Financial Oversight and Management Board
PO Box 192018
San Juan, PR 00919-2018
comments@promesa.gov; david.skeel@promesa.gov

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Dear Chairman Skeel and members of the Financial Oversight and Management Board:

We write as energy and financial experts who have participated as witnesses in Puerto Rico Energy Bureau hearings and have closely followed and commented on the PREPA debt restructuring and transformation initiatives.

We write to express our concern that the most recent PREPA fiscal plan creates an unrealistic representation to bondholders, financial markets and political leaders of the amount of money potentially available for servicing the PREPA debt, primarily by underestimating PREPA's fuel budget.

The Fiscal Plans that the FOMB has produced over the last five years have never managed to be accurate when it comes to forecasting PREPA's fuel costs. Given that fuel costs are the electrical system's largest single expense (63% of the electrical system budget in FY 2023), errors in fuel forecasting have significant implications for any estimate of how much money could be available for other system needs, including maintenance, pensions and the transition to renewable energy.

Our review of prior PREPA fiscal plans shows that every year the Board has underestimated actual fuel expenses for the subsequent year by anywhere from 10% to 45% - with an average deviation of 27% below the actual fuel expense.[1] For context, a 20% deviation from PREPA's forecasted fuel budget for the next five years would amount to $1.3 billion, potentially wiping out a significant fraction of any revenues that the FOMB thinks could be available for debt service over that period.

In this year's fiscal plan, the FOMB's fuel projections are misleading in two respects: first, by failing to present alternative scenarios to the commodity price forecast, and second by making modeling assumptions that the Board itself acknowledges to be unrealistic.

The Fiscal Plan presents a commodity price forecast that dates from April 2022. Given the current highly volatile and uncertain global commodity market, any fuel forecast is highly likely to be wrong over the next several years, which is precisely why the Board should have presented a range of commodity price forecasts to illustrate the potential impact on PREPA's budget and the ramifications for annual operating needs. The hope that savings from fuel costs could be put to future debt service costs is a distant consideration if improving system operations to acceptable standards and transitioning to renewable energy are priorities.

[1] The 2017 Fiscal Plan forecast fuel expenses for FY 2018 of $1.074 billion and $1.083 billion for 2019, which were 10% and 23% below actual expenditures, respectively. (The 2018 Fiscal Plans did not provide forecasts for the fuel budget separate from purchase power expenses). The 2019 Fiscal Plan forecast a FY 2020 fuel budget of $1.14 billion, or 22% blow actual expense. The 2020 Fiscal Plan forecast $835 million for FY 2021, 33% below actual. And the 2021 Fiscal Plan forecast $1.141 billion for FY 2022, 45% below actual.

On top of this, the Board acknowledges that it has introduced a significant error in its fuel cost modeling assumptions. The Board projects a fuel budget of $2.9 billion for FY 2023 and less than half of that amount, $1.4 billion, for FY 2024. This is a much steeper decrease than any of the projected declines in commodity prices.[2]

The Board states that one of the "two principal factors" (other than declining fuel prices) driving the $1.5 billion in fuel savings is a change to its modeling approach.[3] Starting in FY 2024, the Board states that it uses a different model to estimate generation costs and that this model does not consider transmission constraints, meaning that it assumes that a generator located anywhere on the island can supply power to any other part of the island, ignoring the capacity of the transmission system to transmit power between two points. This is not a realistic assumption, nor is the Board transparent about what other modeling assumptions regarding the operation of the generation fleet may have been changed in order to arrive at a 52% year-on-year decline in the fuel budget. The Board itself acknowledges that its modeling change "provides [fuel] expense projections that are significantly lower."[4] There is no way to read this other than an admission that the Board has artificially, and completely unprofessionally, manipulated its fuel cost modeling to the tune of hundreds of millions of dollars.

Fuel costs have already driven rates more than 60% higher than the Board's affordability target of 20 cents/kWh, and there is every reason to expect that fuel savings will not materialize at the level the Board projects.

We are also deeply skeptical of the Board's assertion that the private operation of the electrical system will result in labor cost efficiencies[5], when the reality is that the poorly managed transition to LUMA actually increased the Commonwealth's labor budget by several hundred million dollars annually in order to absorb the workers displaced by privatization. These additional costs will ultimately be paid by the same people who pay PREPA electric bills – moving costs to a different bill is no savings at all.

In short, despite the FOMB's best attempts to argue that Puerto Rico ratepayers can afford to pay even higher rates to pay off PREPA's legacy debt, our analysis of the Fiscal Plan indicates the exact opposite.

Sincerely,

Cathy Kunkel, Energy Program Manager
CAMBIO PR
cathykunkel@cambiopr.org

Anna Sommer, Principal
Energy Futures Group
asommer@energyfuturesgroup.com

Tom Sanzillo, Director of Financial Analysis
Institute for Energy Economics and Financial Analysis
tsanzillo@ieefa.org

Ingrid Vila-Biaggi, President and Co-founder
CAMBIO PR
ingridmvila@cambiopr.org

Cc: Governor Pedro Pierluisi, Representative Rafael Hernández Montañez, Senator José Luis Dalmau, Congresswoman Nydia Velazquez, Resident Commissioner Jenniffer Gonzalez, Congressman Raul Grijalva

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[2] The Board's commodity price forecast shows a drop in prices from FY 2023 to FY 2024 for fuel oil (48%), diesel (36%) and natural gas (29%) and a 50% increase in coal prices.
[3] Fiscal Plan, p. 141.
[4] Fiscal Plan, p. 162.
[5] Fiscal Plan, p. 162.