

**GOVERNMENT OF PUERTO RICO
PUBLIC SERVICE REGULATORY BOARD
PUERTO RICO ENERGY BUREAU**



IN RE: REQUEST FOR PROPOSALS FOR
CONVERSION OF SAN JUAN UNITS 5 & 6 TO
NATURAL GAS

CASE NO.: CEPR-AI-2018-0001

SUBJECT: Resolution and Order on PREPA's
Non-compliance with Orders and
Regulations.

RESOLUTION AND ORDER

I. Executive Summary

The Puerto Rico Electric Power Authority ("PREPA") faces unique and unprecedented situations that deserve and require the upmost attention and thoroughness. It faces a dire financial crisis that precludes it from accessing the bond markets and contributes to its demise. These constraints affect PREPA's planning over the near- and long-term.¹ PREPA's infrastructure at the very least can be described as aging and in urgent need for maintenance.

For the past decades PREPA has been the sole provider in the distribution and transmission of power in Puerto Rico. As such, the electric system of Puerto Rico depended on PREPA which exacerbates the actual economic crisis of Puerto Rico as well. On September 26, 2016 the First Integrated Resource Plan of PREPA was approved, recognizing the urgency to steer PREPA's economic situation towards a prompt recovery. Subsequently, on March 2017, the Puerto Rico Energy Bureau (the "Energy Bureau") approved a Final Resolution through which it approved PREPA's revenue requirement for Fiscal Year 2017 and a procedure for updating those rates for the years thereafter.²

On September 2017, hurricanes Irma and María (the "Hurricanes") ravaged Puerto Rico, leaving behind a collapsed electric system. The blackout caused by the collapse of the system was deemed the longest one in the history of the United States and left the Island in an extremely vulnerable situation. It took PREPA months to fully interconnect the South part of the electric grid with the North part. This was achieved after the completion of extensive reconstruction work done with local staff and contractors with the assistance of contractors

¹ See Final Resolution and Order, Case No. CEPR-AP-2015-002, ¶65, September 23, 2016 ("Approved IRP").

² See Final Resolution and Order, CEPR-AP-2015-0001, January 10, 2017 ("Rate Case").



and linemen from other jurisdictions. In fact, it took almost eight (8) months for PREPA to reestablish the electric service to 99% of its clients.³

The aftermath of the Hurricanes caused scores of deaths and left Puerto Rico with the unsurmountable task to rebuild the electric system amid an already unprecedented economic crisis. The Hurricanes imposed as well additional burdens and situations which were not present when the Energy Bureau approved the IRP and the Rate Case. Accordingly, on March 14, 2018, the Energy Bureau issued a Resolution and Order in which it determined that the Hurricanes may have caused "substantial changes in the demand and group of resources" which would warrant a review of the IRP prior to the three year mandatory review.⁴ Thus, on May 29, 2018, the Energy Bureau ordered PREPA to file an updated IRP no later than October 31, 2018.⁵ Also, on May 4, 2018, the Energy Bureau initiated a proceeding to ensure that PREPA's rates for FY2019 are just and reasonable in light of the extraordinary circumstances caused by the Hurricanes.⁶

Along this line, and even when not contemplated in the approved IRP, on May 16, 2018, the Energy Bureau adopted the Regulation on Microgrid Development, Regulation Number 9028, to among other things "as a means of delivering reliable energy services to customers in need, avoiding the loss of power at critical facilities, promoting customer choice, reducing carbon pollution and spurring economic development while integrating new technology and industry trends into Puerto Rico's energy market."⁷ It was undeniable that after the Hurricanes immediate action was required to at least reduce the possible damages of more hurricanes to an electric system that was already in a dire situation.

On August 14, 2018, the Energy Bureau commenced this case with regard to a Request for Proposal for Conversion of San Juan Units 5 and 6 to Natural Gas. Subsequently, PREPA submitted information as per the Energy Bureau's request as well. After these and other proceedings, the Energy Bureau approved PREPA's RFP.⁸ In accordance with the *Energy Bureau and PREPA Joint Regulation for the Procurement, Evaluation, Selection, Negotiation and Award of Contracts for the Purchase of Energy and the Procurement, Evaluation, Selection,*

³ See El Nuevo Día, La AEE alcanza el 99% de energización a ocho meses del huracán María, May 22, 2018, <https://www.elnuevodia.com/noticias/locales/nota/laaeealcanzael99deenergizacionaochomesesdelhuracanmaria-2423673/>.

⁴ See Section III (B), Resolution and Order, October 4, 2018, In Re: Request for Proposals for conversion of San Juan units 5 and 6 to natural gas.

⁵ See Resolution and Order, May 29, 2018, In Re: Integrated Resource Plan for Puerto Rico Electric Power Authority, Case No. CEPR-AP-2018-0001.

⁶ See Resolution and Order, May 4, 2018, In Re: Review of the Puerto Rico Electric Power Authority FY19 Rates, Case No. CEPR-AP-2018-0002.

⁷ See Regulation on Microgrid Development, May 16, 2018, page 4.

⁸ See Resolution and Order dated October 4, 2018, In Re: Request for Proposals for Conversion of San Juan Units 5& 6 to Natural Gas.

Negotiation and Award Process for the Modernization of the Generation Fleet ("Regulation 8815"), PREPA submitted the Proposed Contract for the award of the RFP to the Energy Bureau for its revision and approval.



To fulfill this Energy Bureau's responsibility, we cannot overlook the unique and extraordinary circumstances faced by PREPA nowadays. Its fiscal crisis, its inaccessibility to capital markets, an aging and highly deteriorated infrastructure that was stroke by two hurricanes, and a continuous risk of hurricanes striking the islands, are some examples. Another situation that weighs on the Energy Bureau's analysis is the economic outcome of the RFP.

During this proceeding, PREPA represented to the Energy Bureau that the conversion of Units 5 and 6 will result in estimated savings of \$1,186.4 million dollars in fuel purchase expenses over the course of five (5) years. The Energy Bureau undertook the task of corroborating said estimate through independent consultants which essentially confirmed PREPA's estimate. The Energy Bureau simply could not overlook nor disregard this situation.

In accordance with the faculties conferred upon the Energy Bureau, particularly its obligation to ensure the sound implementation of public policy regarding power service in Puerto Rico and acting in a proactive manner for the protection of consumers' interests, in order to receive a reliable service at a just and reasonable price the Energy Bureau hereby approves the Contract. This decision considered the special and unusual circumstances surrounding the RFP process as stated above, such as: (a) PREPA'S critical financial situation, (b) the conditions of PREPA's physical infrastructure, (c) the passage of the Hurricanes, (d) the current proceedings undergoing before the Energy Bureau to establish a new permanent rate and to evaluate and approve the new IRP, (e) PREPA's transformation process led by the Government of Puerto Rico, as well as (f) the substantial estimated savings of approximately \$1,186.4 million dollars in the consumption of fuel for a period of five (5) years which will result in a benefit for the consumers of the electric power service provided by PREPA.⁹

II. Relevant Procedural Overview

On August 14, 2018, the Energy Bureau issued a Resolution and Order requiring PREPA to provide to the Energy Bureau, on or before August 16, 2018, certain documents regarding a Request for Proposal ("RFP")¹⁰ issued by PREPA for the conversion of San Juan

⁹ This significant savings in fuel expenses subsist even if San Juan Units 5 and 6 are retired in 2024 and 2026, as shown in one of the alternate scenarios being considered by PREPA as part of its new IRP.

¹⁰ See RFP 81412, Request for Proposals for Fuel Supply in the North and Conversion of San Juan Units 5 and 6, dated July 30, 2018, Section 1.0.



Units 5 and 6 ("Units 5 and 6") to natural gas.¹¹ After several procedural actions which are more fully recounted in our Resolution and Order dated October 4, 2018 ("Resolution and Order"), the Energy Bureau evaluated and approved the RFP.¹² As part of the process for the evaluation and approval of the RFP, PREPA provided all the information and clarified all the inquiries requested by the Energy Bureau.¹³ Besides, as discussed in more detail in the Resolution and Order, the evaluation and approval of the RFP was conducted in compliance with Regulation 8815.

As requested by the Energy Bureau in its Order dated November 21, 2018, on December 26, 2018, PREPA submitted the *Evaluation and Selection Report, Requests for Proposals (RFP) 81412*, required pursuant to Section 7 of Regulation 8815 in connection with the RFP ("Evaluation and Selection Report"). PREPA also submitted a copy of the proposed *Fuel Sale and Purchase Agreement* ("Proposed Contract") for the Energy Bureau's review and approval. Upon the Energy Bureau's request, PREPA supplemented its Evaluation and Selection Report and the Proposed Contract filings on January 14, 2019¹⁴ and January 16, 2019.¹⁵

III. DISCUSSION

A. Act 57-2014 and Regulation 8815

Pursuant to Article 6.3(b) of Act 57-2014, the Energy Bureau has the power to adopt regulations governing the processes for the purchase of energy from other electric service companies and/or modernize its energy generation facilities.¹⁶ In compliance with the corresponding legislative mandate, the Energy Bureau and PREPA adopted Regulation 8815. The purpose of Regulation 8815 is to establish a procurement, evaluation, selection, negotiation and award process for contracting with third parties for the purchase of energy and for the procurement, evaluation, selection, negotiation and award process for the modernization and upgrade of the generation fleet and other PREPA resources, that is consistent and transparent, and that encourages and supports a climate of private sector

¹¹ See Resolution and Order dated August 14, 2018 at page 3.

¹² See Resolution and Order at pages 1-3.

¹³ See Id. at pages 2-3.

¹⁴ See PREPA's Compliance Filing dated January 14, 2019, which included a copy of Exhibit H of the Proposed Contract.


¹⁵ See PREPA's Compliance Filing dated January 16, 2019, which included the financial model developed to evaluate the financial aspects of the submitted proposals in native form with formulae intact.

¹⁶ See Article 6.3(c) of Act 57-2014 and Section 6B(a)(iii) of Act 83 of May 2, 1941, as amended, known as the Puerto Rico Electric Power Authority Act.

innovation and investment in Puerto Rico to address PREPA's specific power generation needs.¹⁷



Regulation 8815 requires that, prior to the issuance of an RFP, PREPA notifies in writing the Energy Bureau of the recommendation of the Project Committee with respect to the proposed project, including all associated documents that explain the project and a detail narrative regarding how the proposed project and the terms of the contract, as described in the proposed RFP complies with the IRP, among other things. The Energy Bureau must request any additional information it deems necessary, within ten (10) days from the receipt of the notification. Upon receipt of such additional information the Energy Bureau has forty-five (45) days to approve, reject or propose modifications to the proposed project.¹⁸ If the Energy Bureau does not act within the specified term, the proposed project and its parameters shall be deemed approved.

 Pursuant to Article 7.1 of Regulation 8815, upon completion of the negotiation of a contract, the Project Committee shall prepare a report, which shall include: (i) the reasons for entering into the Contract, the reasons for selecting the chosen proponent; (ii) a description of the procedure followed, including comparisons between the chosen proponent and other proposals presented; (iii) an explanation of how the pricing terms included in the contract comply with the parameters established in the RFP and previously approved by the Energy Bureau, as well as all other information pertinent to the procedure followed and the evaluation conducted.¹⁹

Once PREPA's Board of Directors approves a contract, PREPA must submit the foregoing report and the proposed contract for the evaluation of the Energy Bureau, together with the required profitability and pricing information analysis. The Energy Bureau must review the terms of the contract to ensure compliance with the previously approved terms of the RFP and the form of the contract included as part of the RFP. The Energy Bureau shall complete its review in a period of not more thirty (30) days from the receipt of any additional information timely requested by the Energy Bureau or the date of submittal of the contract and the report, as applicable. The Energy Bureau may approve or reject the proposed contract.²⁰ Note that once approved by the Energy Bureau, and before its execution, the terms and conditions of an approved contract or the scope of a project cannot be modified without prior approval from the Energy Bureau.²¹

¹⁷ See Article 1.2 of Regulation No. 8815.

¹⁸ *Id.* at Article 4.2.

¹⁹ *Id.* at Article 7.1(a). This report should detail the evaluation by the Project Committee of each of the steps in the competitive solicitation process, including bidder qualification, bid evaluation, and selection of a final shortlist, as well as, its assessment regarding whether the process was conducted fairly and transparently. *Id.*

²⁰ *Id.* at Article 7.1(d).

²¹ *Id.* at Article 7.2(c). Finally, Regulation 8815 is intended to provide flexible procedures and, accordingly, it shall be interpreted liberally so as to effectuate that intent and its purposes. *Id.* at Article 10.3.



B. The Approved IRP

As discussed before and, in more detail, in the Resolution and Order²², the Energy Bureau approved a modified Integrated Resources Plan and Action Plan (the Approved IRP) for PREPA in accordance with the provisions of Act 57-2014. The Action Plan did not include explicitly the conversion of San Juan Units 5 and 6. Nevertheless, on March 14, 2018, the Energy Bureau issued a Resolution and Order in which it determined that the Hurricanes may have caused “substantial changes in the demand and group of resources” which would warrant a review of the modified IRP prior to the three-year mandatory review.²³ Accordingly, the Energy Bureau ordered PREPA to file an updated IRP no later than October 31, 2018.²⁴ Currently PREPA is pursuing the approval of a new IRP.

As the Energy Bureau recognized in the Resolution and Order, due to the conditions of the electric system in the aftermath of the Hurricanes and the critical role of the electric service in the economic development of the Island, it is reasonable that until the new IRP is approved, the Energy Bureau does not remain inert in front of certain beneficial initiatives that do not have a significant impact on the Approved IRP while simultaneously promotes the electric system sustainable development in the long term.²⁵ In the Resolution and Order the Energy Bureau also recognized other initiatives it undertook to pursue these objectives.²⁶

The Energy Bureau reiterates that conversion of San Juan Units 5 and 6 does not constitute a significant modification to the Approved IRP which entails its amendment. It is worth noting that the San Juan Units 5 and 6 have a combined capacity of 440 MW, which is less than 7% of PREPA's total capacity (own generation and purchased). Moreover, the proposed conversion would not necessarily modify the capacity of San Juan Units 5 and 6.

²² See Resolution and Order at pages 5-6.

²³ See Section II, Resolution and Order, March 14, 2018, In Re: Integrated Resource Plan for Puerto Rico Electric Power Authority, Case No. CEPR-AP-2018-0001.

²⁴ See Resolution and Order, May 29, 2018, In Re: Integrated Resource Plan for Puerto Rico Electric Power Authority, Case No. CEPR-AP-2018-0001.

²⁵ See Resolution, January 3, 2018 In Re: Regulation on Microgrid Development, Case No. CEPR-MI-2018-0001 for a situation in which the circumstances required flexibility since it was not expressly contemplated and studied in the IRP.

²⁶ See Resolution and Order at pages 5-6.



C. The RFP and the Proposed Contract

According to the RFP, its intent is to award one contract for natural gas fuel supply, or any other proposed fuel, in the north and for fuel conversion of San Juan Units 5 and 6.²⁷ The award of the contract will be to the qualified firm whose proposal, conforming to the RFP, is most advantageous to PREPA considering price among other factors.²⁸

In the RFP, PREPA states that it is interested in reducing the cost of generation and improving the compliance with environmental requirements for units required to reliably operate at base load in the San Juan area. According to PREPA, one alternative is to seek suppliers for an alternate fuel supply to the newer, existing and more efficient combined cycle units at the San Juan generating station (*i.e.*, Units 5 and 6). Compared to diesel (*i.e.*, #2 Fuel Oil) natural gas is less expensive and has significantly lower emissions. In light of the foregoing, the conversion of combined cycle generation units to alternative fuels should result in benefit to the environment and human health at a lower cost.

Puerto Rico needs reliable base load generation which can be operated around the clock to provide a much-needed stability to the system and a cost reduction. In the case of Puerto Rico, given the lack of base load from hydro or nuclear²⁹ and the projected retirement of coal-fired generation, the best option for base load would be natural gas combined-cycle turbines. The conversion of Units 5 and 6, would make available to PREPA that base load in a relatively short timeline and with a minimal commitment since these units are not projected to be retired in the short or medium term.

The project described in the RFP includes the conversion of Units 5 and 6 which cost is estimated to be between ten and thirty million dollars (\$10,000,000 to 30,000,000). These conversion costs are anticipated to be recovered by the chosen proponent over the first term (*i.e.*, 5 years) of the contract. This contractual structure does not require PREPA to make an upfront capital expenditure.³⁰ According to PREPA, the conversion could represent one hundred and fifty million dollars (\$150,000,000) annual savings.³¹ The RFP establishes the rationale under which PREPA would consider proceeding with the conversion: “[w]hile the Units 5 and 6 are currently only capable of burning #2 Fuel Oil, PREPA will consider

²⁷ Unit 5 and 6 are currently capable of burning #2 Fuel Oil only.

²⁸ See RFP 81412, Request for Proposals for Fuel Supply in the North and Conversion of San Juan Units 5 and 6, dated July 30, 2018, Section 1.0.

²⁹ While in the U.S., where nuclear and coal-fired plants are the base load, gas or diesel fired units are deemed intermediate plants in Puerto Rico, they would seem to be the typical base load given the emissions and operational costs of diesel fuel generation units. See *A Primer on Electric Utilities, Deregulation, and Restructuring of U.S. Electricity Markets*, Department of Energy, May 2002, Section 3.4.

³⁰ See PREPA's Board of Directors Resolution No. 4620 of July 13, 2018.

³¹ *Id.*



converting these units to an alternative fuel if the cost savings associated with the lower cost fuel supply justifies the power plant conversion modification expenditures.³²

The RFP included a form contract containing the terms and conditions to which the chosen proponent will be bound. Among other things, PREPA representatives clarified the following, upon inquiry by the Energy Bureau:

- (i) the RFP contemplates a turnkey project that includes the conversion of Units 5 and 6 to dual fuel units (*i.e.*, natural gas and #2 Fuel Oil). The chosen proponent shall be responsible for the capital costs required for the conversion of the units and modifications to associated turbine controls.³³ These costs shall be included in the proposal in the form of a capacity payment over the initial base five years of the proposed contract;
- (ii) for the conversion work the chosen proponent must use Mitsubishi as the sole source subcontractor³⁴;
- (iii) the proposed contract is for five (5) years with three (3) five-year extensions, at PREPA's sole discretion³⁵;
- (iv) the pricing of diesel fuel is not contemplated in the RFP or the Form Contract although PREPA envisions to have the ability to switch from one fuel to the other, provided market prices allow it. PREPA showed its willingness to include the necessary language during the contract negotiations process with the chosen proponent;
- (v) the chosen proponent shall be responsible for the guaranteed delivery of one hundred percent of the natural gas supply in accordance with the annual quantity nomination provided by PREPA. Should the delivery not take place, the supplier will be subject to the penalty of providing diesel fuel or reimburse PREPA for the difference between their cost of diesel minus the contract price of natural gas and other costs associated to that change.³⁶;

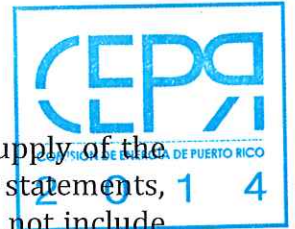
³² See RFP, Section 2.0, page 7. (Emphasis added).

³³ See Section 2.0(IV) of the RFP.

³⁴ *Id.*

³⁵ See Section 3.1 of the form contract included in the RFP package ("Form Contract").

³⁶ See Section 2.0(XI) of the RFP. Nevertheless, similar or equivalent language was not found in the Form Contract.



- (vi) the investment of the offsite infrastructure, necessary for the supply of the fuel, must be assumed by the chosen proponent.³⁷ Based on their statements, PREPA representatives are anticipating that the fuel pricing will not include the return of investment for the offsite infrastructure required for the delivery of the fuel;
- (vii) the cost analysis used for the RFP was based on the differential in prices for diesel and natural gas, the latter deemed less expensive than the diesel in accordance to general pricing information; and
- (viii) PREPA has used essentially its own personnel and consultants already under contract for the preparation of the RFP and an estimate of ten thousand dollars (\$10,000.00) would be a fair and reasonable estimate of the resources (*i.e.*, time from employees and consultant) used by PREPA for the RFP process.³⁸

Furthermore, it is important to note that in the RFP PREPA reserved the right not to award a contract. To that effect, the RFP states: "[i]ssuance of this RFP does not constitute a commitment by PREPA to award a contract. PREPA reserves the right to accept or reject, in whole or part, and without further explanation, any or all proposals submitted and/or cancel this solicitation and reissue this RFP or another version of it, if it deems that doing so is in the best interest of the impacted communities or Government of Puerto Rico."³⁹

In the Resolution and Order we approved the RFP and ordered PREPA the contract to be negotiated with the chosen proponent language expressly contemplating the supply of diesel in case PREPA chooses to do so based on market prices. The Proposed Contract includes the required provision.

IV. Conclusion

It is a widely accepted fact that PREPA's generation fleet is old, inefficient and that the Puerto Rico electric system lacks sufficient reliable and cost-effective generation in the North of the Island where the majority of the demand is located. It is also clear that the conditions of the electric infrastructure in the aftermath of the Hurricanes require the Energy Bureau not remain inert in front of certain beneficial initiatives while simultaneously seeking its sustainable development in the long term. As discussed before, the Energy Bureau verified PREPA's estimates which indicate that the conversion of Units 5 and 6 will result in estimated savings of \$1,186.4 million dollars in fuel expenses over the course of five (5) years. The Energy Bureau simply could not overlook nor disregard this situation. Thus,

³⁷ See Section 2.0(II) of the RFP.

³⁸ Proponents are solely responsible for the costs associated to the preparation of their proposals. See Section 7.3 of the RFP.

³⁹ *Id.* at Section 7.1, page 22.

considering the particular circumstances surrounding the RFP for the conversion of Units 5 and 6 as well as PREPA's compliance with Regulation 8815, the Energy Bureau deems that the approval of the Proposed Contract is warranted.



Considering the foregoing, and pursuant to Section 7.1 of Regulation 8815, the Energy Bureau **approves** the Proposed Contract.

Be it notified and published.

Edison Avilés Deliz
Chair

José J. Palou Morales
Associate Commissioner

Ferdinand A. Ramos Soegaard
Associate Commissioner

CERTIFICATION

I hereby certify that the majority of the members of the Puerto Rico Energy Bureau has so agreed on January 25, 2019. The Associate Commissioner Lillian Mateo Santos recused herself from the consideration of this case and did not intervene. The Associate Commissioner Ángel R. Rivera de la Cruz issued a particular vote dissenting. I also certify that on January 25, 2019, a copy of this Resolution was notified by electronic mail to the following: n-vazquez@prepa.com, astrid.rodriguez@prepa.com and jorge.ruiz@prepa.com. I also certify that today, January 25, 2019, I have proceeded with the filing of the Resolution issued by the Puerto Rico Energy Bureau regarding the Case No. CEPR-AI-2018-0001 and I have sent a true and exact copy to the following:

Puerto Rico Electric Power Authority

Attn.: Nitza D. Vázquez Rodríguez
Astrid I. Rodríguez Cruz
Jorge R. Ruíz Pabón
PO Box 364267
Correo General
San Juan, PR 00936-4267

For the record, I sign this in San Juan, Puerto Rico, today January 25, 2019.

María del Mar Cintrón Alvarado
Clerk

GOVERNMENT OF PUERTO RICO
PUBLIC SERVICE REGULATORY BOARD
PUERTO RICO ENERGY BUREAU



IN RE: REQUEST FOR PROPOSAL FOR
CONVERSION OF SAN JUAN UNITS 5 AND 6
TO NATURAL GAS

CASE NO.: CEPR-AI-2018-0001

SUBJECT: Resolution and Order of January
25, 2019.

Associate Commissioner Ángel R. Rivera de la Cruz, dissenting

Today, the majority of the Puerto Rico Energy Bureau ("Energy Bureau") determined, to approve the proposed Fuel Sale and Purchase Agreement presented by the Puerto Rico Electric Power Authority ("PREPA") regarding the process for the conversion of San Juan Units 5 and 6. For the reasons expressed herein, I dissent.

* * *

A. Compliance with PREPA's Integrated Resource Plan

Act 57-2014¹ defines the Integrated Resource Plan ("IRP") as "a plan that considers all reasonable resources to satisfy the demand for electric power services during a specific period of time, including those related to the offering of electric power, whether existing, traditional, and/or new resources, and those related to energy demand, such as energy conservation and efficiency or demand response and localized energy generation by the customer."² The goal of the IRP analysis and approval process is to determine the optimal resource mix that represents the least-cost option to supply the projected energy demand over the planning horizon of twenty years.

As we have previously stated, the conversion of San Juan Units 5 and 6 was not considered as part of the analysis and authorization process of the IRP approved by the Energy Bureau on September 23, 2016.³ Moreover, preliminary results of the PREPA Updated IRP show that, under certain scenarios, San Juan Unit 6 should be economically retired as early as 2024, with San Juan Unit 5 being economically retired as early as 2026.⁴

¹ The Puerto Rico Energy Transformation and RELIEF Act, as amended.

² Act 57-2014, Section 1.3(ee).

³ See Resolution and Order, Case No. CEPR-AI-2018-0001, November 21, 2018, Commissioner Ángel R. Rivera de la Cruz dissenting, p. 1.

⁴ See PREPA IRP 2018 Preliminary results of the Long Term Capacity Expansion Plan, October 31, 2018, p. 24. On Scenario 2 Strategy 2, Under Base Load, the retirement of San Juan 6 occurs in 2025 and San Juan 5 in 2033, *id.*, p. 13. On Scenario 4 Strategy 3, Under Base Load, the retirement of San Juan 6 occurs in 2024 and San Juan 5 in 2033, *id.*, p. 13

I reiterate my position that the proposed conversion of San Juan Units 5 and 6 is an implicit modification of the Approved IRP and that the Request for Proposals ("RFP") process for the proposed conversion of San Juan Units 5 and 6 doesn't comply with the public policy on energy regarding integrated resource planning.⁵ As I stated before, neither Act 57-2014 nor Act 83⁶ granted the Energy Bureau the power to modify the IRP in this manner.⁷ The Energy Bureau has the power to modify an approved IRP, but such modification must be done following the IRP approval procedures established in Section 6B of Act 83 and Section 6.23 of Act 57-2014.⁸

Furthermore, Section 7.1(d) of Regulation 8815⁹, establishes that the Energy Bureau must evaluate the proposed contract to determine if it is consistent with the IRP. Since the conversion of San Juan Units 5 and 6 is not consistent with the Approved IRP, it follows that the proposed contract for the implementation of such conversion cannot be consistent with it.

B. Compliance with certain provisions of Act 83 and Act 57-2014

Subsection (c) of Section 6A of Act 83 establishes that the fuel and purchased power charges shall only contain the costs directly related to the purchase of fuel and the purchase of power respectively. No other cost or charges can be included in the fuel adjustment clause or the purchased power adjustment clause. Moreover, Section 6.25(b)(9) of Act 57-2014 establishes that the Energy Bureau can only approve under the fuel and purchased power adjustment clause, the costs directly related to the fluctuations due to price changes in fuel and purchased power. Like Section 6A of Act 83, the referenced Section 6.25(b)(9) also establishes that no other cost or charges can be included in the fuel adjustment clause or the purchased power adjustment clause.

⁵ See Resolution and Order, Case No. CEPR-AI-2018-0001, October 4, 2018, Commissioner Rivera de la Cruz dissenting, pp. 3 - 5, and Resolution and Order, Case No. CEPR-AI-2018-0001, November 21, 2018, Commissioner Ángel R. Rivera de la Cruz dissenting, p. 3.

⁶ Act 83 of May 2, 1941, known as The Puerto Rico Electric Power Authority Act, as amended.

⁷ See Resolution and Order, Case No. CEPR-AI-2018-0001, November 21, 2018, Commissioner Ángel R. Rivera de la Cruz dissenting, p. 3.

⁸ *Id.*

⁹ Joint Regulation for the Procurement, Evaluation, Selection, Negotiation and Award of Contracts for the Purchase of Energy and for the Procurement, Evaluation, Selection, Negotiation and Award Process for the Modernization of the Generation Fleet.

According to PREPA, the estimated cost of the conversion of the San Juan Units 5 and 6 to burn natural gas is between \$10 million and \$30 million.¹⁰ As discussed below, this cost represents a capital investment, commonly known as capital expenditure or CAPEX. Such investment will be made to modify San Juan Units 5 and 6 from diesel-fired to dual-fuel units and to improve their capacity factor¹¹ and heat rates.¹² Moreover, PREPA stated that this CAPEX will be embedded as a cost associated to fuel.¹³

Utilities normally fund their CAPEX through loans (e.g. bond issues) that are paid off during the lifespan of the equipment. The source of income for these payments is the utilities' rates. However, as discussed in the most recent rate case, PREPA doesn't have access to capital markets.¹⁴ As a consequence, PREPA's "only source of funds for long-term capital expenditures are today's customers."¹⁵

As stated before, PREPA intends to treat the CAPEX associated to the conversion of San Juan Units 5 and 6 as a fuel cost. This action is problematic in two ways. First, the CAPEX associated with the referred conversion was not part of the revenue requirement approved by the Energy Bureau in the most recent rate case.¹⁶ Therefore, in order for PREPA to recover such costs from its customers (i.e. through rates), it must request authorization from the Energy Bureau. PREPA has not.

Second, if PREPA treats CAPEX costs as fuel costs, then it will recover such costs through the fuel adjustment clause contained in PREPA's current rates. San Juan Units 5 and

¹⁰ See PREPA Governing Board Resolution 4620, Request for Proposal – Fuel for North and Conversion of Units 5 & 6 – San Juan, July 30, 2018, p. 2. See also Administrative File, Technical Conference of August 24, 2018, testimony of Jaime Umpierre at 41:05 – 42:51.

¹¹ See, Memorandum from Walter M. Higgins, Chief Executive Officer and William Ríos Mera, Generation Director, June 20, 2018, p. 2.

¹² See Administrative File, Technical Conference of August 24, 2018, testimony of Jaime Umpierre at 33:50 – 34:36.

¹³ See Administrative File, Technical Conference of August 24, 2018, testimony of Fernando Padilla at 1:32:50 – 1:33:14. See also, PREPA's *Request for Proposals for Fuel Supply in the North and Conversion of San Juan Units 5 and 6*, RFP 81412, July 30, 2018, p. 9. "The Contractor shall include the cost of the scope for PREPA's Unit 5 and 6 conversion as part of its proposal in the form of a capacity payment over the initial Base five (5) year term of the Agreement." In a power purchase agreement, capacity payments are normally associated with a contracted power availability. As an example, the economic clauses of PREPA's current power purchase agreements with AES Puerto Rico, L.P. and EcoEléctrica, L.P. contain capacity payment charges. The costs associated to the capacity payment charges are recovered through the purchased power adjustment clause contained in PREPA's current rates.

¹⁴ See in general, Final Resolution and Order, Case No. CEPR-AP-2015-0001, January 10, 2017, pp. 31 – 35.

¹⁵ *Id.*, p. 32, ¶ 74.

¹⁶ See in general, Case No. CEPR-AP-2015-0001.



6 CAPEX costs **are not** directly related to the purchase of fuel.¹⁷ Nor such CAPEX costs are directly related to the fluctuations due to price changes in fuel and purchased power. Therefore, according to the provisions of Section 6A of Act 83, and Section 6.25(b)(9) of Act 57-2014, PREPA is precluded from recovering such costs through the fuel adjustment clause. Hence, PREPA cannot, nor can the Energy Bureau approve, to recover the costs associated with the conversion of San Juan Units 5 and 6 through the fuel adjustment clause.¹⁸

C. Inconsistency with the original conversion cost estimate

As stated before, the estimated cost of the conversion of the San Juan Units 5 and 6 to burn natural gas is between \$10 million and \$30 million. However, the actual cost associated with the conversion, as stated in the proposed Fuel Sale and Purchase Agreement under our consideration, is significantly different from the original PERPA estimates and from the amount detailed in similar proposals submitted by other bidding companies.¹⁹ No explanation was provided for this variation.

Moreover, from the payment structure detailed in the proposed Fuel Sale and Purchase Agreement, it is not clear what is the cost of financing the CAPEX (i.e. cost of capital). In addition, the proposed payment structure doesn't detail the actual costs of the conversion of San Juan Units 5 and 6; it only reflects the final cost to be borne by PREPA and ultimately PREPA's customers.

One of our main duties as regulators is to determine if the expenditures incurred by PREPA are prudent, especially when the costs associated with such expenditures will be recovered through rates. Based on the provided information, it is not possible to determine

¹⁷ During the most recent rate case, PREPA requested, and the Energy Bureau approved, to recover several costs associated with fuel through the fuel adjustment clause. See Final Resolution and Order, Case No. CEPR-AP-2015-0001, January 10, 2017, p. 59. These costs included: fuels (residual, distillate, natural gas, propane, additives), transportation, inspection, laboratories, storage, handling, delay, taxes, and hedging. *Id.*, Directives on Fuel. CAPEX was not one of these costs. On the other hand, PREPA requested to recover several items as CAPEX costs, including refurbishing individual turbines or generators; building new poles and lines; acquiring advanced transmission and distribution equipment; ordering new utility vehicles, computer systems, and network equipment, among others. *Id.*, p. 63, ¶ 172. The conversion of San Juan Units 5 and 6 is consistent with CAPEX costs. It is not consistent with the procurement of fuel.

¹⁸ The intention to repay CAPEX costs associated to the conversion of San Juan Units 5 and 6 through a "Capacity Payment", (see PREPA RFP 81412, July 30, 2018, p. 9), using revenues recovered from PREPA's customers through the fuel adjustment clause is a direct violation of the provisions of Section 6A of Act 83 and Section 6.25(b)(9) of Act 57-2014.

¹⁹ See in general bid submittals, PREPA RFP 81412. Through Resolution and Order of November 2, 2018 in the instant case, the Energy Bureau determined to grant confidential treatment to such documents. The selected company proposed a "Capacity Payment" schedule for the term of the contract that significantly varies from the estimated conversion cost. No explanation was given, nor a justification was provided for this variation.

at this time if the referenced change in cost is prudent or if the actual cost of capital is appropriate and in the best interest of PREPA's ratepayers.²⁰



D. Inconsistency with the 1974 Bondholder Trust Agreement

Part IV of Section 2.0 of the RFP states in part that "[t]he Contractor shall include the cost of the scope for PREPA's Unit 5 and 6 conversion as part of its proposal in the form of a capacity payment over the initial Base five (5) year term of the Agreement".²¹ This is a clear indication that PREPA intends to treat the CAPEX costs as operational costs. As we discussed above, the result of this action is that the costs associated with the modernization of San Juan Units 5 and 6 would be considered a fuel expense.

The 1974 PREPA's Trust Agreement²² ("1974 Trust Agreement") defines the term "Current Expenses" as:

[T]he Authority's reasonable and necessary current expenses of maintaining, repairing and operating the System and shall include, without limiting the generality of the foregoing, all administrative expenses, insurance premiums, expenses of preliminary surveys not chargeable to Capital Expenditures, **engineering expenses relating to operation and maintenance**, fees and expenses of the Trustee, the 1947 Trustee, the Paying Agents and of the paying agents under the 1947 Indenture, legal expenses, any payment to pension or retirement funds, and all other expenses required to be paid by the Authority under the provisions of the 1947 Indenture, this Agreement or by law, or permitted by standard practices for public utility systems, similar to the properties and business of the Authority and applicable in the circumstances but shall not include any deposits to the credit of the Sinking Fund, the Reserve Maintenance Fund or the 1947 Sinking Fund or deposits under the provisions of Sections 511, 512 and 513 of the 1947 Indenture.²³

The 1974 Trust Agreement defines the term "Improvements" as:

[S]uch improvements, **renewals** and replacements of the System **or any part thereof** and such extensions and additions thereto as may be necessary or desirable, in the judgment of the Board, **to keep the same in proper condition for the safe, efficient and economic operation** thereof

²⁰ See proposed Fuel Sale and Purchase Agreement. Through Resolution of January 3, 2019 in the instant case, the Energy Bureau determined to grant confidential treatment to the Fuel Sale and Purchase Agreement.

²¹ RFP 81412, July 30, 2018, p. 9.

²² Trust Agreement, Puerto Rico Water Resources Authority to First National City Bank, Trustee, January 1974.

²³ *Id.*, Section 101, p. 18. Emphasis supplied.

and to integrate into the System any unit or part thereof, and shall include such electric-power projects as may be authorized to be acquired or constructed by the Authority under the provisions of the Authority Act and such improvements, renewals and replacements of such properties and the System and such extensions and additions thereto as may be necessary or desirable for continuous and efficient service to the public, which shall be financed in whole or in substantial part from the proceeds of bonds issued under the provisions of the 1947 Indenture or this Agreement or from moneys deposited to the credit of the 1947 Construction Fund, the Construction Fund or the Renewal and Replacement Fund.²⁴

Moreover, the 1974 Trust Agreement defines the term "Capital Expenditures" as "all expenditures made on account of the cost of the Capital Improvement Program, as defined in the 1947 Indenture, **and the cost of Improvements under this Agreement** and the 1947 Indenture and those expenditures made for the purposes for which funds are provided pursuant to the provisions of Section 512 of the 1947 Indenture."²⁵ Finally, the 1974 Trust Agreement defines the term "Cost", as applied to any Improvements, as "**the cost of the acquisition and construction** and all obligations and expenses and all items of cost which are set forth in Section 403 of this Agreement."²⁶

One of the purposes of the 1974 Trust Agreement was to allow PREPA "to make provision for the issuance from time to time of revenue bonds on a parity with the bonds issued initially under the provisions of this Agreement for the purpose of paying all or any part of the cost of any Improvements."²⁷ As part of the agreement, PREPA pledged that "upon the acquisition or construction of any Improvements, it will forthwith integrate the properties so acquired or constructed with the System and will thereupon operate and maintain the System and all of such properties as an integrated system."²⁸ Moreover, PREPA also pledged that "**it will not create or suffer to be created any lien or charge upon the System or any part thereof or upon the Revenues** ranking equally with or prior to the

²⁴ *Id.*, pp. 19 - 20. Emphasis supplied.

²⁵ *Id.*, p. 17. Emphasis supplied.

²⁶ *Id.*, p. 18. Section 403 of the Trust Agreement detailed the items of costs associated with the Improvements. They include "the cost of acquisition or construction and equipment and all other items of cost incident to such acquisition and construction and equipment and the financing thereof" including obligations incurred for labor and materials and to contractors and expenses of administration properly chargeable to any Improvements and all other items of expense incident to the acquisition or construction and equipment of any Improvements.

²⁷ *Id.*, p. 4.

²⁸ *Id.*, Section 702, p. 62.



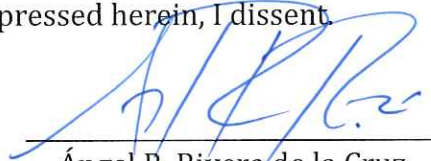
bonds”.²⁹ Therefore, PREPA is required to integrate with the System³⁰ all Improvements and, more important, PREPA cannot create an additional lien on the System or part thereof.

The CAPEX costs associated with the conversion of San Juan Units 5 and 6 **are not** administrative expenses, insurance premiums or engineering expenses relating to operation and maintenance. Therefore, such CAPEX costs cannot be considered operational expenses or Current Expenses, as such term is defined in the 1974 Trust Agreement.

The costs associated with the conversion of San Juan Units 5 and 6 are consistent with a Capital Expenditure associated with an Improvement to PREPA’s System, as such terms are defined in the 1974 Trust Agreement. Therefore, once completed, the converted units will become part of the System for the purposes of the 1974 Trust Agreement. However, the conversion creates a PREPA obligation towards the company to which the RFP was adjudicated, which is different and separate from PREPA’s obligation towards its bondholders pursuant to the 1974 Trust Agreement. Such obligation is tied up with a Capital Expenditure for an Improvement that will be integrated to the System. Therefore, it might be considered a lien on part of such System, which might be in conflict with the provisions of the 1974 Trust Agreement that preclude PREPA from establishing such liens.

Finally, it is important to note that PREPA is currently involved in a bankruptcy-like procedure, pursuant to the provisions of Title III of the *Puerto Rico Oversight, Management, and Economic Stability Act* (“PROMESA”).³¹ The effect PREPA’s obligation (or lien) associated with the conversion of San Juan Units 5 and 6 might have on the PROMESA Title III proceeding is not completely clear at this time. As a result, it is not possible to determine that such conversion is consistent with the 1974 Trust Agreement.

For all the reasons expressed herein, I dissent.


Ángel R. Rivera de la Cruz
Associate Commissioner

In San Juan, Puerto Rico, on January 25, 2019.

²⁹ *Id.*, Section 705, p. 64. Emphasis supplied. The only exception to this provision was the lien and charge of the 1947 Indenture Bonds and the bonds issued and secured by the 1974 Trust Agreement.

³⁰ The 1974 Trust Agreement defined the term “System” as “all the properties presently owned and operated by the Authority as a single integrated system, together with all works and properties which may be hereafter acquired or constructed by the Authority in connection with the production, distribution or sale of electric energy and the acquisition or construction of which shall be financed in whole or in part from the proceeds of bonds issued under the provisions of the 1947 Indenture or this Agreement or from moneys deposited to the credit of the 1947 Construction Fund, the Construction Fund or the Renewal and Replacement Fund.” *Id.*, Section 101, pp. 23 – 24.

³¹ PL 114-187.