

**Testimony of  
Tom Sanzillo, Director of Finance  
Institute for Energy Economics and Financial Analysis (IEEFA.org)  
before the U.S. House Committee on Natural Resources  
on the topic of *Puerto Rico's Transmission and Distribution Agreement*  
Submitted August 4, 2020**

**Introductory statement**

Chairman Raúl Grijalva and members of the Committee, thank you for the invitation to testify. I am the director of finance for the Institute for Energy Economics and Financial Analysis (IEEFA). I testified before the Committee last year on plans for the privatization of the Puerto Rico Electric Power Authority (PREPA).<sup>1</sup>

Prior to my current position with IEEFA, I served in the New York State Comptroller's Office (1994-2006) in several executive-level roles including as First Deputy Comptroller. During that time, the Long Island Power Authority ("LIPA") initiated a series of debt and management changes similar to those involving PREPA. The Comptroller's Office exercised various oversight functions over LIPA. One audit performed by the office reviewed a relationship LIPA had with Keyspan, its privatized system operator.<sup>2</sup> LIPA's administrative staff performance was weak and Keyspan's corporate resources were strong. As a result, LIPA's ratepayers were exposed to additional costs due to LIPA's inability to manage the contract in a professional and efficient manner. Currently, PREPA and the Puerto Rico Public-Private Partnerships Authority ("P3") as

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<sup>1</sup> Sanzillo Testimony. [Testimony of Tom Sanzillo Before the House of Representatives Natural Resources Committee](#). April 9, 2019.

<sup>2</sup> New York State Comptroller. [Long Island Power Authority's Implementation of the New York State Governmental Accountability, Audit and Control Act. Report 2000-S-37](#). August 22, 2001.

the contract administrators for the recently approved LUMA Energy Services (LUMA) are in a weak position to manage the highly complex privatization of PREPA's organization and assets. Before I start, I wish to thank you and your staff for your persistence and patience in the matter of the rebuilding of Puerto Rico.

I submit testimony now on the subject of the LUMA operating agreement with the P3 Authority and PREPA to run Puerto Rico's electricity grid. The scope of the work requires LUMA to manage the transmission and distribution (T&D) and customer service systems, as well as the day-to-day operations of the Authority—its planning, contracting, rate-setting strategies, dispatch activities, power procurement and responsibility to oversight agencies. Far from simply managing the repair, and upgrades to the transmission and distribution system, LUMA will take over the majority of the operational functions of PREPA. Indeed, the only responsibility that appears to remain with PREPA is the payment of the retiree pension obligation.

Exhibit 11 of PREPA's fiscal plan outlines the scope of work of this initiative:<sup>3</sup>

- Operation and maintenance of the T&D assets and system, streetlights and meters
- Control center operations, generation scheduling, and economic system dispatch
- Power procurement, integration of renewable generation and distributed energy resources
- End-customer metering, billing, collections service support, new service interconnection
- Outage management, restoration, coordination of emergency planning and storm recovery

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<sup>3</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority, Exhibit 11: Energy Sector Transformation, Role of GridCo](#). (LUMA). June 29, 2020, p.29

- Regulatory and environmental compliance
- Delivery of grid capital expenditures and deployment of federal funding across system

This agreement suffers from the same flaws that have plagued the Authority for years. Left unattended, this contract is likely to reproduce operational and financial dysfunction.

First, households and businesses need affordable and stable rates in Puerto Rico. Act 17-2019 establishes a 20 cents per kWh electricity rate as the goal that should be achieved by PREPA's transformation.<sup>4</sup> PREPA's recent fiscal plan shows this to be an operationally achievable goal.<sup>5</sup> This agreement grants LUMA powerful rate-making responsibilities but has no accountability measures to achieve a stable, low-rate environment.

Second, Puerto Rico has established a goal of 100% renewable energy by 2050. LUMA's contract has no provisions that establish consequences if that goal is missed. In fact, the contract directs LUMA to support overbuilding natural gas capacity and underfunding renewable energy initiatives by following PREPA's current integrated resource plan (IRP).

Third, PREPA and the Financial Oversight Management Board (FOMB) have decided in this agreement to disregard collective bargaining agreements at PREPA. This will ultimately be settled in the courts, but as a management action, it is singularly shortsighted for the electricity grid. The FOMB bears a particular responsibility here, as this contract represents an open,

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<sup>4</sup> Puerto Rico Law. [Act 17-2019, Statement of Motives](#).

<sup>5</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority](#), p. 10.

hostile act by the board against organized labor. After four years, one would expect the board to have learned that participation in local political conflict is not constructive.

Mr. Chairman, I am limiting my testimony to these three points today but commend to you and the members issues raised in the hearing and in public communication that this contract was improperly let. My office will explore these issues and others related to: A lack of internal accountability in the contract to ratepayers; the questionable nature of the performance metrics identified in the contract; the lack of any consequences if LUMA fails to meet its goals; the inability of PREPA to fulfill its commitments under this contract; and certain inherent conflicts of interest built into the contract structure.

#### **A. Rate Affordability**

The Puerto Rico Legislature passed Act 17-2019 that set 20 cents per kWh as the rate affordability goal of PREPA's transformation process.<sup>6</sup> The Legislature reached this view after an extensive review of Puerto Rico's economic, fiscal and energy condition, and after a survey of the energy laws that govern the Commonwealth. Included in that review was Act 120-2018,<sup>7</sup> the law that forms the statutory basis for the LUMA Energy contract.<sup>8</sup>

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<sup>6</sup> Puerto Rico Law. [Act 17-2019](#). April 11, 2019.

<sup>7</sup> Puerto Rico Law. [Act 120-2018](#). June 21, 2018.

<sup>8</sup> PREPA and P3 Authority. [Puerto Rico Transmission and Distribution System Operation and Maintenance Agreement, Whereas provisions](#). June 22, 2020.

The 20 cents per kWh goal is reflected in PREPA's current FY 2020 Fiscal Plan as operationally achievable under certain circumstances, most notably a heavy reliance on renewable energy and no debt service.<sup>9</sup>

This financial goal reflects several enduring realities of the economy of Puerto Rico.

- The economy is currently in a negative growth phase and is likely to remain so for the foreseeable future.<sup>10</sup>
- Higher rates will mean less electricity consumption by Puerto Rico households.<sup>11</sup>  
Families with no or severely limited access to electricity face life-threatening conditions.<sup>12</sup>
- Higher rates will mean that Puerto Rico's businesses will be faced with an uncompetitive cost structure that impedes the recovery of the Commonwealth's economy.<sup>13</sup>
- Higher rates and the concomitant decline in consumption are disruptive to PREPA's current business model.
- A rate structure that purports to retire PREPA's legacy debt is unrealistic.<sup>14</sup>

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<sup>9</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority](#). June 29, 2020, p. 10

<sup>10</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority](#). June 29, 2020, p. 49.

<sup>11</sup> London Economics International. [Critique of Government Parties' Assertions that the 9019 Settlement Will Not Affect Non-settling Creditors and Will Avoid a Subsequent Title III Filing by PREPA](#). October 30, 2019

<sup>12</sup> Hector Cordero Guzman. [The Socio-Economic Impacts of the Puerto Rico Electric Power Authority \(PREPA\) Restructuring Support Agreement \(RSA\) on the Population of Puerto Rico](#). June 25, 2019.

<sup>13</sup> ICSE. [Testimonies in Opposition to Rate Increases, Puerto Rico Energy Commission, Docket # 2015-0001](#). October 2017.

<sup>14</sup> London Economics International. [Critique of Government Parties' Assertions that the 9019 Settlement Will Not Affect Non-settling Creditors and Will Avoid a Subsequent Title III Filing by PREPA](#). October 30, 2019.

## The LUMA Energy Agreement and Puerto Rico's Rate Structure

The agreement sets no particular operational goals for the rates charged by the new system and no specific savings targets. It is unclear how LUMA Energy's contract requirements are aligned with the current financial plan and rate structure.

The contract gives LUMA Energy broad authority to seek rate increases, and the expectation is that it will seek a rate increase soon.<sup>15</sup> The contract also assumes that LUMA Energy will participate in the collection of a transition charge that is ultimately approved by the Bankruptcy Court to settle PREPA's legacy debt obligations.<sup>16</sup>

This broad structure is likely to result in upward pressure on PREPA's current rate of \$22.5 cents per kWh.<sup>17</sup> The upward rate pressure stems from:

1. **Fees** — The FY 2021 budget for PREPA includes \$119 million in fees for the FOMB, bankruptcy consultants and P3 Authority.<sup>18</sup> LUMA Energy's \$135 million in fees is added to this list.<sup>19</sup> This creates another expenditure of just under 1 cent per kWh. The combination of consultant fees (including LUMA Energy) amount to 1.6 cents per kWh in

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<sup>15</sup> PREPA and P3 Authority. [Puerto Rico Transmission and Distribution System Operation and Maintenance Agreement, Annex II -Front End Transition Plan, p. II-30.](#)

<sup>16</sup> PREPA and P3 Authority. [Puerto Rico Transmission and Distribution System Operation and Maintenance Agreement, Annex I – Scope of Services, Section E – Treasury, p. I-7.](#)

<sup>17</sup> PREPA. [Monthly Report](#). May 2020, p. 25

<sup>18</sup> PREPA. [Puerto Rico Electric Power Authority Fiscal Year 2021 Certified Budget](#). June 30, 2020.

<sup>19</sup> PREPA. [Puerto Rico Electric Power Authority Fiscal Year 2021 Certified Budget. T & D Operator Costs](#). June 30, 2020.

FY 2021. Stated another way, the \$254 million price tag for consultants equals 21% of PREPA's non-fuel budget.

2. **Transition Charge** —The current proposed restructuring agreement calls for an initial rate increase of 2.8 cents per kWh and increases to over 4 cents per kWh.<sup>20</sup> The only reference in the agreement to the transition charge is that LUMA will collect it as part of its operational responsibilities. LUMA has no explicit responsibility for the all-in price of electricity charged to Puerto Rico's ratepayers.
3. **Savings Assumptions** — LUMA Energy has no responsibility for successfully executing PREPA's current menu of savings initiatives or adopting new ones.<sup>21</sup> The stated goal of the new professional team of LUMA Energy is to improve PREPA's historic inability to execute on its operational reforms. Continued failure to implement cost-savings mechanisms will make it impossible for Puerto Rico's electricity system to recover.

LUMA's job will be to implement a budget prepared by LUMA, PREB, and P3, and for the foreseeable future, approved by the FOMB. In May 2018, IEEFA produced a review of PREPA's budget and proposed savings. It noted that there was no mechanism in the budget process that identified actual results of savings initiatives, nor that reported on the savings and integrated the savings into the budget and fiscal plan.<sup>22</sup> To date, neither PREPA nor the FOMB have publicly reported in a professional manner on any achieved

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<sup>20</sup> PREPA. [Puerto Rico Electric Power Authority Fiscal Year 2019 Fiscal Plan](#). June 27, 2019, p. 55 and 62. The FY 2020 Fiscal Plan makes no mention of the Restructuring Agreement that was carried as a projected expense in prior year fiscal plans.

<sup>21</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority, Section 9.3 Operational Measures, FY 2021 Measures](#), p. 62.

<sup>22</sup> IEEFA. [The Puerto Rico Electric Power Authority's Flawed Fiscal Plan](#). May 2018, p. 22-23.

savings or shown how those savings are having a positive impact on PREPA's budget balance.

PREPA's current fiscal plan relies heavily on fuel savings to achieve its short- and long-term fiscal goals.<sup>23</sup> The first major generation project, New Fortress Energy's San Juan 5 and 6, "lost savings" last fiscal year of an estimated \$100 million.<sup>24</sup> Despite an announcement that the project is complete, it has encountered additional business headwinds that PREPA sees as a fiscal risk.<sup>25,26</sup> In FY 2021, PREPA anticipates a fuel savings from its initiatives of between 2 and 3 cents per kWh, approximately \$200 to \$300 million annually.<sup>27</sup> However, if the authority continues to fail to execute on its initiatives, additional "lost savings" will push rates up faster and further.

PREPA's Certified Fiscal Plan and the legislative intent of PREPA's transformation plan must provide affordable rates. Rates that are rapidly approaching 30 cents per kWh under the current business regime and now under the professional guidance of LUMA are unsustainable and intolerable.

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<sup>23</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority](#), p.51.

<sup>24</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority](#), p. 24.

<sup>25</sup> FERC. [Order to Show Cause, Docket CP 20-466-000](#). June 18, 2020.

<sup>26</sup> Jose Ortiz, Chief Executive Officer, PREPA. [Ortiz letter to FERC](#). July 2020.

<sup>27</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority](#), p. 43.

The rate increases under this business design use the additional income to pay for more consultants, legacy debt under the proposed Restructuring Agreement and greater spending on fossil fuel. None of these funds are reinvested in the grid and its employees or for the benefit of ratepayers. All of it ends up in the coffers of mostly off Island beneficiaries – consultants, banks, investors and fossil fuel companies.

## **B. Renewable Energy**

The principal goals to be achieved by a new electricity grid in Puerto Rico are resilience, accessibility and affordability. The Operation and Maintenance Agreement is the principal contract that governs the deployment of organizational resources to achieve these goals, While LUMA is responsible for integrated resource planning and power procurement, none of LUMA's performance incentives are tied to this issue.

The law in Puerto Rico establishes a goal of 100% renewable energy by 2050. There is currently an Integrated Resource Plan process being conducted under the Puerto Rico Energy Bureau's oversight to provide substantial planning tools and investment guidance, purportedly to achieve this goal. However, PREPA's substantive approach to the Integrated Resource Plan is to consistently advocate for natural gas solutions for Puerto Rico. These solutions will not result in Puerto Rico complying with current law. Evidence has been provided during the process that

shows PREPA's plans would result in the overbuilding of natural gas capacity and crowding out of renewable energy.<sup>28</sup>

Despite the lack of an approved Integrated Resource Plan, PREPA has moved forward with a pipeline of natural gas projects independent and apart from any outcome that may emerge from the Integrated Resource Plan. By codifying the dysfunctional IRP process and failing to exclude explicit benchmarks for renewable energy, this agreement continues to support a major natural gas buildout and fails to adhere to the goal of 100% renewable energy for Puerto Rico.

The agreement designates LUMA as the representative of the electricity system to the Puerto Rico Energy Bureau for the purposes of future integrated resource planning.<sup>29</sup> The contract also directs LUMA to align its planning with the Grid Mod Plan.<sup>30</sup> This plan increases the use of liquefied natural gas as a transition fuel that is more efficient and less polluting than the current use of diesel fuel, as well as placing LNG on a long-term, equal footing with solar and storage capacity investments.<sup>31,32,33,34</sup>

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<sup>28</sup> Earthjustice. [Groups argue for 100% renewable energy to the Puerto Rico Energy Bureau](#). February 10, 2020.

<sup>29</sup> PREPA and P3 Authority. [Puerto Rico Transmission and Distribution System Operation and Maintenance Agreement, Section 5.6 \(f\) Integrated Resource Plan](#). June 22, 2020, p. 67.

<sup>30</sup> PREPA. [Grid Modernization Plan for Puerto Rico](#).

<sup>31</sup> PREPA. *Ibid.*, p. 4.

<sup>32</sup> PREPA. *Ibid.*, p. 5.

<sup>33</sup> PREPA. *Ibid.*, p. 6.

<sup>34</sup> PREPA. *Ibid.*, p. 6.

Investments made along these lines, largely with federal dollars,<sup>35</sup> will ensure the overbuilding of natural gas capacity and provide almost no support for renewable energy, the purported goal of Puerto Rico law. Does the management of PREPA expect a significant federal cash infusion beyond the \$20 billion to support renewable energy development?

The main problem with the agreement is that it, like PREPA's general policy direction and investments, does not support a path to 100% renewable energy. Plans have been put forward for greater participation and cost savings initiatives by energy consumers in Puerto Rico through energy conservation and efficiency, photovoltaic systems sited on rooftops or close to the point of use, energy storage (batteries) systems, and other alternatives to centralized generation at fossil fuel plants.<sup>36</sup> By perpetuating centralized generation and supportive transmission and distribution investments, the contract with LUMA facilitates the operation of projects such as the AES coal-burning power plant in Guayama beyond the end of the AES contract term, as well as the rest of the central station fossil fuel plants located in southern Puerto Rico.

### **C. Labor**

The agreement also excludes the organized unions at PREPA from the partnership. The Operating Agreement does not recognize UTIER (the largest current union) or any other union.

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<sup>35</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority, Chapter 11: Federal Funding](#). June 29, 2020

<sup>36</sup> [www.queremossolpr.com](http://www.queremossolpr.com)

LUMA will not be required to recognize the existing collective bargaining agreement with UTIER. The agreement makes it clear that existing seniority and certain benefits will not be honored, and that LUMA is not required to hire existing PREPA employees.

The agreement appears to be contrary to the P3 statute,<sup>37</sup> where certain labor protections are included. Section 15 of Act 120-2018 contains provisions that generally protect the existing workforce. Any agreement under P3 statutes would be in accordance with existing laws, rules and collective bargaining agreements. The law also provides that no employee will lose their job. More specifically, job security, pension benefits and other vested rights are protected under this statute.

The agreement, however, specifically excludes the existing collective bargaining agreement.<sup>38</sup> This provision appears to contradict Act 120-2018.

Partnership arrangements between existing labor organizations and new utility managers are quite common. LUMA Energy LLC is a joint venture between Texas-based Quanta Services, Inc., and Calgary-based Atco Ltd. Approximately 35% of Quanta's 30,500 employees are covered by

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<sup>37</sup> Puerto Rico Law. [Act 120-2018, Section 15](#). June 21, 2018.

<sup>38</sup> PREPA and P3 Authority. [Puerto Rico Transmission and Distribution System Operation and Maintenance Agreement, Definitions, Systems Contracts](#). June 22, 2020, p. 29.

collective bargaining agreements that require payments to employees for wages, salaries, benefits and pensions.<sup>39</sup>

As new operators have taken on new assignments in other jurisdictions, existing collective bargaining agreements and union representation have been integrated into the new contracts. For example, the Long Island Power Authority (LIPA) entered an Operations and Management Agreement with Public Service Enterprise Group (PSEG) in 2013.<sup>40</sup> The agreement identifies the International Brotherhood of Electric Workers (IBEW) as the local union covering the workers, aligns the contract with the existing collective bargaining agreement and further details employee rights under the transition and enforces existing salaries, health plan and pension agreements.<sup>41</sup>

The failure to include labor in the partnership arrangement sets LUMA Energy on a collision course with PREPA's union staff.<sup>42</sup>

PREPA's decision to exclude its union from the partnership agreement represents yet another poor management decision.<sup>43</sup> PREPA has hired LUMA to manage PREPA's transition according

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<sup>39</sup> Quanta Services. [2019 Form 10-K](#), p. 5.

<sup>40</sup> Long Island Power Authority. [Amended and Restated Operations Agreement between Long Island Lighting Company \(LILCO\) d/b/a LIPA and PSEG Long Island LLC](#). December 31, 2013.

<sup>41</sup> Long Island Power Authority. [Amended and Restated Operations Agreement between Long Island Lighting Company \(LILCO\) d/b/a LIPA and PSEG Long Island LLC, Section 4.5 \(C,D\)](#). December 31, 2013.

<sup>42</sup> Bloomberg. [Puerto Rico unions to strike against \\$1.7 billion power deal](#). July 7, 2020.

<sup>43</sup> IEEFA. [PREPA privatization plan overlooks unionized workers as best asset](#). February 25, 2019.

to professional standards.<sup>44</sup> LUMA has long-term experience with existing unions, knowledge of collective bargaining agreements and uses its union relationships as a selling point to potential customers.

PREPA and the Financial Oversight and Management Board have, however, chosen to ignore this professional capacity and instead decided on a conflict-oriented approach with its labor organization.

Such an approach is a poor management decision. UTIER and the professional staffs of PREPA have served the authority well, particularly during periods of acute stress from weather events. While Puerto Rico's political leadership failed, PREPA's leadership failed and, of course, PREPA's generation system failed, UTIER's employees showed up for work. Union jobs with good salaries and benefits are scarce on Puerto Rico and represent an important element of the island's shrinking middle class. Employees live on the island, raise families and spend money in Puerto Rico. The elimination of UTIER and its collective bargaining agreement is another self-inflicted wound to the Puerto Rico economy.

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<sup>44</sup> PREPA. [2020 Fiscal Plan for the Puerto Rico Electric Power Authority](#). June 29, 2020, p. 30. The Fiscal Plan cites the need for professional and technological competence as the key reasons for using a private operator to run the electricity grid in Puerto Rico.

This decision is corrosive to the establishment not only of the management partnership required at PREPA but also of the need by the FOMB (particularly in the absence of responsible gubernatorial leadership) to include all representatives of Puerto Rico's community in the solution to the fiscal problem. The most common and justified complaint against control boards is a certain high-handedness that comes with the imposition of their authority. This authority inherently diminishes the electoral franchise and weakens the control of local elected leaders. This temporary diminution of democratic institutions is done, in theory, to support the restoration of new fiscal and economic practices and to restore the authority of duly elected democratic leaders and local institutions.

The antidote for a board confronted with these pressing dilemmas in Puerto Rico can be found in the experience of several control boards and it does not include confrontation with labor.<sup>45</sup> Ultimately, a time of austerity and conflict can also be a time of education, trust-building and negotiated agreements that help a government move from fiscal and political distress toward a new plan that includes a growing economy and a responsible level of service provision. In this instance, the first major public-private partnership agreement for PREPA, the FOMB has ignored these central tenets of sound control board practice and opted for open hostility toward labor.

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<sup>45</sup> Centro De Priodismo Investigativo. [The Silent Expansion of Fiscal Control Boards in the U.S.](#) June 1, 2017.

## Conclusion

In summary, the LUMA agreement replicates many of the flaws of PREPA's past contracting failures. The Department of Homeland Security's Office of Inspector General just published its review of the Whitefish and Cobra grid reconstruction contracts, showing that PREPA and the Commonwealth lacked the capacity for proper oversight of these contracts, resulting in grid reconstruction projects that were 49% to 4700% over their initially approved costs.<sup>46</sup> The accountability for savings in the San Juan 5 & 6 natural gas contract is so vague that one party to the contract (New Fortress Energy) states that the project will save \$500 million over five years, while the other party (PREPA) states it will save \$280 million over five years. In this case, the LUMA contract provides no accountability for either rate savings or renewable energy goals.

The underlying problems of corruption, poor management and lack of contract oversight would be better resolved by the appointment of an Independent Private Sector Inspector General to monitor the use of federal funds within PREPA and to prevent waste, fraud and abuse.<sup>47</sup>

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<sup>46</sup> Department of Homeland Security, Office of Inspector General. [FEMA's Public Assistance Grant to PREPA and PREPA's Contracts with Whitefish and Cobra Did Not Fully Comply with Federal Laws and Design Guidelines](#). July 27, 2020.

<sup>47</sup> IEEFA. [Letter to Puerto Rico Legislative Assembly](#). October 2019.