

**GOVERNMENT OF PUERTO RICO
PUERTO RICO ENERGY COMMISSION**

IN RE: ALLOCATION OF OVERSIGHT
RESPONSIBILITIES BETWEEN THE
PUERTO RICO ENERGY COMMISSION AND
THE FINANCIAL OVERSIGHT AND
MANAGEMENT BOARD FOR PUERTO RICO

CASE NO.: CEPR-MI-2018-0003

SUBJECT: Policy Statement of the Puerto
Rico Energy Commission

POLICY STATEMENT

I. Introduction

For nine months, the Puerto Rico Energy Commission (“Commission”) has sought the Financial Oversight and Management Board’s (“FOMB”) cooperation in creating logical allocation of regulatory responsibilities. That cooperation has not occurred.¹ At no time has FOMB given any reason for its non-responsiveness. The expected arrival this week of a Puerto Rico Electric Power Authority (“PREPA”) proposed Fiscal Plan now makes such allocation an immediate necessity. The purpose of this Policy Statement is to provide clarity with regards to the Commission’s position on the foregoing matter.

Part II describes the statutory relationship between our two agencies. In that relationship, FOMB has no legal authority to impose substantive electricity obligations on PREPA or Puerto Rico, because the FOMB’s powers are fiscal, not substantive. Given that statutory relationship, **Part III** explains that FOMB’s only logical path is to review a PREPA Fiscal Plan approved by the Commission first. Part III then describes how the Commission will assess PREPA’s Fiscal Plan, and the FOMB cooperation we need to determine whether the Plan satisfies Commonwealth law.

Underlying our approach are PROMESA’s four interrelated legal principles:

1. The FOMB cannot order PREPA to take actions that are beyond the FOMB’s legal authority—authority which is largely confined to fiscal, not substantive, matters.
2. Where a Fiscal Plan involves actions within the Commission’s legal authority, the FOMB cannot bind PREPA, or anyone else, to take those actions without

¹ See the Appendix I for a summary, adapted from Chairman Román’s responses to questions from members of the U.S. Senate Committee on Energy, of the Commission’s efforts to engage the FOMB.

the Commission finding that those actions are consistent with Commonwealth law, as the Commission interprets and administers that law.

3. To the extent PREPA's Fiscal Plan includes actions subject to the Commission's jurisdiction, a "certification" by FOMB has no legal effect unless and until the Commission approves those actions.
4. Where the FOMB, acting within its authority, has ordered PREPA to take actions consistent with the Commission's interpretation of Commonwealth law, the Commission cannot then require PREPA to act inconsistently with the FOMB's orders.

II. FOMB has no legal authority to impose substantive electricity obligations on PREPA or Puerto Rico

A. The FOMB's powers are fiscal, not substantive

A host of PROMESA provisions make clear that FOMB's powers are largely fiscal, not substantive.

The list begins with Section 101(a): "The purpose of the Oversight Board is to provide a method for a covered territory to achieve fiscal responsibility and access to the capital markets." Fiscal responsibility and access to the capital markets does not include transformation of electric industry structure, determination of power supply mix, determination of market structures or asset ownership.

PROMESA repeats this distinction between fiscal and substantive matters in its provisions on the purposes and elements of a Fiscal Plan.

Purposes: The purpose of a Fiscal Plan is to create conditions for a "sustainable level of debt";² to "provide a method to achieve fiscal responsibility and access to the capital markets [...]"³

Elements: A Fiscal Plan must provide for credible "estimates of revenues and expenditures";⁴ "ensure the [sufficient] funding of essential services";⁵ provide

² PROMESA Section 104(i)(1)(B).

³ *Id.* Section 201(b)(1).

⁴ *Id.* Section 201(b)(1)(A).

⁵ *Id.* Section 201(b)(1)(B).

"adequate funding for public pension systems" and for the "elimination of structural deficits";⁶ provide for a "debt burden that is sustainable";⁷ "improve fiscal governance, accountability, and internal controls";⁸ "enable the achievement of fiscal targets";⁹ include "independent forecasts of revenue,"¹⁰ and include a "debt sustainability analysis."¹¹

All these items are fiscal items; they give the FOMB no authority to make substantive decisions about Puerto Rico's electric industry.

More confirmation of the fiscal-substantive distinction appears in Section 203. That provision requires the Commonwealth to submit periodic reports comparing actual revenues and expenditures to budgets, while there is no PROMESA provision requiring reports on substantive actions (e.g., transmission lines constructed, competitive markets created, power supply plans implemented). Furthermore, if there is an "inconsistency" between approved and actual budget figures, the FOMB can "make reductions in nondebt expenditures," "institute hiring freezes," or prohibit certain contracts or transactions.¹² Those are the FOMB's only tools; the FOMB has no authority to mandate particular activities, like power supply mix, new ownership arrangements or new market structures. And the FOMB can cancel the actions it took under Section 203(d)(2)(A) if the instrumentality at issue has "initiated appropriate measures to reduce expenditures or increase revenues;"¹³ again, there is no obligation in the instrumentality to conform its actions to any FOMB preference for industry structures or power supply mix. The FOMB's role is fiscal, not substantive.

It is of course true, and unsurprising, that the Fiscal Plan must "provide for capital expenditures and investments necessary to promote economic growth."¹⁴ If a Fiscal Plan

⁶ *Id.* Section 201(b)(1)(C) and (D).

⁷ *Id.* Section 201(b)(1)(E).

⁸ *Id.* Section 201(b)(1)(F).

⁹ *Id.* Section 201(b)(1)(G).

¹⁰ *Id.* Section 201(b)(1)(H).

¹¹ *Id.* Section 201(b)(1)(I).

¹² *Id.* Section 203(d)(2)(A).

¹³ *Id.* Section 203(e).

¹⁴ *Id.* Section 201(b)(1)(J).

did not have "expenditures and investments" there would be little need to address revenues, debt, funding, targets and all the other items listed in Section 201(b)(1). But the legal source of the "expenditures and investments" is not FOMB's substantive preferences, because FOMB has no power over electricity industry structure; the legal source of "expenditures and investments" is Commonwealth law—specifically, Act 57-2014¹⁵ as applied by the Commission. This reasoning, indisputable on its face, finds explicit support in Section 201(b)(1)(N), which establishes the key constraint on the FOMB: A plan certified by the FOMB must "respect the relative lawful priorities [...] in [...] other laws [...] of a covered territory [...] in effect prior to the date of enactment of this Act."

The clearest statement of Congress's intent to confine FOMB's authority to fiscal, not substantive matters appears in Section 205(a). This provision authorizes FOMB to make *recommendations* about, among other things, "the modification of existing revenue structures, or the establishment of additional revenue structures;"¹⁶ "modifications or transfers of the types of services that are the responsibility of, and are delivered by the territorial government;"¹⁷ "modifications of the types of services that are delivered by entities other than the territorial government under alternative service delivery mechanisms;"¹⁸ and "the privatization and commercialization of entities within the territorial government."¹⁹ The territorial government must consider these recommendations and explain any rejection, but it has no obligation to accept them.²⁰ If these substantive matters were within the FOMB's mandatory authority, Section 205(a) would be surplusage. The FOMB's mandatory authority is fiscal, not substantive.

And there is still another. Section 209 requires the FOMB to terminate when the territorial government has "adequate access to short-term and long-term credit markets at reasonable interest rates"; and has, for four consecutive fiscal years, developed its budgets consistent with "modified accrual accounting standards" and has lived within those budget. FOMB's termination depends on no substantive precondition. FOMB's purpose is fiscal, not substantive.

The confinement of FOMB authority to fiscal matters has only two exceptions. The first exception is PROMESA Section 204(b)(2), which authorizes FOMB to establish policies

¹⁵ Puerto Rico Energy Transformation and RELIEF Act, as amended.

¹⁶ PROMESA Section 205(a)(3).

¹⁷ *Id.* Section 205(a)(5).

¹⁸ *Id.* Section 205(a)(6).

¹⁹ *Id.* Section 205(a)(10).

²⁰ *Id.* Section 205(b).

"to ensure that proposed contracts promote market competition [...]." The Commission sees no current conflict between this PROMESA goal and its interpretations and applications of its Commonwealth law authority.

The second exception is in Title V, which creates a path by which a "Critical Project" can be approved by the FOMB. Congress there made clear its intent that the FOMB's authority over Critical Projects must support the Commission, not preempt it. Specifically, Section 503(b)(1)(D) requires that any project that would connect to PREPA's transmission or distribution facilities "shall be ineligible for Critical Project designation" if the Commission timely determines it will "adversely affect an approved Integrated Resource Plan." Note also that Title V, which creates the Revitalization Coordinator role, confines that role to making recommendations to the FOMB about Critical Projects. He has no other role. It is legitimate for the Coordinator to have a vision for Puerto Rico's electric industry, to guide his recommendations of particular projects. But PROMESA gives neither him nor the FOMB any substantive authority to mandate that vision. As the U.S. District Court held:

Although the FOMB's fiscal plan and budgeting powers give it a strong and substantially determinative voice in overall strategy regarding the Commonwealth's revenues, expenses, and general direction for responsible financial management, they do not imply that the FOMB's role includes detailed operational planning or direct executive authority over the implementation of those plans and budgets.²¹

The FOMB's powers are fiscal, not substantive.

B. FOMB certification of PREPA's Fiscal Plan can bind PREPA on fiscal matters only

The foregoing analysis makes clear that FOMB's "certification" of a PREPA-proposed Fiscal Plan has legal effect, i.e., binds PREPA, only for elements in the Plan that are within the FOMB's powers. Those powers are fiscal, not substantive. Here we describe the subject areas or actions over which FOMB has no powers; then the areas or actions over which it has power, but must exercise that power consistently with Commission actions.

1. Areas over which FOMB has no power

Because the FOMB's powers are fiscal, not substantive, the FOMB has no authority to address, either directly or through its approval of a fiscal plan, any of the following areas, among others:

²¹Opinion and Order Denying Urgent Motion of FOMB to Confirm Appointment of a Chief Transformation Officer at 12 (Docket Entry No. 361, Nov. 16, 2017) (hereinafter, "CTO Order").

Market transformation

1. Current and future market structures (monopoly vs. competition) for various products and services;
2. Whether and to what extent PREPA should continue as a provider of electricity services;
3. Whether and in what roles there should be new provider(s) of electricity services;
4. Divestitures of PREPA assets or business functions;
5. Acquisitions by PREPA of assets or business functions;
6. The mix of government and non-government ownership of electricity assets;
7. The mix of government and non-government provision of electricity services;
8. Whether there should be "wheeling" service, and on what terms;
9. Whether there should be microgrids, and on what terms;
10. Terms of interconnections between PREPA and power producers.

Resource mix

1. Mix of power supply, energy efficiency and demand resources;
2. Integrated Resource Plan;
3. Determine future percentage mix of renewable and non-renewable, and types of each;
4. Establish framework for determining need and value of ancillary services;
5. Establish framework for determining need and value of resource flexibility;
6. Approve near-term IRP action plans;
7. Siting of power supply resources.

Electricity rates

1. Caps or floors on PREPA's rates (including any adjustment clauses);
2. Procedures by which PREPA's rates (including any adjustment clauses) are adjusted;
3. Terms for net-metering;
4. Terms for demand response or energy efficiency.

Operations

1. Reliability parameters for Puerto Rico's electric industry;
2. Performance metrics, reporting procedure and enforcement methods;
3. Restoration plans, priorities and expenditures;
4. Maintenance plans, priorities and expenditures;
5. Generating plant efficiency standards;
6. Criteria and decisions on hiring contractors;
7. Criteria and decisions on hiring, laying off or buying out employees.

All these features of Puerto Rico's electric industry are decisions to be made by the Commonwealth. Whether those decisions reflect fiscal responsibility, and whether they conform to the FOMB's methods for regaining access to capital markets, are FOMB's determinations.

- 2. Areas over which FOMB has power, but exercise that power consistently with Commission actions unless inconsistency is unavoidable**

Below are listed the fiscal matters over which the FOMB has jurisdiction—jurisdiction which FOMB must exercise consistently with Commonwealth law.

1. PREPA's budgets;²²
2. PREPA's spending;
3. PREPA debt issuances and debt restructuring.

3. Conclusion on FOMB certification

The foregoing summary and analysis distills to two principles applicable to FOMB certification of a proposed Fiscal Plan:

1. FOMB certification of a fiscal plan does not bind PREPA to take any of the non-fiscal actions stated in the plan. The reason is that PROMESA, as detailed in Part I.A above, does not grant FOMB any authority over PREPA's non-fiscal activities.
2. FOMB certification does not preempt the Commission from (a) ordering PREPA to take non-fiscal actions not stated in the plan, or (b) prohibiting PREPA from taking non-fiscal actions stated in the plan. While these Commission actions appear to conflict with FOMB actions, potentially triggering the conflict preemption provision of Section 4, FOMB preemption can occur only when FOMB is acting within its authority. FOMB has no authority over PREPA's non-fiscal actions. Thus there is no conflict of constitutional relevance.

In sum, the FOMB has no authority to reshape the Commonwealth's electric industry. (As noted, the sole authority of the Revitalization Coordinator is to make recommendations to FOMB on Critical Projects.) Furthermore, except for certain fiscal actions, PROMESA does not allow PREPA to get FOMB approval of some action not authorized by the Commission, then say that FOMB's approval preempts the Commission. And for those fiscal actions, FOMB must determine and adjust its directives to avoid inconsistencies with Commission actions, except where there is no feasible way to remove those inconsistencies. It is the need to find consistencies that supports, and requires, the cooperative dialogue that FOMB has declined to have with the Commission.

²² On this subject, the Commission has explained on multiple occasions (most recently in its Response to AAFAF's Assertions of Preemption, submitted to the federal court on December 19, 2017), methods by which the Commission and the FOMB can exercise their respective authorities over PREPA's budgets in a way that both agencies' statutory purposes are achieved. FOMB has yet to cooperate with the Commission on designing and implementing these methods. The resulting uncertainty over PREPA's budgeting and spending is creating risks which fall not on FOMB's members—those ones who have failed to cooperate—but on Puerto Rico's citizens—those to whom FOMB's members owe a duty to cooperate.

C. Where FOMB's fiscal powers overlap with the Commission's, PROMESA preserves the Commission's powers unless inconsistency is unavoidable

Repeatedly and explicitly, PROMESA directs FOMB to act consistently with Commonwealth law:

Section 201(b)(1)(A)(i) provides that a Fiscal Plan shall "provide for estimates of revenues and expenditures in conformance with agreed accounting standards and be based on [...] *applicable law* [...]" (emphasis added). Act 57-2014 is "applicable" here because it directs the Commission to ensure that rates are "just and reasonable." Thus FOMB may not approve budgets or prescribe actions that lead to rates that are not just and reasonable. The legal duty to determine what is just and reasonable is exclusively with the Commission.

Section 201(b)(1)(B) requires that the Fiscal Plan "ensure the funding of essential services." The legal duty to determine what services are essential, given the prior reference to "applicable law," lies exclusively with the Commission.

Section 201(b)(1)(J) requires the Fiscal Plan to "provide for capital expenditures and investments necessary to promote economic growth [...]." That provision does not mean that the FOMB determines what capital expenditures are necessary; only that for whatever capital expenditures are necessary, the Fiscal Plan must provide for sufficient financing. Under Commonwealth law, the legal duty to determine what capital expenditures are necessary for electric service lies exclusively with the Commission. That Commission role is confirmed by Section 503(b)(1)(D) which, as explained in Part I.A above, preserves the Commission's power to prevent Energy Projects that "adversely affect an approved Integrated Resource Plan."

Section 201(b)(1)(N) requires the Fiscal Plan approved by FOMB to "respect the relative lawful priorities [...] in the [...] other laws [...] of a covered territory [...] in effect prior to the date of enactment of this Act." Those laws include Act 57-2014, as applied by the Commission.

Separately and together, these PROMESA provisions obligate FOMB to preserve Commission authority. Limiting that FOMB obligation is PROMESA Section 4: "The provisions of this Act shall prevail over any general or specific provisions of territory law, State law, or regulation that is inconsistent with this Act." The Commission's decisions under Commonwealth law cannot conflict with the FOMB's requirements—as long as the FOMB is acting within its authority. And the FOMB's authority is fiscal, not substantive.

PROMESA thus addresses Commonwealth law in terms of preservation and preemption. The necessary logical combination of those two principles is this: In establishing requirements, FOMB must preserve Commonwealth law where possible. If FOMB has a

choice between an action that undermines Commonwealth law and an action that does not, it must choose the latter. PROMESA thus limits both the Commonwealth and the FOMB. In case of conflict, FOMB prevails—but only if the conflict is unavoidable. FOMB must avoid conflict where possible, and it must not create conflict unnecessarily.

III. FOMB's only logical path is to review a PREPA Fiscal Plan approved by the Commission first

FOMB's limited fiscal authority and its obligation to respect Commonwealth law combine to yield only one logical path: The Fiscal Plan that the FOMB considers must be one that the Commission has approved first. Otherwise the FOMB risks wasting its time: reviewing a PREPA-designed plan that lacks Commission approval, granting a certification that has no legal effect on substantive matters within the Commission's exclusive jurisdiction, awaiting a Commission correction of that plan, then repeating its certification process to approve a plan that finally complies with Commonwealth law.

The Commission will play its part, efficiently and expeditiously. Yesterday it issued a Resolution and Order²³ directing PREPA to submit its proposed Fiscal Plan to the Commission, along with all supporting documents and a list of technical witnesses. On receiving the proposed Fiscal Plan, the Commission will organize a public, evidentiary proceeding to review, and if necessary modify, the Plan. The Commission will examine witnesses from PREPA and from those intervenors whose comments are useful. The Commission then will issue a formal resolution describing any changes to the Fiscal Plan that are necessary to align PREPA's originally proposed plan with Commonwealth law, and directing PREPA to submit the modified plan to the FOMB. That modified Fiscal Plan will be the one for the FOMB to consider.

By monitoring the Commission proceeding, FOMB can estimate how large or small will be the changes the Commission will likely make to PREPA's proposed plan. In fact, the FOMB's representatives are invited to participate in the Commission's proceeding, presenting positions—on fiscal matters—that will help the Commission align its decision with the FOMB's fiscal priorities. In the way, the cooperation that FOMB has failed to offer the Commission over eight months will finally occur.

The Commission will make best efforts to complete its review by the date set by FOMB for its decision. The Commission cannot guarantee that result, however. Nor must it. As Part I.C explained, PROMESA requires the FOMB to make decisions consistent with Commonwealth law. If the FOMB's deadlines prevent the Commission from determining, transparently and lawfully, whether the plan complies with Commonwealth law, the FOMB will have no legal basis for certifying it. Thus the needs of the Commission and the FOMB are aligned—just as PROMESA intended.

²³ Resolution and Order, January 22, 2018, Case No. CEPR-MI-2018-0002.



The Commission has no intention of taking more time than necessary. As evidenced by its orders on the Transition Charge,²⁴ Provisional Rates²⁵ and Permanent Rates,²⁶ the Commission has a perfect track record of making decisions on difficult question within tight deadlines. On receiving and preliminarily reviewing PREPA's plan, the Commission commits to issuing a procedural order establishing the date by which the Commission will issue its final order. The Commission recognizes that under PROMESA Section 201(a), the FOMB has "sole discretion" to set the schedules for Fiscal Plans. But the FOMB must set those schedules consistently with its statutory duty to act consistently with Commonwealth law. The Commission's approach achieves these objectives.

One more point: As FOMB is aware, PREPA in recent months has been resisting the Commission's authority—revealing a wish to return to the pre-Act 57-2014 days of unregulated, politically influenced monopoly behavior that so ill-served the Commonwealth. Preventing such behavior is precisely what unifies our two agencies' efforts. The FOMB can best achieve its goals by supporting the Commission's efforts; in this instance, by directing PREPA to comply with the Commission's orders. Without the cooperation of PREPA and the FOMB, the Commission cannot determine if the plan satisfies Commonwealth law. And if the Commission cannot determine if the plan satisfies Commonwealth law, the FOMB cannot certify the plan. In short, the Commission and FOMB must support each other—just as PROMESA intended.

Be it published.

Ángel R. Rivera de la Cruz
Associate Commissioner

José H. Román Morales
Associate Commissioner
Interim Chairman

CERTIFICATION

I hereby certify that the majority of the members of the Puerto Rico Energy Commission has so agreed on January 23, 2018, and on this date I have proceeded with the filing of this Resolution. For the record, I sign this in San Juan, Puerto Rico, today, January 23, 2018.

María del Mar Cintrón Alvarado
Clerk

²⁴ Restructuring Order, June 21, 2016, Case No. CEPR-AP-2016-0001.

²⁵ Order Establishing Provisional Rates, June 24, 2016, Case No. CEPR-AP-2015-0001.

²⁶ Final Resolution and Order, January 10, 2017, Case No. CEPR-AP-2015-0001.

Appendix I – Commission Attempts to Engage the FOMB

On multiple occasions, since May 2017, the Commission has sought to engage the FOMB in a detailed discussion about our respective authorities. The Commission's efforts have not borne fruit.

In May 2017, the Commission's outside counsel held a conference call with attorneys at the Proskauer firm (one of FOMB's several outside firms), for purposes of initiating conversations about our respective authorities. The Commission's outside counsel urged the Proskauer attorneys to recommend to their client the formal commencement of such discussions. The Proskauer attorneys chose not to accept that recommendation, saying instead it was the Commission's task to contact the FOMB.

The Commission has held several informal discussions with the FOMB Chairman and Executive Director, urging them to direct their attorneys to meet with the Commission's attorneys to develop protocols.

On October 29, 2017, the Commission, on its own, prepared a two-page memorandum of understanding. This document, to be signed by the Chairman of the Commission and of the FOMB, would simply direct each entity's lawyers to work on a master protocol and to complete it by a date certain. The intent was to commit both agencies to this essential dialogue. By email of November 2, 2017, the FOMB's Executive Director declined to adopt this MOU, stating that FOMB's legal counsel would be in touch. Thus, as far we know, the FOMB has not directed its lawyers to work with us to produce a master MOU by any date certain.

Subsequently, the Commission's General Counsel, attempting again to get a dialogue in place, sent to FOMB's outside lawyers a master list of all actions the Commission has the duty to take under Act 57-2014. The Commission's General Counsel suggested that the two sets of lawyers use this list as an agenda, to determine how the Commission's duties should interact with the FOMB's duties. A telephone conference (November 9, 2017) held to address this list ended prematurely when the FOMB's lawyers said they needed more time to study it and would reschedule.

In response to the Commission's attempts to coordinate with FOMB on review of PREPA's contracts, FOMB's Executive Director sent the Commission in mid-January a draft letter saying the FOMB would share with the Commission information provided by PREPA, and would take the Commission's comments into account, but that the Commission in return must "suspend review of PREPA's contracts under [the Commission's] regulations." FOMB's response is, of course, the definition of non-cooperation. The Commission has no statutory authority to suspend its own review. Moreover, nothing in PROMESA requires such suspension; PROMESA requires the Commission only to avoid inconsistency. FOMB has

responded to the Commission's ideas for cooperation with an insistence on subordination.

FOMB representatives have said on several occasions they intend to cooperate with the Commission, but no steps toward cooperation have occurred. The one exception is the Commission's General Counsel has now obtained clearance from FOMB's attorneys for Commission's advisors to engage with FOMB consultants from McKinsey.