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

1525 JAN 19 PM 1-10

IN RE: DESIGN OF FUEL PROCUREMENT HEDGING STRATEGY PROGRAM FOR THE	Case No. NEPR-MI- 2022-0004
PUERTO RICO ELECTRIC POWER AUTHORITY	SUBJECT: ICSE INITIAL COMMENTS

ICSE INITIAL COMMENTS ON THE HEDGING PROGRAM

TO THE BUREAU:

Now comes Instituto de Competitividad y Sostenibilidad Económica de Puerto Rico (ICSE) represented by appearing counsel.

I. Introduction

On October 13, 2022, this honorable Bureau in exercising its powers to curtail and tackle electric price volatility initiated the current proceeding in the Order and Resolution of the same date. Given that the proceeding is still nascent in terms of regulatory activity, ICSE takes this opportunity to submit initial comments on what should be the preferential framework according to the Puerto Rico Energy Public Policy as per Act 17-2019.

II.

We appreciate the Bureau's intention to develop a hedging program for PREPA's fuel procurement to mitigate vulnerabilities to price fluctuation. We note, however, that hedging is just one of many tools available to pursue the primary objective of electric price stabilization. In fact, we point out that a continuous program to purchase energy futures is like an insurance program that will have a mostly incremental effect on average costs which translates into marginally higher rates.

It is important to understand that hedging does not lower costs. It is merely a tool that helps provide greater—but not perfect—certainty on future commodity (fuel) prices. To that effect, we respectfully suggest that the PREB take a more holistic view of the program and evaluate a hedging program within the context of other alternatives with the goal of stabilizing and lowering electricity prices. We suggest, for example, that the program be redefined from a "Hedging Program for the Purchase of Fuels in Future Markets" to an "Electric Price Stabilization Program".

To illustrate, we observe that recent WTI oil price futures have dropped from \$114 per barrel in May 2022 to \$77 per barrel in November 2022 with a downward trend.¹ Any hedges purchased at high prices would have expired out of the money and the premium would have been lost. In practice, this could represent millions of dollars that could have been allocated to permanent programs that have a material and long-term impact on consumer purses. Of course, we understand that previously, futures had run up from lower prices, and if hedges had been in place, some of that volatility could have been mitigated. The point is that every dollar that could go to purchasing futures contracts should be weighed against viable alternatives that, on average, could incrementally contribute to stabilizing prices on a long-term basis. These could include energy efficiency programs, subsidies for renewable energy, a fuel stabilization fund, and others.

In order to properly evaluate alternatives, and to supervise the work of the consultant, we reiterate the need for greater transparency on system operational data. It is not only an industry standard in many modern markets, but it is a legal requirement in Puerto Rico that the system operator frequently publishes data associated with unit generation, costs, outages, heat rate, among others. The lack of regularly published information in a standard industry format puts the public, policymakers, industry leaders, investors, and even regulators, at a significant informational disadvantage to the incumbent utility company. The ongoing availability of daily operational capacity, and hourly generational statistics with pricing is critical to evaluate the metrics of operational behavior and the size of hedges and other price stabilization alternatives. The primary data is currently available

¹ <u>https://www.investing.com/commodities/crude-oil-historical-data</u>

and used publicly, but selectively, by PREPA, LUMA, and others to justify their actions or petitions, yet it's regularly unavailable for the public to perform proper research and analysis.

For example, if it is discovered that forced outages in base load power plants (an operational issue) are triggering the frequent use of peaking plants and those are disproportionately contributing to expensive fuel procurement on the spot market, the data would demonstrate it and corrective action could be taken sooner rather than later. The data analysis could then be used to evaluate solutions that better fit the problem and optimize the use of funds, like for example procuring customized energy storage instead of buying ephemeral financial instruments. Similarly, if higher marginal cost units are being triggered by consumption, the use of virtual power plants and demand side solutions could help mitigate, and those could be funded with funds originally allocated for hedging.

We note that this Bureau requested in its Resolution and Order kickstarting the current proceeding with the pertinent information previously discussed. Nonetheless, what ICSE envisions as the most appropriate mechanism is real-time reporting so that information requests, unless very specific, are not needed. The practice for years has been that the Bureau must request information as it deems through resolutions and orders. This is not good public policy. This data should be available at all moments as a matter of public disclosure so that the Energy Bureau and its stakeholders have informational continuity in any research, data analysis, and modeling they carry out in the course of commerce, rulemaking, policy-making, and academic research.

As for the consultant, we appreciate the expertise and market knowledge of the suggested party. However, we urge caution in blindly following the recommendations of a firm that could have economic interests in the solution that it is providing, and respectfully request that the draft results of any study be made available for public comment and scrutiny prior to any decision being made.²

² This statement shouldn't be construed in any way whatsoever as an accusation that there exists an actual economic interest on part of the consultant. ICSE merely states that as a matter of <u>design</u> of regulatory practice, this information should be available as a preemptive measure of the aforementioned circumstance.

Regarding the need for a holistic treatment, ICSE takes this opportunity to once again request that the Bureau evaluate the consolidation of various proceedings. There are various mechanisms to mitigate the damage caused by price volatility. Among these, the most relevant in line with the current public policy are: distributed generation, energy efficiency, and demand response programs, as well as energy generation projects based on renewable sources at both distributed and centralized levels.

There are multiple factors that are considered in their corresponding proceedings that may be complementary to an effort in stabilizing energy prices. In contrast to the variable costs associated to the purchase of fossil fuels, in the case of generation based on renewable sources these costs are replaced by capital costs which are fixed at a particular point in time; that is, they do not fluctuate unlike commodity prices. It is similar with energy storage projects. However, the latter is better suited to mitigate price volatility, since it not only serves as supplementary short-term capacity, but can also complement the existing generation fleet in substituting peaking plants. Thus, lower cost, efficient, fossil fuel-based addispatched at times of peak demand without having to trigger expensive variable cost, *i.e.*, low-efficiency units. This is also complementary to renewable energy intermittency.

Lastly, we note, that for a capital starved electric utility it would be a natural bias to choose solutions that are comprised mostly of high variable costs and low capital costs that can be passed through to the consumer, instead of more optimal solutions that would require capital investment or ceding control. We could possibly point to many examples, including the switch through time of more refined, higher-cost fuels to comply with environmental regulations than making investment in environmental controls. In analogous fashion, the use of peakers and hedging mechanisms could create the illusion of price stability when, in reality, it's an unnecessary increment to variable costs. Therefore, this mechanism does not necessarily provide for the inclusion of ongoing programs under other proceedings. This leads us to conclude once more that the design

³ Meaning "highly efficient generation" as per its definition in Art. 1.11. of Act 17-2019 and Art. 6.29. of Act 57-2014.

of the program in question cannot ignore current realities in the multiple dockets before the PREB.

111.

There are many ways the PREB can go about this proceeding, but the most important aspect is to evaluate the impacts on energy prices entailed by other proceedings, and to consolidate in the current proceeding said analyses. Given these other proceedings represent a more programmatic approach regarding the advancement of public policy, their solutions should take precedence on any additional undertaking.

In terms of the public policy and PREB obligations, there may appear to be conflicting views. For example, one could state that given the PREB's obligation to reduce market price fluctuations, a hedging program is the perfect medium to achieve this. Another could say that Act 17 mandates establishes the sole framework on how to reduce volatility, mainly energy efficiency, demand response, and distributed generation. ICSE rejects this apparent conflict. The PREB's powers are very broad and permit the incorporation of multiple measures not necessarily envisioned in current statutes⁴. However, the statutes are very clear on priority of measures.

A hedging program's necessity and practicality should consider how it would change as the IRP's implementation takes place. Penetration of distributed measures may render a current hedging program inappropriate and even obsolete. Since the public policy indeed exists to abolish fossil fuel dependency, the program in turn should be designed with phasing-out measures as to serve as an additional reinforcement of Act 17 mandates.

IV.

This proceeding may prove a valuable tool for the PREB to control volatility in energy prices. However, there are other mechanisms provided by law that inherently reduce fossil fuel dependency and, as a consequence, lead to stable prices. Mainly, these

⁴ For example, last summer ICSE recommended a different recoupment model in the Rate Proceeding. NEPR-MI-2020-0001, <u>In Re: Puerto Rico Electric Power Authority's Permanent Rate</u>, *Moción en oposición a tratamiento confidencial de reclamaciones a aseguradoras y solicitud para adoptar mecanismo de recobro más beneficioso al consumidor*, pp. 9-12 (July 28, 2022).

mechanisms are accelerating distributed energy, demand response and energy efficiency programs, and overall penetration of renewable energy generation. ICSE recommends developing the current proceeding as to also serve as an additional tool in advancing said statutory mandates and warns that overreliance on hedging programs could have a counterproductive impact on the programmatic agenda enshrined in the energy public policy.

CERTIFY: I hereby certify that, on this same date, we have submitted this motion notified by email to: katuiska Bolaños, <u>kbolanos@diazvaz.law</u>; Joannely Marrero-Cruz, <u>jmarrero@diazvaz.law</u>; Margarita Mercado Echegaray, Margarita Mercado Echegaray, <u>margarita.mercado@us.dlapiper.com</u>; Yahaira De La Rosa Algarín, yahaira.delarosa@us.dlapiper.com.

RESPECTFULLY SUBMITTED, in San Juan, Puerto Rico on January 19, 2023.

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