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Puerto Rico Electric Power Authority Debt Restructuring: A Weak Deal Plagued by Scandal

Executive Summary

The Puerto Rican legislature will soon be asked to approve a debt restructuring agreement for the Puerto Rico Electric Power Authority (PREPA). As detailed in this report, the deal is unaffordable and will jeopardize the financial and physical recovery of the island's electrical system and economy.

The proposed restructuring agreement fails in five critical areas:

- The Transition Charge to support the debt raises utility rates by at least 13%. Several additional costs identified in the bond documents ensure that by the time the deal closes the rate increase will be higher.
- The proposed Transition Charge will grow more rapidly than Puerto Rico's economic growth. This will impede Puerto Rico's plans to expand its economy.
- The Transition Charge places pressure on PREPA's Fiscal Plan and budget that exacerbates budgetary imbalance.
- Puerto Rico's economy is weak and the security protections for investors shaky. The Commonwealth and its advisors have not released any analysis that shows this deal can be rated by credit rating agencies using current methodologies. Comparing PREPA's proposed deal to a successful securitization agreement, such as the one set up by the Long Island Power Authority,[1] exposes serious weaknesses in PREPA's plan.
- Some of PREPA's debt may have been illegally obtained. Recently, the Puerto Rico Financial Oversight and Management Board (FOMB) stated that PREPA was insolvent in 2011. Two debt issuances occurred after 2011, suggesting a 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.[2]

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[1] IEEFA. IEEFA Puerto Rico: What does LIPA's $7 billion bond deal tell us about PREPA's $8 billion deal?.Tom Sanzillo. Cathy Kunkel. May 20, 2019.
[2] 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.

Additionally, the debt restructuring agreement cannot be divorced from the ongoing corruption scandals that have created unprecedented political upheaval in Puerto Rico this summer. On July 10, 2019, the U.S. Attorney announced the arrest of the managing partner of BDO Puerto Rico,[3] the auditing firm that produced PREPA's FY 2016 and FY 2017 audited financial statements. BDO was contracted by PREPA: to prepare monthly financial reports, analyze its budgeting and accounts system, draft budget and accounting reports, and other tasks. These accounting tasks are critical to the accurate presentation of PREPA's financial position, which underlies the debt restructuring. The legislature is now being asked to make a judgement on a debt deal whose underlying financial representations are tainted by potential fraud. We also note the particularly troubling implications of the BDO arrest combined with the lack of an internal control certification accompanying its FY 2016 audit. The FY 2016 audit should be redone and several of its findings, particularly related to multi-billion dollar financial restatements, probed further.[4]

The FOMB announced in August that it will be investigating the auditing, accounting and other services performed by BDO for Puerto Rican government entities since 2016 to determine whether BDO's activities were impaired by fraud.[5]

The terms of the agreement are not in the best interest of the people of Puerto Rico.

The testimony presented by the Puerto Rico Fiscal Agency and Financial Advisory Authority (AAFAF) to the bankruptcy court in support of the debt restructuring now also lacks credibility. Puerto Rico's former Chief Financial Officer Christian Sobrino testified to the court about his key role in negotiating the debt deal on behalf of PREPA in his position as executive director of AAFAF. Sobrino was fired from that position in July 2019 as a result of the chat scandal.[6] Sobrino's testimony argued that PREPA is on track with reforms to its operations and that its contracting process has sufficient oversight.[7] Both of these claims are dubious in light of the apparently systemic corruption of the administration of former Governor Ricardo Rosselló.

In addition to these significant red flags surrounding the negotiation of the deal, we find that the terms of the agreement are not in the best interest of the people of Puerto Rico, the future financial stability of the electrical system, or future investors in the system.

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[3] Carribean Business. Former heads of Puerto Rico Education Dept. and Health Insurance Administration arrested along with president of BDO. July 10, 2019.
[4] PREPA. Independent Auditors' Report, Audited Financial Statements, Required Supplementary Information and Supplemental Schedules for the year ended June 30, 2016. June 30, 2016, p. 29.
[5] Letter from Financial Oversight and Management Board to BDO Puerto Rico, August 7, 2019.
[6] Reuters. Top Puerto Rico officials resign in group chat scandal that ensnares governor. July 13, 2019.
[7] Declaration of Christian Sobrino Vega, ECF No. 7819, Case No. 17 BK 4780-LTS in the United States District Court for the District of Puerto Rico, July 2, 2019, paragraphs 10-11.

Table of Contents

Puerto Rico Electric Power Authority Debt Deal Will Restructure Over $8 Billion in Outstanding Debt

In May 2019, FOMB announced that a deal had been reached between AAFAF, the FOMB, a large segment of PREPA's bondholders, and bond insurer Assured Guaranty, to restructure PREPA's legacy debt. The Restructuring Support Agreement (RSA) establishes a new corporation to issue new securitized debt that bondholders can receive in exchange for existing legacy debt. The new debt will be securitized by a surcharge on PREPA's electric rates, the "Transition Charge." The Transition Charge will be imposed for 47 years, or possibly longer if the first tranche of bonds is not paid off in that time. IEEFA estimates that this structure will result in more than 70% repayment of PREPA's $8.26 billion in outstanding legacy debt.[8]

The deal makes no provision for ensuring that the electrical system is in sound operating condition before debt payments are made. Indeed, by giving bondholders a separate, superior, statutory lien on a portion of PREPA's revenue to fund the Transition Charge, the deal effectively indicates the opposite: that bondholders are the first priority for payment.

This deal is the second attempt to restructure PREPA's legacy debt in recent years. A previous deal, reached in 2016 between PREPA and its creditors, was rejected by the FOMB for imposing a Transition Charge that, just like this one, would be unaffordable and would harm the island's economic recovery.

The Deal Will Result in a Rate Increase That Starts Above 3 Cents/Kwh and Grows Over Time

The Transition Charge starts at 2.768 cents/kWh on July 1, 2020, increases to 4.552 cents/kWh by July 1, 2042 and stays at that level for the remainder of the agreement. All customers that install a grid-connected renewable energy system on their property after September 2020 will also have to pay this surcharge on the electricity generated by their own equipment.

The increase of 2.768 cents/kWh represents a 12.6% increase over the current rate of 22 cents per kWh (fiscal year to date April 2019). The result will be a rate exceeding 24 cents/kWh, more than 20% higher than the aspirational rate of 20 cents/kWh contained in Law 17-2019 passed by Puerto Rico's legislature early this year. The Legislature passed that law because it was the rate deemed necessary to provide affordable power in order for the Island's economy to recover. The FOMB

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[8] PREPA has $8.259 billion in outstanding bonds, according to 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 and tolling certain limitations periods, ECF No. 1235, Case No. 17-BK-4780-LTS in the United States District Court for the District of Puerto Rico, May 10, 2019, paragraph 9. Using electricity sales projections from PREPA's integrated resource plan, IEEFA estimates that the amount collected under this transition charge will pay off principal and interest on more than 70% of this outstanding debt.

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 forecast and if PREPA is not able to improve the efficiency of its generation fleet.[9]

However, in reality, the rate impact will likely be higher than stated in the debt deal, as a result of several hidden costs and fees that are not included in this initial estimate of the Transition Charge. IEEFA estimates these additional costs will increase the initial Transition Charge to more than 3 cents/kWh.

In reality, the rate impact will likely be higher than stated in the debt deal, as a result of several hidden costs and fees.

These charges include:

- Administrative fees to pay for the servicing of the debt[10]. While a servicer agreement is not yet available, the previous 2016 PREPA debt restructuring agreement established a servicer fee of 0.05%[11] of the initial principal of the securitized bonds; in this case that would be $3.2 million per year, or approximately 0.02 cents/kWh.

- Ongoing financing costs**.** The amount of ongoing financing costs that PREPA may fold into the final bond agreement is not specified.[12] Allowable financing costs that may be folded into the bonds and Transition Charge are to be agreed upon by the "Required Parties" (uninsured bond holders, PREPA and Assured).[13] Presumably any further guidance could be left to the Puerto Rican legislature. For PREPA's failed 2016 restructuring agreement, the hiring of advisors under no bid contracts, excessive fees and conflicts of interest were highlighted by the Puerto Rico Energy Bureau in its order approving the Transition Charge.[14]

- Additional payments to Assured Guaranty. The debt deal may include various additional payments to Assured Guaranty[15] related to: 1) a series of interest rate swaps it is engaged in related to PREPA; and 2) future bond premiums. The financing of the swap arrangement assumes an additional

[9] PREPA Fiscal Plan. June 27, 2019, p. 62 and p. 66.
[10] Financial Oversight and Management Board. Definitive Restructuring Support Agreement, Exhibit C: Recovery Plan Term Sheet. May 3, 2019, footnote 2.
[11] Commonwealth of Puerto Rico. In RE: Petition for Approval of Transition Order Filed by the PREPA Revitalization Corporation. 2014, paragraph 233.
[12] Financial Oversight and Management Board. Definitive Restructuring Support Agreement. May 3, 2019, Annex A to Recovery Plan Term Sheet, p. 2-3.
[13] Financial Oversight and Management Board. Definitive Restructuring Support Agreement. May 3, 2019, section 1(a)(lxxxiv).
[14] Commonwealth of Puerto Rico. In RE: Petition for Approval of Transition Order Filed by the PREPA Revitalization Corporation. 2014, paragraph 261.
[15] Financial Oversight and Management Board. Definitive Restructuring Support Agreement, Exhibit C: Recovery Plan Term Sheet. May 3, 2019, footnote 3.

transition or financing charge that is separate from the Transition Charge. The final settlement of this component of the rate is not contained in the agreement.

- Additional unspecified increases. The deal notes that the Transition Charges may be "adjusted from time to time if required under the Definitive Documents."[16] No specificity is provided as to what might trigger such adjustments, and many of the "Definitive Documents" have not yet been written. There is also no indication as to whether such adjustments will be subject to additional regulatory review and Financing Orders by the Puerto Rico Energy Bureau.

- Subsidies. The estimate of 2.768 cents/kWh assumes the cost of the debt deal is spread equally across all electricity customers. However, PREPA subsidizes many classes of electricity users, including government entities. The debt deal allows PREPA to subsidize the transition charge for some classes of customers and spread the cost over the remaining customer classes in order to meet the payment targets, as long as this does not increase the burden on non-subsidized customers by more than 25%.[17] There is a high risk of an increase in revenue losses from non-payment for electricity, particularly from public sector customers.

In addition, the deal directs PREPA to pay the upfront expenses incurred by the bondholders and Assured Guaranty in negotiating the debt deal, as well as the costs incurred by Puerto Rican government entities. These include the costs of bond counsel, other legal counsel, financial advisor and utility consultants.[18] Customers are responsible for paying "reasonable" fees, but there is no definition of what "reasonable" means or who makes that determination.[19] This cost will likely be in the tens of millions of dollars, if not more. Although the deal does not appear to contemplate that these costs would be included in the Transition Charge, they would still be passed through to PREPA customers in the rates.

In short while, the RSA purports to impose a charge starting at 2.768 cents/kWh and

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[16] Financial Oversight and Management Board. Definitive Restructuring Support Agreement. May 3, 2019, Annex A to Recovery Plan Term Sheet, footnote 5.

[17] This provision allows for the imposition of a Subsidy Charge that can be imposed as a separate component of the Transition Charge. The RSA states that the imposition of the Subsidy Charge shall not increase the burden of the Transition Charge by more than 25%. (Financial Oversight and Management Board, Definitive Restructuring Support Agreement, Demand Protection Term Sheet, May 3, 2019). Further PREPA's FY 2016 Audit contains a substantial restatement ($909 million) of PREPA's accounts receivable. The financial statement also expresses uncertainty about future ability to control this component of PREPA's finances due to inherent problems with the calculations related to subsidies and the financial challenges facing municipal and Commonwealth customers. (PREPA, Independent Auditors' Report, Audited Financial Statements, Required Supplementary Information and Supplemental Schedules for the year ended June 30, 2016, p. 20, 29-30).

[18] Financial Oversight and Management Board. Definitive Restructuring Support Agreement. May 3, 2019, section 22.

[19] Financial Oversight and Management Board. Definitive Restructuring Support Agreement. May 3, 2019, section 22.

increasing from there, IEEFA estimates that the charge will start at more than 3 cents/kWh, once additional costs are factored in.

The Debt Deal Is Unaffordable and Will Impede the Financial and Physical Recovery of the Electrical System

The rate increase imposed by the debt deal greatly increases the risk that PREPA will be unable to escape from its current state of financial dysfunction.

The Rate Increase Will Be Imposed on a Declining Economy

The Transition Charge (which increases over time) to pay off the legacy debt 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.[20] 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 projects overall economic decline after a brief period of federal stimulus lasting through FY 2023.

Even if Puerto Rico generates savings, GDP is expected to remain flat or decline.

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.[21]

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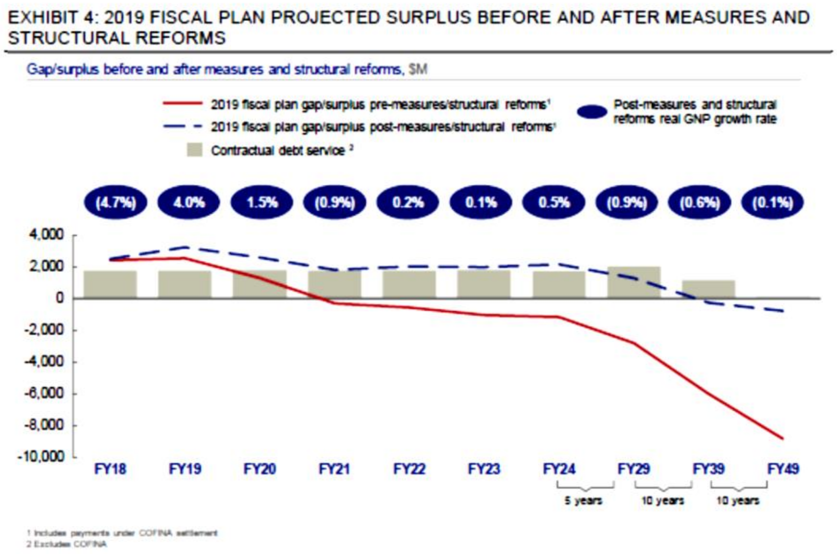
[20] Financial Oversight and Management Board for Puerto Rico. 2019 Fiscal Plan for Puerto Rico, May 9, 2019, p. 25.
[21] Ibid.

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



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

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 Puerto Rico Sales Tax Financing Corporation) debt. The inclusion of other Commonwealth legacy debt service obligations would imply fiscal deficits starting in FY 2027.[22]

In testimony supporting the PREPA debt deal, a witness for PREPA and AAFAF 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." [23] This goal 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 worthy 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

[22] Ibid., p. 25-26.
[23] 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.

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). 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 Fiscal 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."*[24]

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 increased pressure to increase the rates to the remaining customer base, thereby inhibiting growth and long-term viability."[25]

These criticisms are just as valid for the current PREPA debt deal.

The Rate Increase Will Impede PREPA's Ability to Balance Its Budget and Drive Cuts to Operational and Maintenance Expenses

PREPA's recurring revenues – the dollars it collects for services provided – are highly sensitive to macroeconomic and policy factors outside of the power authority's control. Declining population and flat to negative economic growth will continue to put downward pressure on PREPA's sales and revenues.

Declining sales would make it difficult for PREPA to achieve budget balance even without the debt deal because, like most electric utilities, a high proportion of its costs are fixed. Indeed, aside from fuel, purchased power and some maintenance

[24] 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.
[25] Financial Oversight and Management Board for Puerto Rico. Oversight Board Does Not Approve PREPA's RSA. June 27, 2017.

expenses, which together account for about half of PREPA's current expenses, the rest of its expenses are fixed. When sales decline, these expenses are shared across fewer kilowatt-hours, driving rates higher and/or causing cuts to capital investment, maintenance and labor. Rising rates provide an incentive for customers who can afford it to self-generate their own power, driving sales down still further. The debt deal, by imposing a new charge that escalates over the first twenty years of the agreement, exacerbates this dynamic.

Declining sales would make it difficult for PREPA to achieve budget balance, even without the debt deal.

IEEFA analyzed the projected impact of the debt deal on PREPA's budget. We assume the current physical and financial conditions of PREPA:

1. A system in a state of disrepair requiring an almost total replacement.
2. An economy that is very weak and a population that is poorer than that of the poorest state in the continental United States.
3. A public authority in bankruptcy with no access to capital markets.
4. No current financial statement for FY 2018, no publicly available audit for FY 2017 and a questionable audit for FY 2016 that was prepared by a firm (BDO Puerto Rico) whose managing partner was indicted for fraud related to contracting scandals in other branches of the Puerto Rican government.
5. A current generation system heavily reliant on oil, coal and natural gas.
6. An operating environment highly susceptible to hurricanes.
7. An ineffective management tainted by scandal and run by political operatives.

Table 1 shows a structural imbalance in PREPA's financing if the debt is approved and if PREPA is to achieve the goal of affordable rates below 20 cents/kWh. We assume the PREPA Fiscal Plan estimate of electricity sales for 2023 of 13.5 GWh.[26]

[26] PREPA Fiscal Plan. June 27, 2019, p. 54.

Table 1: Estimate of FY 2023 Revenue and Expenditures

Line Items	Amount
Revenues	
Electricity Demand (GWh)	13,491
Electricity Rate Revenue (at 20 cents/kwh), $M	$2,698
Expenditures ($M)	
Debt	
1. Transition Charge	$ 400
2. Financing Charge – New Needs	$ 590
Fuel/Purchase Power	$1,300
Operations	$ 870
Subsidies	$ 260
Total	$3,420

Table 1 projects an upper limit of revenue of $2.7 billion. The Fuel and Purchase power line item assumes current fuel purchase prices at volumes consistent with the projected reduction in demand by FY 2023 in the Certified Fiscal Plan. We have reduced the fuel costs by $300 million to reflect potential savings. The Operations budget is adapted from the PREPA FY 2020 budget estimate for labor and non-labor operating costs, maintenance expenses and the pension charge.[27] The subsidy amount is taken from the Fiscal Plan.[28]

The calculation for new needs to rebuild the system is derived by taking the previous Fiscal Plan estimate of $2.9 billion for new generation[29] and assuming annual debt service of $319 million for generation and 2 cents per kWh for non-generation capital expenditures (see Appendix 1).[30] By 2023, the cost of debt service is approximately $590 million for new needs. Even if new needs are funded slowly or significantly offset by infusions of federal money, the structural imbalance created by the Transition Charge remains.

As shown in Table 1, revenues from electricity sales are lower than expenses for debt, fuel, operations and subsidies. There is a $720 million gap between revenues and expenses. The elimination of the Transition Charge would substantially reduce the gap. The remaining gap requires continued diligence through a program of cost reduction and revenue discipline. At this juncture, the only certainty is that approval of the debt deal would add $400 million to a budget that is already in structural deficit.

[27] We reduce the budget by $200 million for FY 2023 to reflect the absence of fees for financial advisors that are included in the FY 2020 budget. (See: Financial Oversight and Management Board. Puerto Rico Electric Power Authority Fiscal Year 2020 certified budget. June 30, 2019.)
[28] PREPA Fiscal Plan. June 27, 2019, p. 55.
[29] PREPA. August 1, 2018 Fiscal Plan. August 1, 2018, p. 43. (Note: IEEFA calculation assumes interest at 6%.)
[30] Ibid., p. 43.

Raising the rate above 25 cents per kWh could, on paper, eliminate the deficit. But the Legislature passed the bill setting the 20 cents per kWh standard because that is what the Puerto Rican economy needs to recover. And as we note, raising the rate to 25 cents or more will likely not only undermine the economy as a whole, but also reduce PREPA's ability to modernize and increase the likelihood of its returning to bankruptcy.

Raising rates will reduce PREPA's ability to modernize and increase the likelihood of another bankruptcy.

Because the debt deal – unlike the 1974 Trust Agreement that governed PREPA's previous debt issuances – privileges repayment of legacy debt above other uses for electrical system revenue, the likely result will be a continuation of the problems that have plagued PREPA in the last decade as the economy has declined, including crowding out of capital investment, cuts to maintenance, and inability to mount a professionally sound re-staffing and reorganization of the authority.

Imposing a high legacy debt burden on the existing system, before any of the promised cost-saving initiatives have materialized, increases the likelihood that these savings will never take place. Instead, as has recurred over the past decade, there is a great likelihood that the system will be starved of capital investment as potential investors deem the risk too great; the fuel budget will continue to consume over half of the rate dollar;[31] the pension system will continue to be underfunded; customers who can afford to do so will defect from the grid, increasing costs on the less affluent customers who remain; and the axe will fall on the only budget items left over to cut, namely maintenance and the workforce.

The decision on the debt deal cannot be made in isolation from the realities of PREPA's severe financial and organizational constraints and the Commonwealth's ongoing fiscal and economic stresses. The Transition Charge will have a cascading impact that will most likely weaken the ability of the electricity system to maintain an operational budget that meets professional utility standards.

A Comparison with the Long Island Power Authority Illustrates the Economic Weakness of the PREPA Deal

The Long Island Power Authority (LIPA) has often been cited in comparison to PREPA because of the magnitude of its debt burden, which, similar to PREPA, was

[31] PREPA officials and private companies have made a number of public statements that attest to significant cost reductions for fuel switching from oil to natural gas. The estimates provided by these sources lack credibility. (See: Testimony of Tom Sanzillo before the U.S. House of Representatives Natural Resources Committee. April 9, 2019, pps. 5-6; IEEFA. New natural gas deal fits same old pattern for choosing contractors. January 22, 2019; and IEEFA. Bad gas deal hurts PREPA chance for a turnaround. March 28, 2019.)

incurred for an asset that produces no value to the current electrical system.[32]

In 1998, LIPA initiated a $7 billion series of bond issuances to pay for the cost of the Shoreham nuclear plant, a power plant that was constructed, but never used. PREPA's RSA addresses more than $8 billion in legacy indebtedness, money that was spent without producing a system in good repair.

In 2013, in order to improve the management of this debt, LIPA adopted an investment model[33] that PREPA is now substantially replicating. Part of LIPA's debt was transferred to the Utility Debt Securitization Authority (UDSA), a bankruptcy-remote special purpose entity, whose sole purpose is to issue securitized bonds and pay them off with a targeted rate surcharge.

PREPA's proposed structure and LIPA's current debt structure are similar. Further comparison, however, yields a series of differences between the two organizations and operating environments that serve as a red flag for the PREPA transaction.

A 2017 Moody's credit opinion for LIPA's restructuring bonds was based on: "(1) the strength of the State of New York's legislation and the irrevocable financing order authorizing the creation of the restructuring property; (2) the size, stability and diversity of the service area's ratepayer base; (3) the ability and experience of the servicer; and (4) the credit enhancement in the form of a mandatory uncapped true-up mechanism, a non-declining operating reserve account and a debt service reserve account."

In at least three of those areas, the contrast between PREPA and LIPA could not be more extreme.

- One of LIPA's key strengths is the economy of Long Island, encompassing two of the most affluent counties in the United States, with median household incomes greater than $90,000 per year and a growing economy. According to Moody's "the area economy is arguably one of the strongest in the country and continues to be a primary positive factor underpinning the rating."[34] LIPA's customers at the time also paid some of the highest rates in the country (19.2 cents per kWh). [35] Puerto Rico's median household income is less than $20,000 per year and its customers pay rates that are even higher. And Puerto Rico's economy is projected to be stagnant to declining over the long term.

- Secondly, LIPA has an experienced servicer. In PREPA's case, given that the securitization bonds are supposed to be issued before any privatization transaction closes, it appears likely that – at least initially – PREPA itself will take on the role of servicer. PREPA will be a weak servicer since it is in a

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[32] IEEFA. IEEFA Puerto Rico: What does LIPA's $7 billion bond deal tell us about PREPA's $8 billion deal?.Tom Sanzillo. Cathy Kunkel. May 20, 2019.
[33] Moody's Investor Service, Utility Debt Securitization Authority Restructuring Bonds, Series 2013 T and 2013 TE, December 17, 2013, PBJ SP 349420.
[34] Moody's Investor Services, Long Island Power Authority. Credit Opinion. November 21, 2017, p.2.
[35] Ibid., p.3.

state of financial and operational dysfunction and already suffers from high levels of electricity theft. Its ability to accurately enforce and collect a new debt service charge should not be taken for granted.

- And, thirdly, there is no true-up mechanism for the PREPA debt deal, meaning that there is no automatic adjustment to the transition charge if revenues are not sufficient to pay scheduled debt service. While this is an attempt to protect ratepayers from the risk of declining demand, it will be seen as credit negative.

The one weakness that Moody's cites for the LIPA debt charge serves to further emphasize the weakness of the PREPA debt deal. Moody's 2017 credit opinion characterized the LIPA debt charge as "relatively high compared to charges in other utility cost recovery bond transactions."[36] The debt charge is 9.64% of the overall rate, and this is considered "relatively high" for two of the wealthiest counties in the country. In Puerto Rico, which has a lower per capita income than any of the 50 states, the debt charge will start at 13% of the rate and escalate from there.

Finally, it is worth noting that the above comparison of the legacy debt for LIPA and PREPA does not reflect the cumulative impact of all debt service on LIPA's and PREPA's rates. LIPA's customers pay both for the legacy debt related to the Shoreham nuclear plant and ongoing operational debt used to maintain LIPA in a state of good repair. LIPA's FY 2019 budget shows total debt service of $762 million out of a total expense budget of $3.5 billion.[37] In other words, 22% of the electricity rate for LIPA customers goes towards debt service to support both legacy obligations and operational debt requirements. By contrast, as shown above in Table 1, PREPA's cumulative debt would equal 29% of FY 2023 expenditures, or 37% of each rate dollar assuming a 20 cents/kWh price of electricity.

The Debt Deal Creates Uncertainty That Could Hinder PREPA's Ability to Raise Capital for Investment in the Electrical System

The electrical system requires major capital investment, estimated at more than $12 billion in the August 2018 Fiscal Plan, with a projection of 58% coming from federal funds.[38] PREPA is planning a series of transactions that utilize both direct and indirect debt payments to support the investment in new physical plant.[39] Presumably, those investing in Puerto Rico's electrical system will seek legally

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[36] Ibid.
[37] Long Island Power Authority. Powering Long Island's Clean, Reliable, and Affordable Energy Future. 2019, section II, p.2.
[38] PREPA Fiscal Plan. August 1, 2018, p. 48.
[39] These include a concession agreement for the transmission and distribution system, in which the concessionaire may invest some of its own capital in the system, to be paid back through the concession fee. PREPA recently signed a contract for the conversion of the San Juan power plant to natural gas, under which the cost of the conversion will be paid off through an increase in the fuel cost (essentially hiding the cost of debt in the fuel cost). And PREPA is planning to enter into new contracts for power generation, in which private companies will build and operate the plants and sell power to PREPA.

binding assurances similar to those embedded in the Transition Charge, i.e. priority of repayment in case the electrical system goes bankrupt again.

However, the debt deal creates uncertainty around the priority of repayment between the legacy debt and the new debt needed for the electrical system to function. The deal requires that future indebtedness be funded by another transition charge or other dedicated revenue stream.[40] But it is unclear what would be the order of priority between payment of these new transition charges versus the legacy debt transition charge if and when the electrical system falls into financial difficulty again, which is highly probable given the burden the debt places on the system. Despite the various provisions in the RSA to maintain the integrity of the Transition Charge revenues for the sole purpose of legacy debt repayment, the risk of litigation to settle future disputes between legacy and new debt holders during a future period of financial distress is high.[41]

The debt deal creates uncertainty around the priority of repayment between the legacy debt and the new debt.

There Is a Risk That the Deal May Not Be Rated Investment-Grade by Rating Agencies

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, impairing its ability to raise capital in the future.

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

[40] Financial Oversight and Management Board. Definitive Restructuring Support Agreement. May 3, 2019, Annex A to Recovery Plan Term Sheet. (Note: Section B.3 requires additional indebtedness to be secured by another transition charge or Financing Charge that is a dedicated revenue stream to support the new debt.)
[41] The Restructuring Support Agreement seems to suggest that the legacy debt is at least partially protected if a rating agency attests that any new debt would not adversely affect the rating of the legacy bonds. We fail to see how this provision enhances protections for either the legacy bondholders or any new investor. (See: Financial Oversight and Management Board. Definitive Restructuring Support Agreement, May 3, 2019, Annex A to Recovery Plan Term Sheet, p. 12).

underwritten by the Transition Charge. The purpose of this structure is to isolate the structure for repayment of the bonds from the rest of PREPA's finances, and to secure the debt with a steady, reliable revenue stream that should allow a lower interest rate on the debt. The integrity of the revenue stream should improve the creditworthiness of the transaction, and the special purpose vehicle is expected to have a higher bond rating than PREPA.[42]

The PREPA debt deal, however, introduces a significant new twist into this relatively well-understood utility debt securitization structure. 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 on the debt. 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 in particular, the risk of demand declining further than originally predicted – through outmigration from the island or from customers moving off the grid – is not academic. This structure is designed to insulate Puerto Rico's 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.[43] 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. The potential for significant levels of delinquent principal and interest payments on the books of the securitization vehicle (which will also be reported on PREPA's books) is unlikely 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.

The legislature is being asked to approve a settlement whereby 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 counsel[44] attesting to the legality of this bond transaction. The legislature should be fully informed about whether its approval is facilitating a bond transaction that meets investment grade standards. As noted above, a failure of the

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[42] 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. RatingsDirect 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).

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

[44] 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.

transaction to achieve an investment-grade rating will have a negative impact on PREPA's ability to raise capital for future investment.

The recent indictment of PREPA's auditor and the announcement of an investigation by the FOMB only intensifies the questions of whether this proposed bond transaction can be provided an investment grade rating. Section 206 of the PROMESA[45] 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."

Did the FOMB accept the 2016 audit without asking questions?

The investigation into the auditor and presumably into the released FY 2016 audit and unreleased, but reportedly completed, FY 2017 audit needs to consider the following questions: 1) Why did the FY 2016 audit exclude the results of the auditors internal control audit[46] that has been integrated into PREPA's recent audits? The internal control audit attests to the reliability of the financial statement. Did PREPA and the FOMB deliberately exclude this audit from BDO's scope of work? Did the audit occur and the results were withheld? 2) Did FOMB accept the FY 2016 audit without the internal control audit and ask no questions? 3) 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? 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 lost revenue?

PREPA's Assertions That the Debt Deal Will Result in Lower Electricity Rates Are Not Credible

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

[45] Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), Public Law 114-187, 130 Stat. 549 (2016).
[46] PREPA's website contains audited financial statements from FY 2008 to FY 2016. All of them except the BDO audit contain either an attestation or a separate letter on the findings of the internal control audit. For an example see PREPA's FY 2015 audited Financial Statements, pp. 148-149.

ultimately lower rates. These statements have been inconsistent, lacking in credibility and incompatible with PREPA's published Fiscal Plan.

The savings claims made by the ex-Governor and PREPA, as reported in the press, have been inconsistent. In one instance, Rosselló alleged operational savings amounting to 5.4 cents/kWh by 2023.[47] This is based on estimated savings from the conversion of two units at the San Juan power plant to natural gas (savings of 1.4 cents/kWh), conversion of the Mayaguez power plant to natural gas (savings of 0.4 cents/kWh), conversion of the Palo Seco power plant to gas (savings of 2 cents/kWh), and other unspecified initiatives. Another news article reports the total savings from conversions to natural gas at 3.8 cents/kWh with 1.2 cents/kWh of that savings attributed to the construction of a new natural gas plant at Palo Seco made possible by using federal funds.[48]

The projected savings in both of these articles are implausibly high. PREPA's fuel budget for the first nine months of FY 2019 was $1.03 billion, or 8.6 cents/kWh. The implication of the Governor's statements is that PREPA can eliminate 44% of its fuel budget through savings from just three power plants, which together comprise less than 30% of the generation from the plants the authority owns.

And, in fact, PREPA's certified Fiscal Plan published in June 2019 estimates that FY 2023 rates inclusive of the debt deal will be 25 cents/kWh, or about 14% higher than current rates.[49] This estimate assumes that PREPA successfully implements improvements to the efficiency of the generation system, negotiates less expensive renewable energy contracts and receives anticipated federal funding.[50]

It is likely that rates will be higher than projected in the Fiscal Plan, given PREPA's poor track record with cost savings initiatives. Previous cost-cutting initiatives, including those developed during the 2016 RSA process[51] and in the FY 2019 Fiscal Plan, have yet to show significant savings in rates. Fiscal year-to-date rates in 2019 are 22 cents/kWh,[52] compared to FY 2016 rates of 18.63 cents/kWh.[53] Subtracting out the fuel and purchased power component of the rate (because oil prices have risen since 2016), the non-fuel and purchased power component of the

[47] The Weekly Journal. Gov. Rosselló Announces Measures to Lower Energy Rates. May 14, 2019.
[48] El Nuevo Día. El director ejecutivo de la AEE prevé que la corporación podrá mitigar alzas en la facture. May 16, 2019.
[49] PREPA. Monthly Report to the Governing Board. April 2019, p. 26.
[50] PREPA Fiscal Plan. June 27, 2019, p. 66
[51] Direct Testimony of Sonia Miranda, Antonio Perez and Virgilio Sosa on behalf of the Puerto Rico Electric Power Authority, Puerto Rico Energy Bureau Case No. CEPR-AP-2015-0001, May 27, 2016.
[52] PREPA. Monthly Report to the Governing Board. April 2019, p. 26.
[53] PREPA. Monthly Report to the Governing Board. June 2016, p. 24.

rate has increased by more than 1 cent/kWh,[54] despite the announcement of numerous savings initiatives and a more than 15% drop in employee headcount.[55]

PREPA faces significant and well-documented managerial problems that impede the successful implementation of operational savings initiatives.[56] The Authority has a history of weak performance on operational improvements, costly scandals, procurement irregularities and excessive hiring of political appointees.

Effective oversight could improve PREPA's chances of achieving savings. In the Title III case, UTIER has proposed the introduction of an Independent Private Sector Inspector General (IPSIG) into PREPA's management structure in order to add an element of ongoing oversight that has been absent.[57] Yet parties to the debt deal have opposed the implementation of an IPSIG. To assume the successful implementation of significant savings initiatives with little to no supporting documentation and in the absence of an independent monitor is not credible.

The Debt Deal Will Require the Repayment of Debt That May Have Been Issued Illegally

The FOMB and AAFAF (on behalf of PREPA) have negotiated this bond deal without any attempt to investigate the legality of the debt that is being restructured. This is 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.[58] PREPA originated two bond issuances totaling $1.3 billion in 2012 and 2013.[59] Yet the FOMB has made no attempt to verify 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 legal.

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[54] Fuel and purchased power expenses for FY 2016 were $1,893 million. Subtracting from total revenues of $3,232 million leaves $1,339 million or 7.75 cents/kWh. Fuel and purchased power expenses for FY 2019 through April are $1.7 billion. Subtracting from total revenues of $2.891 billion leaves $1,191 million or 9 cents/kWh.
[55] Headcount has fallen from 6,754 employees in FY 2016 (according to August 2, 2018 Fiscal Plan) to 5,656 in April 2019 (PREPA Monthly Report to the Governing Board, April 2019).
[56] See, for example: Expert Declaration of Sandra Ringelstetter Ennis, ECF No. 1106, Case No. 17 BK 4780-LTS in the United States District Court for the District of Puerto Rico, February 25, 2019.
[57] See: UTIER Objection to Insurers' Motion for Relief from Automatic Stay and to Pray for the Appointment of an Independent Private Sector Inspector General (IPSIG), ECF No. 1158, Case No. 17 BK 4780-LTS in the United States District Court for the District of Puerto Rico, March 29, 2019.
[58] Adversary Complaint to Avoid Fraudulent Transfer by the Puerto Rico Electric Power Authority, ECF No. 1416, Case No. 17 BK 4780-LTS in the United States District Court for the District of Puerto Rico, June 30, 2019, paragraph 6.
[59] 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.

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 pre-audit of PREPA's 2013 debt issuance. [60] (The Commission was subsequently disbanded by ex-governor Rosselló). The pre-audit 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),[61] counsel,[62] financial advisors,[63] and consulting engineer.[64] The pre-audit 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.[65]

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.[66] The PREPA bonds in question total $3.7 billion.[67] 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 FOMB for the restructuring and privatization of PREPA.[68] Citi's interest in advising the oversight board 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 is based upon debt levels that may not have been validly incurred.

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[60] Puerto Rico Commission for the Comprehensive Audit of the Public Credit. Pre-audit Survey Report on PREPA Power Revenue Bonds Series 2013A.
[61] Ibid., p. 33.
[62] Ibid., p. 29.
[63] Ibid., p. 31.
[64] Ibid., p. 28.
[65] Ibid., p. 33.
[66] 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.
[67] 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).
[68] Caribbean Business News, Citigroup appointed by Puerto Rico fiscal board to lead power utility restructuring. February 13, 2018.

Conclusion and Recommendations

The PREPA debt deal should be rejected as fundamentally financially unsound. The deal imposes an increase in electric rates over the next 47 years, even as Puerto Rico's population and economy are projected to continue declining. The result will be to exacerbate the same dysfunction that has driven the electrical system into physical and financial ruin during the last decade of economic decline on the island: by prioritizing the repayment of legacy debt, the electrical system will be starved of funds for operational needs and greater financial risk will be imposed on those who seek to make new investments in the electrical system.

Counter to claims made by PREPA and ex-governor Rosselló, the increase imposed by the debt deal will not be offset by other operational savings to achieve an overall lower rate. For the legislature to approve this deal would require abandoning the 20 cents/kWh rate affordability target passed earlier this year in Law 17-2019, as well as abandoning any commitment to restoring the electrical system to financial stability.

The PREPA debt deal should be rejected as fundamentally financially unsound.

There are three immediate recommendations that flow from this analysis.

1. The current debt deal should be rejected by the Puerto Rican Legislature. The debt burden imposed by the agreement will hinder PREPA and the Commonwealth's ability to provide affordable rates and to manage its re-emergence into the debt market in a credible way.

2. PREPA and the Commonwealth would be well served by the reinstatement of the Commission for the Comprehensive Audit of the Public Credit. After several years of negotiations among creditors and the Commonwealth regarding PREPA's debt, there remains no resolution to the issue of whether this debt was legally incurred and, if it was, whether the diligence conducted by the Commonwealth, PREPA and its advisors violated any laws. The initial audit by the Commission pointed to critical defects in the diligence process. The Kobre & Kim report commissioned by the FOMB more generally continued these observations for the Commonwealth as a whole and has resulted in litigation testing the validity of certain debt issued by the Commonwealth. Recent statements made by the FOMB imply that PREPA bond issuances may have been made when PREPA was actually insolvent. And another $3.7 billion of PREPA debt has just been challenged in court by bond insurers.

3. Whether the debt deal goes forward or not, whether PREPA is able to privatize or not, whether the FOMB remains, is reformed or eliminated, the Commonwealth would be well served by the creation of an Independent Private Sector Inspector General to assist PREPA and the Commonwealth

manage any reforms they undertake going forward. The IPSIG would provide day-to-day monitoring of PREPA's operations with a goal of eliminating waste, fraud, and abuse, and reporting violations of law to appropriate authorities. The climate of corruption requires a steady ongoing presence to reassure the Puerto Rican people, the markets and PREPA's federal partners that its money is being used well and its decisions are being made with the public interest as the sole criteria.

Appendix I: PREPA's Flawed Fiscal Plan and FY 2020 Budget

PREPA's 2019 Fiscal Plan approved on June 27, 2019 and its Fiscal Year 2020 Budget approved on June 30, 2019[69] represent a significant and ominous step backward for the FOMB and for fiscal discipline at PREPA.

First, the 2019 Fiscal Plan eliminates any transparency regarding PREPA or its successor's future debt and debt service assumptions related to capital investments needed to rebuild the grid. The 2019 Fiscal Plan subsumes and obscures new generation costs into new purchased power arrangements. The costs for purchased power identified in the Fiscal Plan appear to include operations, fuel and capital costs.[70] Ratepayers will therefore be paying for debt service, but it will be obscured. In the past, PREPA misused debt proceeds, inflated revenue projections and masked the deteriorating quality of the grid, but the amount of debt was nevertheless reported on its annual Financial Statement. This new accounting treatment will obscure future debt and debt service payments and impair rate considerations, debt issuances and other financial processes the authority or its successors require to regain financial credibility.

The discussion of purchased power expenses in the Fiscal Plan does not make explicit reference to capital costs, but appears to subsume them into fuel costs.[71] This lack of transparency creates the climate for a repeat of out-of-control capital spending.

Second, the debt service discussion in the Fiscal Plan focuses exclusively on PREPA's legacy debt and the pending debt restructuring agreement.[72] The Fiscal Plan assumes there are no other debt considerations for PREPA going forward. This irresponsible disclosure distorts the full impact of the cumulative debt load that the electricity system will need to carry as a result of the high recovery rates provided in the RSA and the new debt requirements to rebuild the grid.

The FY 2020 budget[73] now appears to include this distortion as part of FOMB's certification. The Budget contains separate lines for fuel ($1.1 billion) and purchased power ($671 million). The New Fortress Energy contract[74] recently approved by PREPA is slated to go into service in FY 2020. This contract requires PREPA to pay for fuel deliveries of natural gas and, as part of the fuel payment, to repay the cost of upgrading the San Juan 5 and 6 plants. Combining debt service and fuel expenditures in this way means that neither the fuel costs of PREPA nor the debt service costs are accurately portrayed in its budget, Fiscal Plan and perhaps

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[69] Financial Oversight and Management Board. Puerto Rico Electric Power Authority Fiscal Year 2020 certified budget. June 30, 2019.
[70] PREPA Fiscal Plan. June 27, 2019, p. 62 and 69.
[71] Ibid., p. 70.
[72] Ibid., p. 102-110.
[73] Financial Oversight and Management Board. Puerto Rico Electric Power Authority Fiscal Year 2020 certified budget. June 30, 2019.
[74] IEEFA. IEEFA Puerto Rico: Bad gas deal hurts PREPA chances for a turnaround. March 28, 2019.

future Financial Statements. Recent scandals and legal actions related to both the fuel and debt suggest that greater transparency is needed for the future health and recovery of Puerto Rico's economy.

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