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Puerto Rico Electric Power Authority and Debt Restructuring Under PROMESA, P.L. 114-187

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Related Authors

- D. Andrew Austin
- Richard J. Campbell

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D. Andrew Austin, Analyst in Economic Policy (aaustin@crs.loc.gov, 7-6552)
Richard J. Campbell, Specialist in Energy Policy (rcampbell@crs.loc.gov, 7-7905)

In recent years, the Commonwealth of Puerto Rico (CPR) has faced a fiscal crisis resulting from economic contraction, high public sector debt levels, outmigration, and other factors. In recent weeks, the finances of the Puerto Rico Electric Power Authority (PREPA)—or in Spanish, the Autoridad de Energía Eléctrica (AEE)—have attracted specific attention. PREPA's debt—about $9 billion—is larger than that of any other operational U.S. public corporation. Planned actions to address the debt, and high electricity prices due to the deteriorating state of the island's generating and transmission infrastructure, may adversely affect its economic development prospects and the well-being of its residents. Moreover, the restructuring of PREPA could have wider implications for municipal finance and infrastructure policy.

PREPA has been one of the largest U.S. public power utilities, serving about 1.4 million customers. According to 2014 industry statistics, PREPA ranked in the top 10 of U.S. public power utilities in terms of net electric power generated, with about 12.7 million megawatt-hours and approximately $4.6 billion in sales. PREPA's 6,023 megawatts in power generation capacity continues to be dominated by fossil fuels, especially heavy fuel oil. Residential customers currently pay $0.20 per kilowatt-hour (kWh), a rate above that in any mainland state, but below those on some Caribbean and Pacific islands.

Financial and political forces combined to reshape PREPA in 2014. In May 2014, Puerto Rico enacted an energy reform law that established a rate review board. Lack of financial liquidity prompted PREPA to intensify negotiations with creditors, requiring the appointment of a chief restructuring officer (CRO) and a revamped board. In November 2015, PREPA and a coalition of creditors reached a Restructuring Support Agreement (RSA) which called for an exchange of old for new bonds representing a 15% reduction of debt levels. In February 2016, Puerto Rico enacted a PREPA Revitalization Act to fulfill requirements of the RSA. PREPA requested rate increases in April 2016, arguing that revenues fell short of covering costs by nearly $0.08 per kWh. The lack of access to a debt restructuring process under a Chapter 9 bankruptcy (an option not available to Puerto Rico under federal law) likely complicated negotiations between PREPA and creditors.

PROMESA and Debt Restructuring Processes

In June 2016, Congress passed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA; P.L. 114-187) to address the crisis. Among other provisions, PROMESA established the Financial Oversight and Management Board for Puerto Rico (Oversight Board) and created processes for adjusting the island's public debts and for developing sustainable fiscal plans. Puerto Rico's Governor was charged with developing fiscal plans for CPR and its public corporations, subject to Oversight Board certification. In Title III, PROMESA drew on provisions of the U.S. Bankruptcy Code. Title VI of PROMESA set up a collective action process similar to strategies used in sovereign debt workouts. The RSA was expected to be implemented through Title VI. On March 22, 2017, the House Committee on Natural Resources held a status hearing on the PREPA RSA.

The PREPA fiscal plan outlined proposals and projections for the utility's finances, operations, capital investments, and market environment for the coming decade. The plan projected a 23% reduction in energy sales, and called for setting a $0.21 per kWh target rate by 2023.

Extensions of the RSA shielded PREPA from suits from participating creditors. However, on July 2, 2017, the Oversight Board decided to initiate a Title III debt restructuring process. On July 18, 2017, a creditor coalition holding nearly two-thirds of PREPA's debt sued to lift a stay on litigation and have a receiver appointed under terms of a 1974 bond agreement. A hearing on the case was scheduled for August 9, 2017.

Operational Challenges Facing PREPA

Although Puerto Rico has taken steps to make its power generation more efficient, significant operational and investment hurdles exist. PREPA's power generation remains heavily dependent on old, inefficient, and unreliable oil and diesel-fired plants. PREPA contracts with two private generators that use other fuels: an AES plant fueled by coal, and an Eco Eléctrica combined-cycle electric power plant that uses natural gas (imported mostly from Trinidad and Tobago) as liquefied natural gas (LNG). A second LNG terminal is under development with an in-service date in the second quarter of 2018. Concerns about the Title III process, however, may complicate that project. Completion of the terminal may allow for the expanded use of natural gas as a power generation fuel for PREPA and potentially other electricity generators in Puerto Rico. PREPA has planned to increase its natural gas-fired power generation from 34% in 2018 to 57% of all electric generation by 2026. In July 2010, Puerto Rico enacted a Renewable Energy Portfolio Standard (RPS), which essentially requires PREPA to supply increasing amounts of retail electricity sales from eligible "green energy" resources, rising to 20% of retail sales by 2035.

PREPA's business practices have also raised concerns. PREPA's revenues are reduced by unbilled power generation, with approximately 14% of power generated by PREPA classified as lost or unaccounted for in recent years. PREPA had not been billing many municipalities and government offices, in part to offset payments in lieu of taxation, as well as some nonprofit organizations and businesses. PREPA has recently become more aggressive in collecting past due amounts. Some of PREPA's largest unpaid accounts, however, were accumulated by other public corporations that are also facing debt restructuring processes.

PREPA's Prospects

Now that PREPA has entered into a PROMESA Title III debt restructuring process, changes in the structure, finances, and operations of the utility appear likely. How well PREPA serves its mission in future years may well depend on changes in its governance. Some have called for privatizing PREPA as a means of addressing governance issues. Measures imposed through the RSA, such as appointing a more technically oriented board and a CRO, might also be seen as hardening fiscal constraints. Recent changes in PREPA's board have raised concerns among creditors, while the Governor views those changes as necessary for implementing his proposals to rescue the utility.