

Appendix A

Commission-FOMB Cooperation: Essential Protocols

This document describes procedures by which the Commission and FOMB can coordinate their decisions affecting PREPA. The bold headings identify each subject or action over which the Commission has authority under Commonwealth law. The italicized material has two purposes. First, it describes, where relevant and necessary, the policy reasons for the Commission's obligations, so that FOMB—which is not experienced in utility regulation—understands why Puerto Rico's welfare depends on the Commission carrying out its duties. Second, it presents a proposed procedure by which the two agencies would make decisions.

Underlying each of the draft ideas are the following legal or policy principles:

- a. The Commission has been, since 2014, the statutory agency responsible for ensuring that PREPA's performance serves the Commonwealth's public interest, as that public interest is defined by Act 57-2014 and other statutes. The Commission, or any successor, will continue in that role after FOMB exits Puerto Rico.
- b. PROMESA does not make FOMB Puerto Rico's utility regulator. FOMB does not have authority to mandate or authorize substantive electricity actions that are within the Commission's jurisdiction but have not been approved by the Commission. For a detailed explanation, see the Commission's Policy Statement issued January 23, 2018 and the Complaint against FOMB and PREPA filed with the federal Court on March 4, 2018.
- c. The preemption provision of PROMESA § 4 signals "conflict preemption," not "occupation of the field" preemption. See the Policy Statement. At the same time, PROMESA requires FOMB to act consistently with Commonwealth law. The combination of these two PROMESA features yields this result: FOMB's directives to PREPA, when taken within FOMB's PROMESA authority, preempt the Commission only when it is not possible to design those directives consistently with Commonwealth law, as applied by the Commission.
- d. PREPA, supported by AFFAF, routinely disobeys or ignores Commission orders, usually citing as a reason FOMB's presence and its asserted powers. FOMB has not directed PREPA to obey the Commission's orders; nor has FOMB issued any orders that would achieve what the Commission must achieve under Act 57. The result, well-known to FOMB, is that PREPA is acting as an unregulated monopoly, contrary to the letter of Act 57 and the intent of PROMESA.
- e. There is no benefit, only harm, from a series of lawsuits in which FOMB challenges Commission actions, the Commission challenges FOMB actions, PREPA resists Commission orders and/or the Commission sues PREPA for failure to heed Commission orders.

- f. There is, for each area listed below, some solution that makes the best use of the Commission's and FOMB's powers, so as to end PREPA's practice of noncompliance.

With this document, the Commission intends to display the type of thoughtfulness and advance thinking that are necessary to serve its constituents. With reciprocation by FOMB, the public will be served.

The document addresses the following seven subject areas:

- 1. *Spending, cost recovery and rate-setting***
- 2. *Contracts***
- 3. *Customer relations***
- 4. *Supply and demand resources***
- 5. *Internal PREPA operations***
- 6. *Finance***
- 7. *Market structure transformation***

1. Spending, cost recovery and rate-setting

1.1. Approve budgets

1.1.1. Purpose

1.1.1.1. In a nonprofit utility, all costs, once incurred, must be reflected in rates. But for rates to be just and reasonable, they must reflect only prudent costs. The Commission thus can ensure just and reasonable rates only by preventing imprudent costs before they are incurred. The only way to do so is by establishing advance caps on spending, through procedures that (a) review and approve (or modify) budgets before they go into effect and (b) audit PREPA to ensure to that its spending does not exceed the approved budgets.

1.1.1.2. Separate from establishing caps on spending is ensuring sufficient spending. Approving budgets, then setting rates consistent with those budgets, ensures that sufficient funds are available to (a) carry out PREPA's obligation to serve, as that obligation is defined by an approved Integrated Resource Plan (IRP) and other projects ordered or approved by the Commission or mandated by Commonwealth law; and (b) comply with obligations to bondholders.

1.1.2. Procedure

1.1.2.1. (a) PREPA submits its annual budget simultaneously to the Commission and FOMB, under a schedule that the Commission and FOMB develop jointly in consultation with PREPA. The proposed budget would conform to advance guidelines prepared jointly by the Commission and FOMB. There should be separate budgets for (i) capital projects and (ii) operations and maintenance.

(b) The Commission would hold an official proceeding under Act 57 to review, modify as necessary, then approve a budget. FOMB can participate in this proceeding to avoid duplicative or serial processes. The Commission would play this role because (a) it has that duty under Act 57 and (b) it has the technical expertise and administrative procedures that ensure a rigorous and efficient investigation. Rigor is especially important given PREPA's history of undisciplined spending and inadequate recordkeeping, as detailed in the Commission's Rate Order of January 10, 2017.

1.1.2.2 The total budget approved by the Commission must be consistent with any FOMB-approved Fiscal Plan (assuming such FOMB-approved Plan does not contain details outside the FOMB's authority to mandate—as explained in the Commission's Policy Statement). "Consistent" means that PREPA can simultaneously operate within the budget and carry out all Fiscal Plan activities. "Consistent" means the budget does not leave PREPA with insufficient funds to carry out the Plan; nor does the budget include projects not within the Fiscal Plan,

unless such projects are required by a Commission-approved IRP (which the Fiscal Plan must accommodate anyway, per PROMESA's requirement that the Fiscal Plan be consistent with Commonwealth law).

1.1.2.3 For this joint effort to work, (a) FOMB will need to direct PREPA and AFFAF to drop its appeal of the Commission's Jan. 2017 Rate Order establishing Commission review of PREPA's budgets, which is pending in federal court due to AFFAF's Notice of Removal (which FOMB authorized). The Notice of Removal implicitly misinterprets PROMESA section 4 as establishing "occupation of the field" preemption, whereas section 4 establishes only "conflict" preemption. There is no conflict today; and if the Commission and FOMB work out a coordinated procedure schedule for budget review, there will be no conflict. It is illogical for FOMB to assert conflict when it has not participated in coordination efforts aimed at avoiding conflict.

1.1.2.4. The FOMB has authority to modify a Commission-approved budget, to the extent required for consistency with an FOMB-approved Fiscal Plan. The FOMB does not have authority to approve a budget, or a Fiscal Plan, that is inconsistent with a Commission-approved IRP.

1.1.2.5. If PREPA refuses or fails to comply with a Commission-approved budget, the FOMB and the Commission shall execute one or more joint strategies to produce compliance, using both Commonwealth law and PROMESA. FOMB and the Commission should design those strategies now, then ensure that PREPA understands them. Such design and notice will, we hope, make these strategies unnecessary.

1.2. Establish revenue requirement

1.2.1. The Commission will establish PREPA's revenue requirement, as required by Act 57, according to its normal procedures. The revenue requirement in total must be consistent with the approved budgets and thus with any FOMB-approved Fiscal Plan. For example, if the Fiscal Plan calls for a particular level of payments for debt service, the Commission-set revenue requirement must include a line item for that debt service. It is possible, however, that some or all of the debt service associated with existing debt will be addressed outside of the normal revenue requirement through a special charge, similar to that approved by the Commission in its Resolution of June 21, 2016.

*1.2.2. **Questions** for the Commission and FOMB to address together, to avoid inconsistencies among the revenue requirement, the Fiscal Plan and any approved budgets.*

- 1.2.2.1. *Given the Judge's CTO Order, does PROMESA allow FOMB's Fiscal Plan to specify individual projects, and costs for those projects? What is the appropriate level of detail for an FOMB-approved PREPA Fiscal Plan?*
- 1.2.2.2. *If an FOMB Fiscal Plan mandates or approves specific projects, should that FOMB Fiscal Plan have project cost caps? If not, what is the means of ensuring project budget compliance?*
- 1.2.2.3. *What are the best procedures for ensuring that the Fiscal Plan does not include projects the Commission deems inconsistent with an approved IRP, given that PROMESA sec. 503(b)(1)(D) renders such projects ineligible for Critical Project status?*
- 1.2.2.4. *Where the FOMB Fiscal Plan identifies a particular project and cost level, the Commission has the legal authority, for rate purposes, and in advance of spending, to reduce the allowable cost of a particular item from the FOMB-approved level if the Commission finds a lower cost is reasonable. By what procedure do we ensure that PREPA understands this point, so that PREPA does not lobby FOMB—which lacks the Commission's expertise and its procedures for truth-seeking—for an excessive project budget and then assert that the Commission is preempted from requiring a lower budget? Under preemption precedent a lower Commission budget for a given project does not cause a conflict with FOMB because PREPA can comply simultaneously with a low budget and a higher budget; by not exceeding the lower ceiling it is not violating the higher ceiling. A difference is not a conflict; a conflict exists only if compliance with both orders is impossible. (We recognize that this reasoning does not work in the other direction; the Commission cannot authorize PREPA to spend more money than a Fiscal Plan has allowed—again assuming the FOMB requirements in the Fiscal Plan do not exceed FOMB's PROMESA authority.)*

1.3. Establish revenue allocation and rate design

- 1.3.1. *The Commission would establish revenue allocation and rate designs in PREPA rate cases.*
- 1.3.2. *There is no FOMB authority to establish or modify revenue allocation or rate designs.*
- 1.3.3. **Question:** *Revenue allocation involves allocating costs among customer groups. To protect and promote economic development, the Commission has statutory authority to under-allocate fixed costs to commercial and industrial customers (thus necessarily over-allocating costs to residential customers). How may, or should, or must, the Commission take into account FOMB policies on economic development when the Commission makes revenue allocation decisions?*

1.3.4. **Question:** *PREPA's revenue projections are based on assumed elasticities of demand. Those elasticities vary by customer class. Revenue therefore may vary depending on cost allocation. What procedures are necessary to ensure that revenue projections in an FOMB-approved Fiscal Plan are consistent with revenue allocation and rate designs established by the Commission?*

1.4. Establish procedure for updating revenue requirement and rates

There are no incremental issues here relative to those raised in other sections under spending, cost recovery and rate-setting.

2. Contracts

2.1. Substance

2.1.1. *Consistent with the Commission's obligation to prevent imprudent costs before they are incurred, the Commission will review and approve contracts. Act 57 imposes that duty. Also, Act 57 as well as the Commission IRP Order impose an obligation that PREPA competitively bid specific generation-related projects as a means of securing the best cost for these projects. The Commission's duties include overseeing that process. Act 4-2016 has some variations on this point for public-private partnership projects but the Commission duty to prevent imprudent costs remains.*

2.1.2. *A conflict could arise if the FOMB and the Commission have different views about any feature of a contract—its purpose, its cost, its allocation of risk, the appropriate counter-party, the process of selecting the counter-party, or the manner of implementation. However, such difference of opinion would create a preemptive conflict only if FOMB **ordered** PREPA **not** to execute a particular contract, while the Commission **ordered** PREPA **to** execute that contract, assuming FOMB was acting within the limited scope of its authority (e.g., its reason for rejecting a contract was fiscal rather than substantive, as explained in the Commission's Policy Statement).*

*A difference of opinion also would arise if FOMB **ordered** PREPA to enter a particular contract, while the Commission ordered PREPA **not** to enter that contract. But that difference of opinion would not trigger preemption because, as explained in the Commission's Policy Statement, FOMB has no authority to order PREPA to enter particular contracts where the effect is to determine substantive electricity policies.*

2.1.4. *FOMB's policy on contracts says that to the extent FOMB says so, contracts must be the "result of a competitive and transparent procurement and tender process...." If FOMB says a particular contract need not be the result of a competitive bidding process, that statement does not prevent the Commission from requiring a competitive process. The situation would represent a difference of opinion but not a conflict,*

*because PREPA will be able to comply simultaneously with the FOMB and the Commission orders. There would be a conflict only in the unlikely case that the FOMB mandated that there **not** be a competitive procurement. Such a mandate would be beyond the FOMB's statutory authority. The Commission with its continuing expertise is in the better position to determine when conditions justify a waiver of or adjustment to competitive bidding.*

2.2. Procedures

2.2.1. PREPA would submit each proposed contract to the Commission and the FOMB simultaneously. On receiving the contract, FOMB and the Commission would determine a review schedule.

2.2.2. Per that schedule, each agency would act, giving its reasons. Before actions become formally issued, informal collaboration between the two entities would be useful. For example, the Commission would assess the contract and its associated scope of work in terms of prudent practices, consistency with the approved budget and consistency with the IRP (where the IRP is relevant).

2.2.3. Commission and FOMB should identify now the scheduling plan, and also the criteria each will apply, so that each entity's scrutiny is supportive of the other's.

2.2.5 In addressing contracts, the Commission will consider the resource needs identified in the IRP, as informed by the Commonwealth's situation. The IRP, for example, provides a list of specific transmission projects related to expansion. Any proposal for a transmission project deviating from this list must be accompanied by a justification of its necessity and cost-effectiveness.

2.2.6. PREPA needs to notify the Commission of all contracts, even those under the stated cap, so we can keep an eye out for patterns, like contracts just slightly under the approval cap amount.

3. Customer relations

3.1. Approve bill format.

3.2. Establish customer complaint procedures.

3.3. Design and implement customer education.

There is no FOMB authority in this area; therefore no potential for conflict and therefore no need for protocol.

4. Supply and demand resources

4.1. Establish and enforce reliability parameters

- 4.1.1. Establish customer- and system-level reliability standards (including whether NERC standards apply).
- 4.1.2. Establish and enforce planning reserve margin level (target and operational).
- 4.1.3. Determine equivalent load carrying capability for renewable resources.

The FOMB has no authority in the reliability space; therefore, there is no potential for Commission-FOMB conflict.

4.2. Create IRP

- 4.2.1. Establish load forecast and capacity requirements for the forecast period.
- 4.2.2. Determine composition of optimal future resource portfolio, subject to load and resource balance, renewable portfolio standard requirements, resource costs and availabilities, and other statutory considerations. Resource portfolio includes generation retirement schedule and additions of appropriate types of future resources (generation, T&D, storage, and other) in appropriate sizes and at appropriate locations.
- 4.2.3. Establish framework for determining need and value of ancillary services.
- 4.2.4. Establish framework for determining need and value of resource flexibility.
- 4.2.5. Determine need for additional major transmission projects.
- 4.2.6. Approve near-term IRP action plans.

Under Act 57, the Commission will carry out all six of these steps.

The Fiscal Plan must carry out, and therefore be consistent with, the IRP; not the other way around. See PROMESA Section 503(b)(1)(D). There is no authority in FOMB to impose an IRP or any particular mix of resources. The FOMB can of course inform the Commission of its views on industry structure and resource mix, and recommend scenarios to be evaluated. But the statutory authority to approve the resulting resources, and the rates necessary to pay for such resources, lies exclusively with the Commission.

4.3. Establish RFPs and competitive bidding procedures for power supply, energy efficiency and demand resources

There is no statutory FOMB role in establishing RFPs or competitive bidding procedures. Those are internal PREPA operations over which the Commission has statutory authority.

4.4. Approve sites for power supply resources

FOMB has no authority in this area. While the Commission does not have direct authority over siting, it can approve or deny projects based on cost, which is itself affected by siting.

5. Internal PREPA operations

- 5.1. Establish performance metrics, reporting procedure and enforcement methods.
- 5.2. Appoint independent monitors to oversee restoration contracting and work.
- 5.3. Establish standards for, and approve, restoration plan.
- 5.4. Establish standards for, and approve, maintenance plan.
- 5.5. Establish power plant efficiency standards.
- 5.6. Establish criteria for, and approve, hiring of contractors.
- 5.7. Approve disaster preparation and restoration plan (for future events).
- 5.8. Approve plans for workforce recruitment, development and compensation.

Other than contracting, FOMB has no authority over these areas. Therefore there is no possibility of conflict, provided the Commission's decisions in these areas are consistent with the Fiscal Plan.

6. Finance

- 6.1. Approve financing plans.
- 6.2. Approve issuance of debt.
- 6.3. Approve restructuring of debt.

Under Section 6.3(n) of Act 57, the Commission has obligation to “oversee PREPA’s debt issues.” But its approvals must be consistent with FOMB decisions about debt restructuring and with any appropriate FOMB-approved Fiscal Plan.

The Commission must reflect the FOMB's debt restructuring decisions in its decisions on revenue requirement.

Question: *For the Commission’s review of debt issuances, what is appropriate information-sharing and sequencing between Commission and FOMB?*

7. Market structure transformation

- 7.1. Determine current and future market structures (monopoly vs. competition) for various products and services.
- 7.2. Appoint provider(s) of monopoly services.
- 7.3. Implement competition for competitive services.
- 7.4. Approve any transfer of PREPA assets or business functions.
- 7.5. Determine appropriateness, and terms and conditions, of "wheeling."
- 7.6. Distributed generation, community solar and microgrids by third-parties to end-use customers: Determine interconnection terms, compensation, payments for transportation, locational choices and other parameters .
- 7.7. Determine net-metering terms.
- 7.8. Establish remaining plans for distribution system.
- 7.9. Determine energy efficiency policy and providers.

The FOMB has no authority over these decisions. Decisions by the Commission, or by any successor agency or by the Legislature, decisions must be consistent with an FOMB-approved Fiscal Plan. But that Fiscal Plan does not restructure markets; its focus is debt and solvency, all as explained in the Policy Statement.