What is in the PREPA Plan of Adjustment?

On December 16, 2022, the Financial Oversight and Management Board (FOMB) issued its proposed "Plan of Adjustment" for the Puerto Rico Electric Power Authority (PREPA) debt, which totals more than $9 billion plus pension liabilities. This is the third effort to restructure PREPA's debts in a supposed attempt to end the public corporation's bankruptcy and restore it to financial health and market access. All previous restructuring proposals have been rejected because they were deemed unaffordable for the island's economy. Yet this most recent restructuring plan imposes an even heavier burden on residential customers, businesses and the economy.

The Plan proposes to:

1. **Issue new debt to partially pay PREPA's existing debt**

Under the Plan, PREPA would issue two new sets of bonds, together totaling "approximately" $5.4 billion in new debt. One set of bonds ("Series A"), amounting to $590 million, would go towards paying 84% of the debt owed to the "fuel line lenders" who had loaned money to PREPA to purchase oil. The FOMB estimates those bonds being paid off in five years (but it could be up to 15 years).

The other set of bonds ("Series B"), totaling $4.8 billion, would go towards paying the bond debt and other liabilities (including $400 million in legal and financial advisor fees for all of the parties in the PREPA bankruptcy proceeding). Those bonds would be repaid with approximately 6% interest and the FOMB expects them to be repaid in 35 years (but it could be up to 50 years).

The Plan establishes that electrical system operational costs will take priority over debt repayment, but also mandates that, while the Series A bonds are outstanding, rates must be raised if they are not sufficient to pay the debt service (see below).

2. **Raise electric rates – by an unspecified amount – to pay off the new debt over the next 35 to 50 years**

The Plan will impose a "Legacy Charge" on electricity consumers in order to pay off these new bonds. The Plan only states that this charge will be a combination of a "fixed fee" (a flat monthly charge on electric bills) and a "volumetric fee" (a cost per kilowatt-hour of electricity consumed). This charge would be in effect for the next 35 to 50 years. The FOMB proposes to exempt low-income customers (including those that currently receive certain electricity subsidies and those with an income below a threshold "similar" to that required to qualify for Medicaid) from the fixed fee and the majority of the volumetric fee.

The Plan does not include an estimate of how much this Legacy Charge will be. However, a November 2022 FOMB document revealed that their last offer to bondholders during mediation included a residential fixed fee of $21 per month and a volumetric fee of $0.0075/kWh for the first 500 kWh of consumption and $0.03/kWh thereafter. For the average residential customer consuming 420 kWh monthly, this represents an annual increase of nearly $300 (a household consuming 900 kWh monthly would face an annual charge of $441). This level of rate increase is **higher** than that proposed in the last debt restructuring agreement, which was rejected because it was deemed unaffordable for the economy.

A fee of this magnitude would impose an incredible burden on families and would serve as a strong economic disincentive for grid-connected rooftop solar systems, because customers with such systems would still pay the fixed fee, amounting to $252 a year in debt charges, under the FOMB's November proposal.

The Legacy Charge will be based on the FOMB's forecast of electricity consumption in Puerto Rico over the next decades. The Plan specifies that if, during the first 35 years of the Plan, sales end up being higher than forecast and the Legacy Charge thereby collects more revenue than projected, this money would also be used to pay bondholders (in the form of a Contingent Value Instrument), meaning that bondholders would end up with more than initially promised.[1] On the other hand, if, during the first 5 to 15 years of the Plan (in which the bonds for the fuel line lenders are outstanding), sales end up being lower than forecast, PREPA and PREB would be required to increase the Legacy Charge to a level sufficient to pay the debt service.

The Plan does not include an estimate of the ongoing financing fees related to the plan, which electricity customers will also have to pay.

The FOMB argues that the bankruptcy court has the power to impose the Legacy Charge on customers, even if the Puerto Rico Energy Bureau (the entity that regulates electric rates) is opposed.

3. Weaken the PREPA Employee Retirement System

The Plan proposes to weaken the PREPA Employee Retirement System, converting it from a defined contribution to a defined benefit plan. It also raises the retirement age and eliminates cost of living adjustments for the pension system. This lack of cost-of-living adjustment for retirees contrasts sharply with the FOMB-approved contract with LUMA Energy, which includes an automatic cost of living adjustment in the annual fee paid to the private operator.

[1] It is worth noting that, in practice, the FOMB's previous Fiscal Plans have consistently included forecasts that have turned out to underestimate future sales.

The Plan lacks transparency and economic analysis

Despite being 96 pages long and accompanied by a 400-page explanatory statement, the Plan is lacking in basic information – including on the key question of how much it will cost the people of Puerto Rico over the next 50 years. This speaks eloquently to the lack of importance given by the FOMB on the impact of the Plan of Adjustment on Puerto Rico's economy and to the lack of analytical rigor that has consistently affected FOMB's fiscal plans and debt proposals.

The FOMB continues to emphasize privatization as key to the transformation of PREPA, with the Plan calling for the continuation of the LUMA contract and the privatization of PREPA's power plants.

The Plan includes no analysis to indicate that it is economically viable. Prior FOMB-approved Fiscal Plans had established an affordability target for rates of 20 cents/kWh. It is clear that the 20 cents/kWh goal has been abandoned in favor of an ideological commitment to privatization and paying bondholders.

What happens next?

In order to go into effect, the Plan of Adjustment must be approved by the Title III bankruptcy court. The bankruptcy court judge will have the opportunity to approve, deny or modify the Plan. Before the judge makes her determination, various classes of creditors, including pensioners, will have an opportunity to vote on the Plan. In addition, the legislature could attempt to place conditions on the Plan of Adjustment, as they are currently attempting to do through PC 1429.

The bankruptcy court judge has stated that she hopes to be able to approve a PREPA Plan of Adjustment by July 2023.

***

Clearly, this new attempt by the Board to restructure PREPA's debt represents another disastrous blow for families and for the island's economy. We urge you to stay informed through CAMBIO regarding opportunities in the upcoming months to voice your opposition to this proposal.