

Puerto Rico Goes for an Electric Industry Trifecta

By

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Tri-fec-ta: a run of three wins or grand events

On June 21, 2018 the Governor Ricardo Rosello-Nevarés of Puerto Rico signed into law the Puerto Rico Electric Power System Transformation Act (Act). The new law sets up a process and institutions by which Puerto Rico will attempt that most difficult of electric industry trifectas: asset privatizing, industry restructuring and the establishment of wholesale and retail market regulation.

Heretofore, this trifecta of electric industry transformation has been attempted with mixed success in Central and Eastern Europe and Latin America. Each of the three components: privatization, restructuring and regulation, has proven difficult to implement and sustain on its own where attempted. A trifecta like this is all the more difficult when tried together with new legislation, unproven policymakers and newly appointed regulators.

The Electric Industry in Puerto Rico

The Commonwealth of Puerto Rico has a population of 3.6 million with all electric service provided by the state owned Puerto Rico Electric Power Authority (PREPA) serving approximately 1.5 million customers. Electricity rates are around \$0.20/kilowatt-hour (kWh) in 2017. PREPA owns 4,878 MW of diesel fueled power plants providing about 66% of the island's requirements. Another 961 MW of generation is under power purchase agreements (PPA) from independent power producers using, coal and natural gas. In 2010, Act 82 was passed establishing a renewable portfolio standard (RPS) with a target of 20% renewable by 2035.

Privatization

Privatization is the transfer of ownership of government assets to private owners. Any privatization in Puerto Rico is complicated by the island's bankruptcy proceedings and in particular, the financial and physical condition of the state owned Puerto Rico Electric Power Authority (PREPA). The bankruptcy is under procedures established by federal law the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA). The transformation Act reverts to privatization procedures used by Puerto Rico's Public Private Partnership Authority (known as P3) with technical assistance from the Puerto Rico Energy Commission (PREC) as newly reestablished.

The Act calls for the complete sale of all power plants owned by PREPA to private operators under future PREC regulation. PREPA's transmission and distribution system will remain state assets, but management would be privatized by a multi-year concession agreement to a private corporation.



Details as to starting wholesale and retail rates, conditions of operation, etc. will be left to be determined by a combination of contract language and future PREC regulatory decisions.

The Act requires that no sales can occur without a PREC issued Energy Compliance Certificate which PREC must issue within fifteen days of application. To ensure public acceptance each power plant sale will need to be approved by both Puerto Rico's Legislative Assembly and Governor.

Restructuring

Restructuring in electric industry terms is essentially the separation of the ownership of electric power generation, and sometimes transmission, from the previously vertically integrated electric power enterprise. The separation of power plants from PREPA and sale to individual private owners restructures the industry in Puerto Rico and sets it up for potential future competitive wholesale and eventually retail electricity markets. Sales of PREPA's power plants would be administered by a Partnership Committee under the P3.

However, buyers will need to know in advance of purchase whether there is an acceptable, from a financing perspective, starting position as to electricity prices and wholesale sales conditions. An initial starting position would probably not be one initially involving an untested and future wholesale island power market. Most likely, the buyers will want and probably need purchased power agreements with the new transmission and distribution concession operator as approved by PREC, the regulator.

Restructuring in the US, United Kingdom, Europe and elsewhere has usually involved the parallel development of a wholesale market, which, although not required for restructuring, is a prerequisite for any future retail market.

Regulator Re-Established

The Act expands the current Puerto Rico Energy Commission (PREC) from three to five members to be appointed by the Governor with Senate confirmation. The Chair and four Associate Commissioners will start initially with staggered terms and eventually all will be appointed to six year terms. The Governor shall select nominees from a list prepared by an executive search firm and the Act has education and experience criteria for nominees. Each commissioner shall have ability to appoint one administrative assistant and one "trusted advisor". On June 11, 2018 the Senate approved the Governor's nomination of engineer and attorney Edison Aviles Deliz as the new President of the PREC.

The Act directs the PREC to provide "technical, expert, financial and human resources assistance to the Authority" for each PREPA Transaction. It further establishes time lines for acting on requests and other decisions.

All of the restructuring and competition issues have been formidable, contentious and approached differently in the continental US where public service commissions have a hundred



year history in most states. Many states are still grappling with issues including reversing direction when necessary (see California for example). The PREC will have its hands full.

Energy and Regulatory Policy Advisory

The Act also calls for the establishment of a “Blue-Ribbon Task Force on the Formulation of Energy Policy and the Regulatory Framework” which will recommend legislation to be approved by the Legislative Assembly 180 days after the approval of the Act. As suggested by its name, this body of volunteers would prepare and present legislation establishing the structure and regulatory policies of Puerto Rico’s future electric industry. Decisions concerning the structure of new power plant licensing, wholesale power market design, PREC authority, wholesale and retail competition policy, fuels policy, demand side management and distributed energy resource connections could all be issues addressed by the new legislation to be proposed by the Blue Ribbon Task Force. Whether a committee such as this will be up to the task remains to be seen.

Winning a “trifecta” is unlikely in horse or greyhound racing, but not impossible. In this case Puerto Rico does not have to be great or perfect in each area it needs to be competent and reasonable. It won’t be easy, but it is possible. Buena Suerte!