Partners. [PREPA Revenue Allocation Review](#). June 30, 2019, [p. 8-9](#).

²⁹ PREPA. [PREPA Agreement with Filsinger](#), July 16, 2019.

³⁰ Filsinger Energy Partners. [PREPA Revenue Allocation Review](#). June 30, 2019. p. 4. "cash expenditures may not reflect current accrued liabilities." The disclosure on page 4 points to a \$357 million rise in accounts payable from the start of the fiscal year July 1, 2018 through April 2019.

³¹ Filsinger Energy Partners. [PREPA Revenue Allocation Review](#). June 30, 2019. p. 8.

³² *Ibid.*, p. 4.

³³ [S.2328 - PROMESA](#).

³⁴ PREPA. [FY 2017 Annual Audited Financial Statement](#). June 28, 2019.

1. Why do the FY 2016 and FY 2017 audits exclude the results of the internal control audit,³⁵ which had been integrated into PREPA's reporting up to the time of BDO's engagement. The internal control audit attests to the reliability of the financial statement and the potential for fraud. Did PREPA and the FOMB deliberately exclude this audit from BDO's scope of work? Did the audit occur and were the results withheld? Were Ernst & Young's prior internal control reports defective?
2. Did FOMB accept the FY 2016 and FY 2017 audits without the internal control audit and ask no questions?
3. The FY 2016 audit contains prior year adjustments characterized as misstatements of approximately \$2.3 billion.³⁶ The audit does not attest to the years covered by these misstatements or if the restatement is comprehensive. As noted by the earlier Audit Commission report, the prior auditor, Ernst & Young, may have been negligent as far back as the FY 2012 financial statement.
4. The FY 2016 restatement contains what appears to be a \$909 million write-off of revenue owed PREPA by its customers, presumably including the Commonwealth and municipalities. How was it determined that this money was improperly accounted for and how much electricity was actually provided by PREPA to public agencies that was not paid for by those agencies? Did the Board of Directors of PREPA agree that they would no longer pursue this revenue? The FY 2016 audit seems to imply this is a recurring issue.

On August 7, 2019 in the wake of the indictment, the FOMB released a request for proposals for financial services to review the work performed by BDO.³⁷ The list of accounting contracts with BDO to be covered under this investigation included seven professional services and consultant agreements between PREPA and BDO worth more than \$2.7 million.

BDO's work for PREPA requires this additional vetting because the indictment raises questions as to whether the company or its employees were engaged in inappropriate or illegal activities regarding PREPA and other Commonwealth agencies.

What remains, however, in addition to any findings that are exculpatory or raise further questions, is the fact that the FY 2016 and FY 2017 audits have no certification that BDO conducted a basic internal control review.³⁸ The internal control test helps the auditor and end users of audits determine the likelihood of fraud in the organization. The failure of the financial statement to include this report without explanation from PREPA, the auditor and the FOMB, is a significant red flag.

The Puerto Rico Legislature is being asked to proceed with the drafting and passage of a statute that enables PREPA to move forward with the RSA. In the current operating environment, the Legislature is being asked to act despite the fact that: 1) PREPA's annual financial statements going back during an undetermined period are likely to have contained material misstatements of several

³⁵ PREPA's website contains audited financial statements from FY 2008 to FY 2017. All of them except the BDO audits for FY 2016 and FY 2017 contain either an attestation or a separate letter on the findings of the internal control audit. For an example see [Audited Financial Statement for FY 2015](#), pp. 148-149.

³⁶ PREPA. [Audited Financial Statement for FY 2016](#), p. 29.

³⁷ FOMB. [BDO RFP Investigation](#). August 7, 2019.

³⁸ Public Company Accounting Oversight Board. [AS 2201: An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements](#). June 12, 2007.

billion dollars; 2) some of the audits where these misstatements were disclosed were prepared by BDO, itself currently under investigation; 3) BDO's two fully prepared and published audits for FY 2016 and 2017 are under investigation. There is reason to believe that PREPA's financial statements for several years are unreliable and, therefore, cannot provide the basis for moving forward with the RSA.

C. Governance: The current governor should not be allowed to approve the RSA. Her tenure is short and her decisions may be overturned by the next election.

The Legislature, if it drafts and passes a bill based upon the current RSA, will allow the transaction to proceed with an unelected, temporary governor signing off on the legislation and perhaps the transaction. This transaction will have an impact for at least 47 years. Given the history and controversy surrounding this debt deal, the Legislature will be communicating to the capital markets that the bill it passes has the full support of the Puerto Rico government. This is not accurate.

In January 2021, a new governor will take office and be responsible for implementing a series of rate increases and terms and conditions of the debt deal that will constrain the ability of PREPA to borrow for future projects. It remains to be seen whether a new governor, with a new mandate from the public during a time of controversy, will actually be committed to this deal as it is proposed.

Governor Vazquez's signature on the legislation and the transaction may be legal, but it may not prove to be binding.

On July 24, 2019, Governor Rosselló announced his resignation effective August 2, 2019. He was succeeded by Wanda Vázquez Garced to fill out the term of office. A new election for the governor will be held in November 2020.

Governor Rosselló left office after several weeks of large public demonstrations in opposition to his administration. Demonstrators criticized the governor for scandalous handling of the Commonwealth's finances and governance, particularly in the wake of the 2017 hurricanes. A cornerstone of Governor Rosselló's tenure was his attempts to improve PREPA through a series of organizational changes that would privatize the agency.³⁹ One important component to the privatization plan is to pass a debt restructuring plan that would meet the needs of the Commonwealth's creditors. The RSA is the agreement that purportedly achieves this goal.

When Governor Rosselló first took office, he was presented with a prior Restructuring Agreement that was prepared by PREPA with the assistance of AlixPartners. The Legislature had passed the Transformation Act⁴⁰ in the 2016 legislative session. The Puerto Rico Energy Commission approved the AlixPartners RSA on June 21, 2016. Once Governor Rosselló took office, January 2, 2017, his Administration continued negotiations regarding the AlixPartners RSA with the creditors. On June 28, 2016, the FOMB voted to reject the plan because it was unaffordable. The Board, with the governor's approval, agreed to move the case into the bankruptcy courts.

When Moody's Investor Service, a bond rating agency, assesses this type of transaction it pays careful attention to whether the legislation sufficiently protects the deal from future legislative or

³⁹ Bond Buyer. [Governor Rosselló Plans to Privatize PREPA](#). June 20, 2018.

⁴⁰ S.B. 1523. [PREPA Transformation Act 2016](#). February 16, 2016.

other intrusions by the political process. The risk of a future governor or legislature taking action to impair the rights of the creditors is taken into consideration.⁴¹

The Legislature and current governor cannot provide a meaningful promise not to impair the agreement given that there will be an election and a new governor in place by the end of 2020 and that this issue of PREPA's debt arrangement is likely to be an electoral campaign issue.

D. Governance: A new debt deal should be fully reviewed and approved by the Puerto Rico Energy Bureau.

The Transition Charge proposed under the RSA results in a rate increase for PREPA's customers. The RSA, as structured, does not provide for the Puerto Rico Energy Bureau (PREB), Puerto Rico's rate-setting agency, to conduct proper hearings and review in order to determine the reasonableness of any rate increase. In fact, the RSA does not make provision for a full prudence review by the Puerto Rico Energy Bureau.⁴²

The prior securitization deal designed by AlixPartners and approved by the Legislature provided only a perfunctory review by Puerto Rico's energy regulator. The review consisted largely of a mathematical determination to approve what amounted to the arithmetic accuracy of the plan. In that case, Puerto Rico's regulator objected to the limited role it played in the assessment of the debt deal.⁴³

The review by Puerto Rico's regulator did raise several red flags related to the selection of financial and other advisors, fees paid to them, and the ability of PREPA to execute various aspects of the debt deal. The Final Order by the Commission also found the need to establish further reviews.

As the Legislature moves forward with this RSA, the Energy Bureau needs to be provided with authority to do the following:

1. Audit the legacy debt. As new debt issuances need to be approved by the PREB regarding reasonableness and alignment with the public interest, the legacy debt deal should be reviewed for the same issues.
2. Based on that audit of legacy debt, indicate to the courts which part of the debt is prudent and reasonable and which part is imprudent, unreasonable and/or illegal.
3. Determine, and inform the court, which part of the reasonable debt should be allocated to the ratepayers, and which part should be allocated to other stakeholders such as underwriters, consultants, legal advisors, etc.
4. Determine how much of the debt service should be allocated to be paid by the PREPA ratepayers.

The lack of a full prudence review allowed the prior flawed RSA proposal to move forward to the FOMB. The FOMB ultimately rejected that proposal because it was financially infeasible and did not

⁴¹ Moody's Investor Service. (\$) [Moody's Global Approach to Rating Securities by Utility Cost Recovery Charges](#), PBSF 404798, Section 3.1 Protection Against Future Impairment. June 22, 2015, p. 3.

⁴² The Demand Protection Sheet of the RSA, PREB Role accords the PREB a role in the regulation of the RSA only after the Securitized Bonds are issued (p. 1-A-8). The Conditions Precedent of the Annex A Term Sheet does not require a full prudence review and order from the PREB as a condition precedent to the bond issuance, p. 13-14.

⁴³ Puerto Rico Energy Commission. [Final Order](#). June 21, 2016.

address the fundamental operational reforms needed at the agency.⁴⁴ By granting the Energy Bureau the authority to review the prudence of the current transaction and its full impact on rates, the Legislature and the market⁴⁵ will have confidence that the rate-setting has been subjected to professional review.

VII. THERE IS A WORKABLE APPROACH.

A reworking of the proposed debt deal can help ratepayers and bondholders.

PREPA or its successor cannot rebuild if ratepayers must also support a substantial debt load from the past. Puerto Rico's people and its economy cannot afford the RSA. The Legislature would be approving a substantial long-term rate increase, an unnecessary drain on Puerto Rico's economy, a demand on the public to pay debt that it may not owe, and a deal with vague and complicated terms that can only hinder economic growth.

There is a different approach that can both pay back creditors a reasonable amount and not overburden Puerto Rico's rate payers with prohibitively expensive long-term legacy debt. This would allow PREPA to use forward-looking investment from both the bond market and the federal government to rebuild the electricity system and to be in a position to pay for it out of future rates.

How to Rework the Debt Deal

The outstanding principal of PREPA's debt is \$8.26 billion. This amount is carried on the FY 2017 financial statement and is generally agreed upon by the parties in the Title III litigation.

IEEFA provides below a series of reasons why the debt covered in the RSA should not be repaid in full by electricity consumers through the rate dollar and identifies other sources of payment on the debt. Since any actual outcomes that would flow from these facts will be negotiated, it is difficult to say now exactly how much each stakeholder should pay. Further, there are overlapping amounts of debt involved in these discussions.

A careful review of these issues makes clear three things:

- Ratepayers do not have to bear the burden of this debt alone.
- Bondholders do not have to absorb all losses, but have recourse beyond the ratepayer.
- There is also ample money available to ensure that small bond holders who are Island residents can be compensated for their bonds. They stand as the principal victims of the fraud that has been committed.

1. At least \$5 billion may be illegal debt.

PREPA and its rate payers may not actually owe \$8.26 billion. We have noted above that fully \$5 billion has been identified by insurers and FOMB as questionable indebtedness. Insurance companies have made a claim of \$3.7 billion and FOMB stated that when PREPA issued another \$1.7 billion in debt it was insolvent. These matters, until fully litigated, raise questions as to the validity

⁴⁴ PROMESA Board. [Privatize Puerto Rico's Power](#), in *The Wall Street Journal*, June 29, 2017. This is an Op-Ed from the Board on its disapproval of the PREPA debt deal.

⁴⁵ See Moody's for discussion on the necessity of a formal rate order as part of the bond rating for an issuance using this securitization structure. (https://www.moody.com/research/Moodys-Updates-its-Utility-Recovery-Charges-Methodology--PR_328414)

of the creditors' claims that the debt is owed by PREPA's ratepayers. Settlements in these cases may result in damage settlements that result in third parties having to pay the cost of the illegally issued debt. Why is the Legislature going to assume that Puerto Rico's people should pay for debt that they may not owe?

The Legislature should also consider more fully the Kobre and Kim study that spends more than 100 pages of a 600-page report raising issues with the validity of Puerto Rico's debt. It is clear that a more detailed review of Puerto Rico's debt, including PREPA's, would yield actionable claims.

Those advisors who provide information to the Legislature that the \$8.26 billion in outstanding principal of PREPA debt is actually owed by the ratepayers are once again negligent in their diligence responsibilities.

2. Bondholders should accept a principal reduction between 70 percent and 90 percent of debt paid by PREPA ratepayers.

Any new debt arrangement should be consistent with Puerto Rico's ability to pay. As noted above, even after Puerto Rico institutes years of financial reforms, its economy will remain in flat or negative growth and its fiscal condition will be out of balance. Any promise by the Legislature to pay back 60 percent or 70 percent of the face value of PREPA's outstanding indebtedness is reckless.⁴⁶

Bondholders took a risk on Puerto Rico and the risk did not pan out. The substantial losses need to be accepted. Bondholders who accept less from PREPA and the Commonwealth need to preserve their rights to move against other stakeholders in the process. Clearly bondholders have been harmed by illegally issued debt, negligent due diligence and political corruption. To hold ratepayers responsible for decades of institutional negligence is legally questionable, unfair and, in the end, impractical.

As noted in a prior 2014 report by IEEFA, bondholders that held PREPA debt had an estimated \$7 trillion in assets.⁴⁷ For its large bondholders, Puerto Rico's debt constituted a negligible percentage of their overall holdings. These investment houses, including the hedge funds that bought Puerto Rico's distressed debt, were appropriately hedged against losses incurred. The bondholders who were hurt the most were small bondholders who were on-island residents relying on the income for basic needs.

The Legislature should not accept significant levels of debt placed on ratepayers. If necessary, it should set by statute that bondholders are to be accorded no more than 10% of the face value of existing bonds. The Legislature should also, to the degree possible (see below), provide support for bondholder remedies against those who were negligent in the issuance of the debt.

3. Bond insurers should pay the full amount of claims.

The bond insurers Assured Guaranty, National Public Finance and Syncora were paid premiums by PREPA to insure the payment of principal and interest payments in case of default. As per their policies, they should make good on the payments to bondholders for the remaining principal and interest. Instead, the RSA provides significant benefits to the insurers and absolves them of their

⁴⁶ For discussion of the criteria for recklessness in the issuance of public bonds see: Securities and Exchange Commission. [Orange County](#). January 24, 1996.

⁴⁷ IEEFA. [Opportunity for a New Direction in Puerto Rico's Electric System](#). August 2015.

responsibility to pay claims on the debt.⁴⁸ As also noted, some insurers have brought suit against underwriters who allegedly provided insurers with inaccurate or misleading information that they used when writing PREPA's policies.

This litigation can offset the obligations by the insurance companies to pay claims associated with PREPA's debt and keep creditors whole for that debt which is covered by the insurers.

The issuers of RSA and other debt deals involving the Commonwealth will seek insurance in the future, and as such many of the insurers can regain losses through future premium payments. Insurance companies and bondholders undermine their own ability to participate in Puerto Rico's economic growth by insisting on unsustainable levels of repayment for legacy debt.

The Legislature should not include in the RSA or allow any part of the insured debt to be repaid as part of the Transition Charge. To do otherwise is tantamount to paying for the insurance coverage twice—once through premiums already paid and now again through a refinancing of the debt that takes insurers off the hook for future principal and interest payments.

4. Underwriters should bear a considerable part of the burden.

PREPA and its ratepayers have paid hundreds of millions of dollars to attorneys, accountants, financial advisors, investment banks, credit agencies, insurance companies, engineers and a host of consultants to ensure that its debt issuances were in compliance with applicable laws and regulations. AlixPartners was paid a reported \$40 million for financial services to PREPA and the deal it designed was disapproved by the FOMB. Filsinger puts PREPA's Title III expenses at \$57 million in FY 2019.⁴⁹

The review by the Commission for the Comprehensive Audit of the Public Credit and the study performed by Kobre & Kim⁵⁰ for the FOMB each contained examples of negligent, if not reckless and perhaps fraudulent diligence performed by these experts. Both Kobre & Kim⁵¹ and the Audit Commission make clear that there are probable courses of action against these companies, many of them currently are still under contract and supplying advice to PREPA and other Commonwealth agencies.

Since the amount of debt involved in PREPA and Puerto Rico is substantial, it has a broad impact on the market for bonds and the integrity of the markets' self-policing mechanisms.⁵² The bond market is relatively unregulated, despite its enormous size.⁵³ Therefore, every stakeholder in the bond market bears responsibility for the collective integrity of the whole.

The underwriting community broadly understood is at risk of losing integrity and contracts due to the negligence displayed in Puerto Rico. The Commonwealth might consider a review of all of its financial advisors and consider contract cancellations, fee clawbacks and disbarments. Federal support can also be useful if the Treasury and Justice Departments also consider reviews of the

⁴⁸ Bloomberg. [Bond Insurers Soar After Puerto Rico Strikes Debt Deal](#). August 9, 2018.

⁴⁹ Filsinger Energy Partners. [PREPA Revenue Allocation Review](#). June 30, 2019. p. 4.

⁵⁰ Kobre & Kim LLP. [Final Investigative Report to The Financial Oversight & Management Board of Puerto Rico](#). August 20, 2018.

⁵¹ IEEFA. [IEEFA update: Accountability for the banks, law firms, accountants and credit agencies that orchestrated Puerto Rico's \\$72 billion debt crisis](#). September 4, 2018. This update analyzes the Kobre & Kim report.

⁵² MSRB. [Self-Regulation and the Municipal Securities Markets](#). January 2018.

⁵³ U.S. Securities and Exchange Commission, [Speech by SEC Commissioner: Regulation of the Municipal Securities Market: Investors Are Not Second-Class Citizens](#), October 28, 2009. Speech by Elisse B. Walter, SEC Commissioner.

contracts of those doing business with the federal government who are also in Puerto Rico. The federal government will ultimately absorb a lot of the losses directly and indirectly in Puerto Rico. It has an interest in ensuring that contractors doing business with the federal government are acting responsibly. States and cities with significant participation in the bond market would also do well to review companies under contract to determine if they are dealing with companies that enabled the deterioration of Puerto Rico's finances.⁵⁴

If the Legislature ignores the potential for substantial cash payments⁵⁵ by these advisers as a resource to help settle PREPA's debt, it too will be guilty of a level of negligence that is hard to understand. The underwriters should be compelled to form a pool for PREPA's debt of between \$3 billion and \$5 billion in cash payments to settle claims related to their negligence.

5. Criminal prosecution must be considered.

A series of grave offenses have been committed against the people of Puerto Rico and against those who invested in PREPA. One of the most unfortunate outcomes from constant political interference with effective oversight of the agency is that no responsibility has ever been assigned for the instances of fraud that have been perpetrated.

Puerto Rico cannot pay back its debt, but any future claim to integrity by the Commonwealth and PREPA must demonstrate a willingness to take strong action against those who broke the law. Governor Rosselló eliminated the Audit Commission and the Legislature went along with it. This was a mistake. Audits and reviews on Whitefish, the oil scandal, excessive political hiring and flagrant negligence on debt practices have all been conducted, but reports have gone unissued or, despite serious findings of poor administration, there has been no follow-up enforcement.

The recent indictment of BDO is a step in the right direction. Equally important will be the outcomes of the FOMB's review of BDO's performance throughout the Commonwealth. If this aspect of accountability goes unattended, Puerto Rico's legislative action and any claims about forthcoming payments to bondholders will not be credible.

6. Re-pay small, on island bondholders 100% of principal on their bonds.

It has been reported that many small bondholders who live in Puerto Rico on limited incomes have invested in PREPA and Commonwealth bonds.⁵⁶ As noted throughout this letter, large institutional bondholders are the principal bondholders⁵⁷ and they have many remedies to secure their interests that do not require increased ratepayer costs.

Also, as noted above, the amount of insurance coverage, investor losses and cash payments from underwriters involved should exceed the \$8.26 billion of outstanding bonds. An ample amount can

⁵⁴ See for example, New York State vendor integrity rules that offer a series of questions that every contractor is expected to answer regarding their past performance. Most of the vendors identified in the Audit Commission and in the Kobre & Kim report would have difficulty completing this integrity check without explanation. New York State Grants Management, [Vendor Integrity Questionnaire](#). See also: New York Office of General Services, [Vendor Responsibility](#), May 1999.

⁵⁵ See Jefferson County case: Securities and Exchange Commission. [JP Morgan Settlement](#), November 2009. For a more detailed journalistic treatment of the problem see: Business Insider, [Story of Jefferson County Bankruptcy](#), October 2011.

⁵⁶ CNBC. [Broken bonds: The role Wall Street played in wiping out Puerto Ricans' savings](#). December 18, 2017

⁵⁷ Center for the Abolition of Illegitimate Debt. [Who Owns Puerto Rico's Debt, Exactly? We've Tracked Down 10 of the Biggest Vulture Firms](#). December 3, 2018.

be set aside to assess how big the liability is for smaller investors and how the benefits should be distributed. Any bill drafted by the Legislature on PREPA's debt should make provision for reimbursing these bondholders.

Island resident bondholders were encouraged to invest in Puerto Rico on false pretenses. It is a mainstay of the bond market that individuals do not stand a chance against large institutional investors.⁵⁸ Small investors are largely inexperienced in bonds and most do not have other savings and resources that can hedge their losses like large institutional funds.

Puerto Rico's Legislature must extend protection to this group of investors who are without recourse.

VIII. PERMANENT CHANGE TO CLEAN UP PREPA

Whatever is decided on the debt deal, PREPA needs ongoing effective oversight. It needs the imposition of an Independent Private Sector Inspector General.

Since 2016, IEEFA has been calling for the installation of an Independent Private Sector Inspector General (IPSIG) to act as an independent corruption monitor within PREPA. The IPSIG would work with the governor and agency heads; it would not replace the legitimate leadership of Puerto Rico. An IPSIG would be empowered to investigate PREPA's operations, implement reforms to eliminate wasteful and/or illegal activity, and report violations of law to enforcement authorities. While IEEFA has proposed this model for PREPA, an IPSIG could also be implemented to reform any of Puerto Rico's other mismanaged agencies vulnerable to corruption.

What is an IPSIG?

An IPSIG can be defined as an "independent, private sector firm (as opposed to a governmental agency) that possesses legal, auditing, investigative, and loss prevention skills, that is employed by an organization (i) to ensure that organization's compliance with relevant laws and regulations, and (ii) to deter, prevent, uncover, and report unethical and illegal conduct committed by the organization itself, occurring within the organization, or committed against the organization."⁵⁹ In other words, an IPSIG can be "individuals or entities [charged] with legal, auditing, investigative, and other [powers] [...] to help monitor the activity of specified City vendors [a/k/a Contractors]."⁶⁰

An IPSIG is not a typical receiver. This inspector general focuses on evaluating and recommending the implementation of reliable mechanisms to identify deviations from the law and regulations that create risks that affect an organization and acts aggressively to identify and correct problems of waste, fraud and abuse that prevent the organization from fulfilling its mission.

The primary roles of an IPSIG are **to monitor, audit and investigate** the activities of the organization in order to detect unethical conduct, violations to the laws, regulations or collective bargaining agreements and to report them to law enforcement authorities or other entities with jurisdiction. Also, to design and implement programs to prevent illegal, unethical and wasteful

⁵⁸ Annette Thau, [The Bond Book 3rd Edition](#), McGraw Hill Education, 2010, p. 8.

⁵⁹ International Association of Independent Private Sector Inspector Generals (IAIPSIG). Remarks of Hon. Margaret J. Finerty before the Federal Bar Council, [Monitorships, IPSIGs and Independent Investigations: The Increasing Privatization of the Investigation and Prosecution Functions in Corporate Oversight](#), October 19, 2005.

⁶⁰ Center for the Advancement of Public Integrity, The Integrity Monitor Program, [The Role of the Private Sector in City Contract Oversight](#), Issue No. 9, September 2016, page 1.

behavior, and to monitor the implementation of these programs.”⁶¹ Consistent with this, the IPSIG must respect the existing collective bargaining agreements in accordance with the constitutional rights to collective bargaining and to carry out the legitimate concerted activities of the exclusive representatives of the workers of PREPA. In addition, the IPSIG will respect the independence and decision-making power of the Employee Retirement System of PREPA.

An IPSIG team is typically comprised of individuals with skills in investigations, auditing and prosecution. An IPSIG team appointed to oversee PREPA would also possess expertise in the operations of a public utility. An organization can either hire an IPSIG voluntarily or an IPSIG can be imposed upon an organization externally, for example by a court order.

Where the culture of the organization is primarily legitimate or amenable to reform, the IPSIG may, in addition to the prevention and control of illegal or unethical conduct, be a major participant with management in enhancing the economy, efficiency and effectiveness of the organization.

The purpose of installing an IPSIG at PREPA would be to move the agency away from its current state of organizational dysfunction and to an organizational culture that embraces the practice of professional and ethical standards as first principles, at all levels. The simple idea is that “good ethics is good business.”

The IPSIG would be authorized by the federal bankruptcy court, working in an innovative way with the Financial Oversight and Management Board and the governor. As the authorizing entity, the bankruptcy court would appoint a company or team to act as the IPSIG. The bankruptcy court would be the final decision-maker in the selection of the IPSIG team. The team would report to the court and should also report to the Puerto Rico Energy Bureau on a regular basis.

The overriding objective of this proposal is to put PREPA on an internal track toward sound management that can support efforts to modernize the electrical system and secure the confidence of the market and public. The IPSIG would not have authority to usurp the management responsibilities of the currently existing board and management. If working cooperation develops between the IPSIG team, PREPA staff and management, and Puerto Rico’s political leaders, the IPSIG would be a source of important organizational and managerial improvements.⁶² On the contrary, if cooperation with PREPA’s board and management is not workable, the IPSIG’s recommendations would have the force of a direct order, but only enforceable through a petition to the bankruptcy court. Also, in the event that PREPA’s board and management are resistant to the IPSIG’s investigations and proposed reforms, the IPSIG would ultimately have leverage to report perceived misconduct by PREPA for potential federal law enforcement.

The basis of an IPSIG plan of action is usually a compilation of findings and recommendations from existing oversight reports and stakeholder input. Thus, those who have been the biggest critics of the agency become participants in the solution. The IPSIG team would utilize regular access to PREPA’s stakeholders, including business partners, labor organizations, individual employees and interested outside organizations, as valuable sources of information. At the end of its tenure, the

⁶¹ IAIPSIG. [Monitorships, IPSIGs and Independent Investigations: The Increasing Privatization of the Investigation and Prosecution Functions in Corporate Oversight](#), October 19, 2005. See also: [Report of the Civil Prosecution Committee of the New York State Bar Association Commercial and Federal Litigation Section 1994 The Independent Private Sector Inspector General](#). December 22, 1994.

⁶² International Association of Independent Private Sector Inspector Generals. [Monitorships, IPSIGs and Independent Investigations: The Increasing Privatization of the Investigation and Prosecution Functions in Corporate Oversight](#). October 19, 2005.

IPSIG would produce a final report including a long list of specific recommendations for administrative, financial and operational changes at PREPA.

Given the proposed reporting structure, the IPSIG will act as a force multiplier for the Bankruptcy Court, the United States Attorney for Puerto Rico, and the Financial Oversight and Management Board. We envision a multi-disciplinary IPSIG team (legal, audit, investigation, and loss prevention) with an ongoing presence at PREPA, from the boardroom to the work site. The IPSIG will be working with PREPA management and reporting to the United States Attorney for Puerto Rico and the Finance Oversight and Management Board regularly, with additional periodic reporting to the Court. The IPSIG will be positioned to provide real-time intelligence on the organization at every level.

The Institute for Energy Economics and Financial Analysis and its experts are available to discuss any of these issues with you in greater detail at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "Tom Sanzillo". The signature is written in a cursive, flowing style.

Tom Sanzillo
Director of Finance
Institute for Energy Economics and Financial Analysis