

**Testimony of José Román Morales, PE
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**Before the
U.S. Senate Committee on Energy and Natural Resources**

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Chairman Murkowski, Ranking Member Cantwell and Members of the Committee:

My name is José Román Morales. I am the Acting Chairman of the Puerto Rico Energy Commission. Thank you for inviting me to appear and for your interest in Puerto Rico's plans to transform its grid. My testimony makes four main points:

1. In the immediate future, the Commission continues to carry out its vital duties under Act 57.
2. However, the Commission continues to face unnecessary, avoidable obstacles in carrying out its statutory duties
3. Looking forward into the longer term, the Commission seeks to define the contours of Puerto Rico's energy market privatization, competitive structure, and infrastructure needs.
4. The Commission continues to be at the disposal of the Commonwealth Legislature to assist in its efforts to define a new regulatory infrastructure and new market structure models.

I. The Commission continues to carry out its vital duties under Act 57.

The Commission has continued to carry out its statutory duties. As mentioned on my previous testimony, the Commission started an investigation for resilient solutions for the grid. Such investigation led to the rulemaking process to promote the development of microgrids.

- a. Microgrid rules.

On October 27, 2017, the Commission began an investigation with regards to the state of Puerto Rico's electrical system as result of Hurricane María's landfall on the Island

("October 27 Resolution").¹ As a result of the damages to the electrical system and considering the critical role of the electric service in the economic development of the Island and the day to day lives of its citizens, the restoration of electric service was one of the main objectives in the short term.

Nevertheless, it is insufficient to merely identify strategies that allow for the restoration of electric service in the shortest possible amount of time, rather, it is also necessary that those strategies promote the development of a resilient, modern and agile electric system. Aware of the need to restore electric service fast and effectively while simultaneously seeking its sustainable development in the long term, through Resolution and Order issued on November 10, 2017 ("November 10 Resolution"),² the Commission identified the installation of distributed generation, energy storage and microgrid systems as available alternatives consistent with these objectives. The Commission promulgated Draft Rules for the development of Microgrids on January 4th, 2018 and is about to publish the final version of the same. The regulation process incorporated input and comments from a vast number of parties from the electric sector, both from the Island and from the mainland US.

- b. The Commission has issued new IRP rules, and is preparing to guide PREPA's 2018 IRP.

The Commonwealth is currently at a decisive moment for the development of Puerto Rico's electrical system. The clear mandate of Act 57 to transform it into an efficient, cost-effective and resilient electricity system today becomes more important than ever. The development of new technologies, the introduction of microgrid systems, as well as the decrease in the cost of energy storage systems, have changed the reality of the country's energy market, and in turn introduces new opportunities and alternatives in the transformation process. Likewise, the ravages of Hurricanes Irma and María have forced us to make vital decisions about what the Island's energy future should be, so it is of utmost importance that these decisions are made based on a rigorous analysis of the needs of the country within an orderly and objective planning process.

As a result of the above, it became necessary to update the regulations applicable to the preparation of the integrated resource plans (IRP) of the Puerto Rico Electric Power Authority ("PREPA"). In accordance with the requirements of Act 57, PREPA must submit for approval a plan "that considers all reasonable resources to meet the demand for electrical services during a twenty-year period, including those related to the energy supply, whether existing, traditional and/or new resources, and those related to energy demand, such as conservation and energy efficiency, response to demand or "demand response", and localized generation by the client. "

¹ Case Num. CEPR-IN-2017-0002, In Re: Energy Commission Investigation Regarding the State of the Puerto Rico Electric System after the Passing of Hurricane María.

² Id.

Based on the experience gained in the first evaluation and approval procedure of the IRP, the recent changes in the reality of the Puerto Rico energy system and in order to establish an adequate and useful process for long-term resource planning, the Commission developed the new rules. The rules seek to provide the Authority with a clear framework for the preparation of future IRPs in such a way as to achieve a rapid and effective transformation for the benefit of the people of Puerto Rico.

Moreover, as part of the IRP, several load forecasts will be studied in detail, as well as current generation and demand resources so that a reliable, resilient, efficient electrical system can be developed. In addition, the rules address aspects related to the establishment of performance inducement metrics and the implementation of energy efficiency and demand response programs.

The Commission ordered PREPA on March 15, 2018 to file an updated IRP for review by October 2018.

- c. We have initiated a proceeding to set new rates for FY2019, to reflect PREPA's new cost structure.

For the first time in PREPA's 77-year history, PREPA's rates were set by an objective, professional regulator based on evidence and testimony produced under oath. Those rates were scheduled to enter into effect on FY2017. The 2017 Rate Order also established procedures for determining rates applicable to FY2018, as well as procedures for subsequent "three-year rate cases" and "one-year budget examinations."

The 2017 hurricanes have drastically affected PREPA's costs, revenues and expectations of future sales, making it unlikely that the rates in effect today satisfy the statutory "just and reasonable" standard. The Commission therefore initiated the proceeding to set new rates for the period July 1, 2018 through June 30, 2019 ("FY2019 Rates"). These new rates must:

1. Recover the reasonable cost of providing service during FY2019.
2. Begin recovery of costs that were approved for recovery by the 2017 Rate Order and incurred by PREPA, but have not yet been recovered from PREPA's customers.
3. Reflect reasonable expectations for federal funding to support hurricane recovery efforts.
4. Reflect all feasible efforts to reduce costs, consistent with the long-term objective of reliable, high-quality service.
5. Address the unique challenges regarding debt service

6. Be based on a revenue requirement that complies with any overall expenditure cap established by the Federal Oversight and Management Board (“FOMB”).

II. However, the Commission continues to face unnecessary, avoidable obstacles in carrying out its statutory duties.

In my last appearance before this distinguished Committee I expressed the Commission’s need for jurisdictional certainty and sufficient resources.

The Commission is financially self-sustainable as its income is derived from electric rates, which PREPA collects and then disburses directly to the Commission. It is financially independent from the Commonwealth Government. Nevertheless, it requires approval from the Governor’s Office for procurement of external consultants, outside counsel and personnel. The Commission is still waiting—ten months after the beginning of FY18—for approval on personnel and external consultants needed for FY18. In addition, PREPA has not made its statutory regulatory payment for the second half of FY18, straining the Commission’s resources.

In addition, FOMB claims in its documents to support independent, strong regulation of monopoly electric services. But its actions are undermining regulation by giving PREPA an excuse to avoid the Commission’s orders—PREPA gives as its reason that the Commission’s powers are preempted by the FOMB. But PREPA deeply misunderstands what the Congress provided. Congress did not give FOMB authority to singlehandedly establish Puerto Rico’s energy policies, but rather commanded FOMB to work with Commonwealth entities to achieve the fiscal and financial accountability expected from any government entity. The powers Congress gave to FOMB are fiscal, not substantive. Yet, whether intentionally or inadvertently, FOMB has freed PREPA from regulatory control, delaying the implementation of operational and substantive reforms ordered by the Commission which, had they been undertaken, would have placed PREPA on the path of fiscal responsibility and assisted FOMB on its duties as they related to PREPA.

FOMB continues its practice, which I summarized in my last appearance, of ignoring every Commission effort to cooperate in the adoption of a set of procedures that would allow the Commission and FOMB to support each other’s work. The most recent effort by the Commission was the draft protocols attached to my testimony, which have been shared with FOMB. It is a balanced document, addressing each major area of the Commission’s Act 57 authority and describing ways for the FOMB and Commission to mesh their work in that area. FOMB has consistently rejected our offers for cooperation. Instead FOMB argues that it can “substitute” for the Commission, and has provided as much in the certified PREPA Fiscal Plan. Congress did not grant FOMB that authority.

The result has been an unwarranted and unnecessary delay in the implementation of measures to achieve financial and operational responsibility. The Commission’s 2016 IRP Order and 2017 Rate Order represent significant steps to getting PREPA back on track towards financial and operational responsibility and providing Puerto Rico’s citizens with

reliable, cost-effective energy service. These measures are in-line and consistent with FOMB stated goals for PREPA. Had FOMB agreed to work with the Commission, instead of against it, PREPA's transformation would be one year ahead of schedule. Instead, Puerto Rico still finds itself in square one.

I ask Congress to assist Puerto Rico's energy evolution by reminding FOMB of the limits of its authority, and of its obligation to act as much as possible in concert with, rather than in conflict with, Commonwealth law. I also ask Congress to make clear to FOMB that the scope of its authority does not extend to substantive regulatory matters for which it has no expertise and that it should not interfere with the Commission's jurisdiction.

III. Defining the contours of Puerto Rico's energy market privatization, competitive structure, and infrastructure needs

There are many decision-makers involved in Puerto Rico's electric industry—PREPA, the FOMB, the Legislature, the Governor, the Commission, the Federal Government. Among all these players, there should be a common goal: **performance for the consumer**. But the term "privatization," to be useful, needs more clarity. Otherwise people will confuse ideologies with solutions. There are distinct concepts that sometimes get confused and combined.

1. Market structure: This term describes the level of competitiveness of a market, in terms of the factors that affect competitiveness. Those factors include: number and types of buyers and sellers, their shares of the market, nature of the product or service being bought and sold, the geographic boundaries of the market, and ease of entry and exit into the market (including the presence or absence of entry barriers). Market structures range from perfect competition to complete monopoly. Within that range are structures like duopoly (two sellers), oligopoly (a few sellers), and monopolistic competition.

Analysis of market structure can be applied to each of the next three topics--asset ownership, operational responsibility and business ownership.

2. Asset ownership: This term means what it says: The physical assets are owned by a particular company. Asset ownership is different from market structure. In a monopoly market structure, the assets could be owed by a government entity or by a private company. Similarly, in a competitive market, various assets could be owned by the government or a by a private company. For example, the PR government, through PREPA or some other entity, could continue to own one or more of the generation, transmission or distribution assets, but contract out responsibility for maintenance, operation, and/or other activities to private companies. Involving private parties does not necessarily mean that the private companies operate as well as own the facilities. One advantage of the government maintaining ownership is that if the private party's performance is unsatisfactory, the government cancel the contract (or let it expire), then transfer performance responsibility to another party.

3. Operational responsibility: The assets are owned by X, but responsibility for operation is contracted by X to Y. For example, on most of the U.S. mainland, the

transmission network is owned by investor-owned (for-profit) utilities, but complete responsibility for design, planning, operation and even billing lies with non-profit "regional transmission operators."

4. Business ownership: Business ownership refers to which entity keeps the profits from the business. Usually, business ownership follows form asset ownership--but not necessarily. One could imagine a baseball stadium, where the assets are owned by the City, but the business of operating it (grounds keeping, scheduling, renting out hot dog stands, etc.) has been awarded by the city, in the form of a franchise or concession, to a private company, where the profits then are split between the City and the private company.

So, when someone speaks of "privatization" it is not clear what it is they propose to privatize: Assets, operational responsibility, or the business. And is not clear whether they want Puerto Rico's historically monopolistic market to remain monopolistic or to convert it into a competitive market. Instead of "privatization" a better description of the transformative process to take place is "restructuring". There is more to this transformation than a change of ownership. Too often people talk about "privatizing," and "new market structures," when what they really want to do is escape the costs of the past, address only their own needs, and leave the resulting problems to others. That approach will not solve Puerto Rico's problems.

To produce the performance Puerto Rico needs, we must follow a logical sequence of steps:

1. Describe the mix of products and services that customers need, taking into account all types of customers: residential, large and small commercial, large and small manufacturing, tourism, government, agricultural.
2. Describe the qualities of those products and services, in terms of reliability, timeliness, innovation, ease of use.
3. Identify the market structures (i.e., monopoly, competition) that will provide those products and services most cost-effectively.
4. Identify the types of companies that can most cost-effectively provide those products and services (e.g., local companies, mainland companies, pure play companies, traditional utilities, independent companies)
5. For the products and services to be provided by a monopoly market structure, create the regulatory principles and procedures for the following:
 - a. How to choose the best monopoly provider (which need not necessarily be PREPA)
 - b. Deciding whether the monopoly providers can or should be government companies, investor-owned companies or both.

- c. How to regulate the monopoly provider, in terms of price and quality
 - d. How long the monopoly provider should have the privilege of serving, before we offer the privilege to others
6. For the products and services to be provided by a competitive market structure, create the regulatory principles and procedures for the following:
- a. Moving the assets and data from the current provider (PREPA) to the new competitors.
 - b. Establishing licensing requirements to ensure that the new competitors compete fairly and treat customers well.
 - c. Addressing any "stranded costs" on the books of PREPA--which must be paid for as part of any transition to competition.
 - d. Decide whether the eligible competitors can be only private companies or also government companies.
 - e. Educate consumers about how to choose their suppliers.
 - f. Create rules that prevent consumer fraud.
 - g. Create rules that prevent "cream-skimming" by sellers.
 - h. Create rules that prevent some customers from escaping their fair responsibility for past costs.

If we do not follow that logical sequence of steps, it will be "every man for himself." No car gets to its destination safely if every passenger is grabbing the steering wheel and headed in a different direction.

IV. The Commission continues to be at the disposal of the Commonwealth Legislature to assist in its efforts to define a new regulatory infrastructure and new market structure models.

On a typical scenario, when a State decides to restructure its utility, it delegates the responsibility to the Regulatory Entity to carry out the process, to make recommendations to the state legislature if needed and establish the regulatory framework. Puerto Rico is not going through a typical scenario. There are many decision-makers and stakeholders involved in Puerto Rico's electric industry—PREPA, the FOMB, the Legislature, the Governor, the Commission, the entrepreneurs, the think tanks, etc. All with ideas, plans and proposals to address Puerto Rico's situation.

All ideas—all paths to performance—should be on the table. All ideas should compete in a merit based, fact based, transparent process. The process that best fits the description is the IRP approval by the Commission. We must find the best paths to performance.

The IRP approval process will determine the correct mix of resources that is most cost effective. The right mix product and services, from centralized generation to decentralized, from the impact of demand response programs to energy efficiency, to address the highest consumption that occurs at night for higher penetration of renewable energy sources.

The Commission is ready and able to assist the Commonwealth, FOMB, and Congress to define the new regulatory frameworks and market structures for the benefit of the people of Puerto Rico.

Conclusion

In this testimony, I have sought to explain the Commission's work and plans for transforming our electric industry. The need for an independent entity, free of politics and focused on merits, with the single-minded goal of bringing cost-effectiveness and competitive rigor to the Commonwealth's most important infrastructural industry, could never be greater.

Chairman Murkowski, Ranking Member Cantwell and Members of the Committee, thank you for this opportunity to testify. I look forward to your questions.