

PREPA's IRP and Petition for Rate Review),<sup>6</sup> PREPA's maintenance contracts with Mitsubishi-Hitachi and Alstom Caribe,<sup>7</sup> PREPA's multiple power purchase agreements with renewable energy providers,<sup>8</sup> and PREPA's power purchase agreement with EcoEléctrica.<sup>9</sup> Appendix A to this Order provides detailed insight into these and other examples. As the aforementioned list shows, these concerns are not limited to contracts related to a specific area of PREPA's operations, but rather span multiple areas of PREPA's business.

While the Commission has not made a finding regarding the prudence of these actions, they provide an insight into the type of decisions within PREPA that fuel the Commission's concerns. Particularly, the Commission is concerned that PREPA's management culture, a product of its 70-year long self-regulated monopoly status, is unwilling or unable to obtaining the type of concessions from its contractors generally sought after by investor-owned utilities worried about their bottom line.

### **b. The case for Commission oversight**

In order to be financially and operationally sustainable, a utility's rates must be sufficient to recover all of its costs, provided such costs are deemed by the regulator to be prudent. In the traditional setting of an investor-owned utility, a regulator is able to induce prudent spending and performance by preventing a utility from recovering through its rates costs which are deemed by the regulator to be the result of imprudent actions—those costs are thus paid for by the utility's shareholders, not ratepayers. This *after-the-fact* review is known as *cost disallowance*. The certainty that imprudent actions will result in lost revenues aligns the interests of shareholders and ratepayers, leading to better performance.

PREPA's case is different. PREPA is a government-owned, non-profit utility; it has no shareholders. Because it has no shareholders, all of its costs must be recovered through its rates, which means that ratepayers are entirely responsible for the costs incurred by PREPA. Once a cost is incurred, there is no practical choice but to reflect those costs in PREPA's rates. If the Commission were to prevent PREPA from recovering a cost deemed as imprudent, PREPA would operate at a deficit, or would have to cut other necessary spending. Neither result is consistent with a financially healthy and sustainable utility providing reliable service. This certainty of recovery of costs reduces management's incentives to seek during negotiations concessions from contractors that would reduce PREPA's overall costs and exposure to risks and, ultimately, benefit PREPA's ratepayers. *Before-the-fact* review by the

<sup>6</sup> See, in general, the Part IV(A)(3) of the Final Resolution and Order, In Re: Integrated Resource Plan for the Puerto Rico Electric Power Authority, Case No. CEPR-AP-2015-0002, September 26, 2016 ("Resolution and Order on PREPA's IRP") and Parts Two, Three and Four of the Commission's Resolution and Order on PREPA's Rates.

<sup>7</sup> Resolution and Order on PREPA's Rates at ¶¶208 and ¶¶211 – 218, respectively.

<sup>8</sup> Resolution and Order on PREPA's IRP, at ¶¶171-188.

<sup>9</sup> Resolution and Order on PREPA's Rates, at ¶152.