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## PRO BANKRUPTCY

# In Puerto Rico's Troubled Energy System, McKinsey Gets Paid by Both Government and Vendors

McKinsey helped craft a privatization process for Puerto Rico's electric grid, and a venture backed by one of the consulting firm's clients later won the contract. McKinsey has said that it wasn't involved in the selection process.



Puerto Rican residents protested the Luma Energy LLC power grid operation contract in front of the governor's mansion in Old San Juan in August.

PHOTO: THAIS LLORCA/SHUTTERSTOCK

By *Alexander Gladstone*

Updated Oct. 10, 2022 12:35 pm ET | WSJ Pro

McKinsey & Co., the consulting powerhouse that advises not just Puerto Rico's government but also the primary contractors and vendors for the island territory's energy system, is facing scrutiny in the wake of the power grid's continued dysfunction.

Since McKinsey was hired as the top consultant to Puerto Rico's financial-oversight board, which oversees public spending, the firm has helped officials shape efforts to overhaul the territory's electricity system through a privatization process that resulted in a venture backed by one of McKinsey's clients winning the lucrative contract to operate the grid.

Puerto Rico now faces a major reconstruction of its energy infrastructure after last month's Hurricane Fiona, another challenge for residents who have endured years of costly, unreliable electricity service. Even before Fiona hit the island, hundreds of demonstrators gathered in the streets of Old San Juan in recent months to protest the frequent blackouts and high costs plaguing consumers. Much of the public anger has centered on Luma Energy LLC, a joint venture half-owned by McKinsey client Quanta Services Inc. that in 2020 won the \$1.5 billion grid operation contract.

Blackouts in some parts of Puerto Rico have increased since Luma took on the contract, Puerto Rican residents said. In August, the Puerto Rico Energy Bureau found a key metric on reliability "indicates that Luma has yet to realize improvements in reliability in terms of outage durations." On other metrics, such as customer response times and workplace accidents, the data show improvements under Luma, according to regulatory data.

Gov. Pedro Pierluisi and other officials who backed the Luma hiring have turned increasingly critical of its performance.

Starting in 2017, McKinsey developed "privatization/corporatization plans" for the oversight board to break up the bankrupt, government-owned Puerto Rico Electric Power Authority, or Prepa, and put private companies in charge of generating and delivering power.

A McKinsey spokesman said that the firm's work for the oversight board focused on the development of the fiscal plan and budget for Prepa and "analyzing a range of options that could be pursued, including an operational and maintenance agreement with a private operator for Prepa's transmission and distribution system." McKinsey wasn't involved in the selection of Luma as the grid operator, and didn't assist in its contract review, the spokesman said.

McKinsey has earned at least \$120 million in fees advising the oversight board, established by the federal government to steer the territory back to fiscal health after an economic crisis. The firm also advises power-plant operators that generate electricity in Puerto Rico as well as companies that supply the diesel, natural gas, and other commodities, according to court disclosures filed by the firm in May.

"The privatization has not furthered the island's renewable-energy goals," because renewable-energy-related requirements are lacking in the Luma contract, said Ingrid Vila-Biaggi, president of Puerto Rico-based sustainability nonprofit CAMBIO. Puerto

Rico's reliance on imported fossil fuels is a big reason why power prices are so high, amounting to roughly double what consumers in the mainland U.S. pay, she said, noting that renewable energy amounted to just 5% of Puerto Rico's power generation as of 2021, and the territory is far from meeting its target of 40% renewable generation by 2025.

A spokesman for Luma said that over the past 16 months, "Luma has made significant progress in advancing clean energy priorities and improvements to the electric system, even as we address important issues our customers care about such as making the energy system more reliable and reducing outages."

The Puerto Rico government has set ambitious renewable energy targets, and the operating contract with Luma complies with those laws, a spokesman for the oversight board.

McKinsey disclosed its private client relationships in Puerto Rico in May to comply with a federal transparency law that went into effect this year for lawyers, bankers and other advisers working on the territory's bankruptcy case.

Carlos Lamoutte, a lawyer based in San Juan, in September sought a court order disqualifying McKinsey from working for the oversight board, alleging conflicts of interest in the firm's work for both the oversight board and private clients in Puerto Rico.

Sen. Marco Rubio (R., Fla.), one of the co-sponsors of the transparency law, said in a statement to The Wall Street Journal that "the U.S. Government needs to break all ties with McKinsey and tighten disclosure requirements to ensure the company cannot play both sides again."

In a response to Mr. Lamoutte's motion, McKinsey said that the client connections it disclosed are in matters unrelated to Puerto Rico's bankruptcy proceedings. The oversight board has also said in court filings in the case that McKinsey's work for clients that negotiated or obtained government contracts in Puerto Rico isn't by itself a basis to disqualify the firm from the bankruptcy case.

The oversight board spokesman also said that McKinsey's role is to review contracts for compliance with board-certified fiscal plans, not to select contract winners, which is done by public agencies in Puerto Rico.

McKinsey's May disclosure detailed hundreds of clients with interests in Puerto Rico, and the firm said it will file a supplemental disclosure this month detailing additional

connections that were omitted from the earlier list.

Under the transparency law, fees can be denied to any professionals if they aren't a "disinterested person," meaning they can't have an interest "materially adverse" to the financial interests of the government and its stakeholders. The Justice Department has asked that McKinsey, as well as other professional firms that are required to file supplemental disclosures, not be paid for at least 30 days from when they file their supplemental disclosures, to allow for potential fee objections to be filed.

McKinsey's clients include a who's who of the major contractors and vendors in Puerto Rico's energy system. EcoElectrica LP, which owns a gas-fired power plant on the island's southern coast, is a McKinsey client, as is EcoElectrica's parent company Naturgy Energy Group SA, a Spain-based energy multinational. In 2019, Puerto Rico awarded the two companies a \$9 billion contract for EcoElectrica to provide power and Naturgy to supply natural gas, according to public filings. Another McKinsey client, Puma Energy Caribe LLC, since 2018 has been awarded contracts worth more than \$2.1 billion to ship fuel oil, filings show.

New Fortress Energia LLC, an energy company owned by McKinsey client SoftBank Group Corp., in 2019 won a \$1.5 billion contract to convert two publicly owned power-generation facilities in San Juan Bay to run on natural gas. McKinsey also advises AES Corp., a Virginia-based utility and power generation company that operates a coal-fired generation plant in Puerto Rico, according to the May disclosure.

An associate partner at McKinsey was involved in "key decisions on privatization process," for the energy system, billing records from 2017 show. The McKinsey spokesman said that partner's role expressly excluded any decision-making and negotiation responsibilities.

McKinsey later analyzed proposed regulations for the "procurement, evaluation, selection, negotiation and award" of partnership contracts and sale contracts for the transformation of the electric system, fee applications show. Another McKinsey partner guided strategy for engagement with the federal government on the electric utility's fiscal planning and privatization process.

McKinsey's corporate clients have won tens of billions of dollars of government business in Puerto Rico since the firm began its work for the oversight board, a review by the Journal found.

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