



New Opportunities to Develop and Maintain Infrastructure and Other Projects in Puerto Rico

On June 8, 2009, the Governor of Puerto Rico signed into law the Public-Private Partnerships Act (the “Act”). The Act is expected to trigger the creation of public-private partnerships (“P3s”) for the development and maintenance of infrastructure projects such as toll roads, urban trains, energy production plants and correction and rehabilitation facilities.

Eligible Projects

The Act provides that only the development, construction, operation or maintenance of the following projects may be the object of P3s:

- (i) landfills, including methane recovery, and other facilities for the management and disposal of solid waste, such as recycling plants, composting plants and waste to energy plants;
- (ii) dams, including the infrastructure required for treating and distributing water and for the production of hydroelectric energy, and the treatment of waste water and potable water;
- (iii) alternative energy production plants, such as wind, solar and ocean thermal, as well as energy transmission;
- (iv) transportation systems of any kind, including air and sea;
- (v) educational, health, safety, corrections and rehabilitation facilities (however, with respect to educational facilities, the private partner must be a worker’s cooperative, a worker’s corpora-

tion or a non-profit entity);

- (v) low-income housing;
- (vii) sports, recreation, tourist and cultural facilities;
- (viii) wired or wireless communication networks;
- (ix) high technology, computer or mechanization systems; and
- (x) Any other activity, facility or project that may be identified from time to time as a priority project by means of legislation.

The Authority for Public Private Partnerships

The Act authorizes government agencies, instrumentalities and subdivisions (such as municipalities) to enter into P3s and creates the Authority for Public Private Partnerships (the “Authority”) as the agency responsible for implementing P3s. The Authority is charged with evaluating and selecting P3s, undertaking viability studies, determining whether a P3 is advisable, supervising (together with the participating governmental entity) P3s, reviewing and making recommendations with respect to each P3 agreement, hiring outside experts and advisors, entering into interim or temporary service contracts (for example, if the contractor defaults on its P3 agreement) and issuing regulations governing the establishment of P3s.

Notably, the Authority may not transfer title to any publicly owned property to private persons or entities. Any facility developed by a contractor will be transferred to the relevant participating government entity at the end of the term of the P3 agreement. P3s are also required to comply with all applicable site approvals and permits. Since it is generally believed that this process is unduly burdensome, the Act provides for the creation of an inter-agency committee to evaluate site consultations and issue permits.

The Authority will generally use a request for proposal process, based on qualifications, best price, or both. However, the Authority may negotiate contracts directly without a request for proposal (i) if another method would be unreasonable or impractical, (ii) when the P3 will last less than a year or the estimated investment does not exceed \$5,000,000, (iii) when there is only one provider of the service (such as those which involve intellectual property, business secrets or licenses or rights which are held by one person), and (iv) when a request for qualification or proposal has been made and there has been no response, or the response has not complied with the requirements of the request, and if in the Authority's judgment issuing a new request would delay the P3 unduly.

The P3 agreement must be approved by the Board of Directors of the Authority, the participating governmental entity and the Governor. Once the Governor approves the P3 agreement, it will become effective when the proponent and the participating governmental entity execute it.

Minimum Requirements of Private Partners

Any proponent must comply with the following requirements and conditions, in addition to any

other conditions that may be set forth in the request for qualification or request for proposal for such P3:

- (i) be authorized to do business in Puerto Rico;
- (ii) possess sufficient capital, guarantees or other financial resources, in the judgment of the Authority;
- (iii) enjoy a good reputation and have the management, organizational and technical capability to develop and manage the P3; and
- (iv) certify that neither he, or in the case of an entity, its directors or officers, or in the case of a corporation, its shareholders with substantial and direct control over the corporation's policies, or in the case of a partnership, its partners, or in the case of natural or legal persons, any other natural or legal person that serves as the alter ego or economic conduit for such person, has been convicted of corruption, whether in Puerto Rico, the United States, or any foreign country. The proponent must also certify that it is complying, and will comply at all times, with laws that prohibit corruption, or regulate crimes relating to public funds or the public function, including the Foreign Corrupt Practices Act.

The Public Private Partnership Agreement

P3 agreements must include, among others, the following provisions:

- (i) definition and description of the services to be rendered, the work to be realized or the facility to be developed by the selected proponent;

- (ii) in the case of new facilities, or repairs to an existing building, the financing plan, development, design, construction, reconstruction, repair, replacement, maintenance, operation or administration of the facility;
- (iii) the term of the P3, which in the case of concessions may not exceed 50 years, but in certain cases may be extended by up to 25 additional years, subject to legislative approval;
- (iv) the rights (if any) that the proponent or the participating governmental entity or both may have over the income, or a portion thereof, derived from the function, services or the facilities which are the object of the P3 or any real property included as part of the P3;
- (v) the contractual rights and mechanisms available for the participating governmental entity to secure compliance by the selected proponent with the terms and conditions of the agreement, including but not limited to, compliance with quality of services, maintenance of the equipment or facilities, compliance with the approved design and other guidelines for construction, repair or improvements, or to verify compliance with proponent's obligations under the agreement;
- (vi) in cases where the selected proponent will charge a fee to the public or to the participating governmental entity for services rendered or for the use of a facility, the agreement will have to specify the rights of the proponent, if any, to determine and collect the amounts due, the limitations and contractual restrictions the proponent will have to alter such fees, and the options available to the participating governmental entity to ensure compliance with such limitations. In addition, the agreement will set forth the mechanisms and procedures which the participating governmental entity will utilize to settle controversies and complaints by the public regarding the services, function or facility;
- (vii) the events of termination of the agreement, and the rights and remedies available in case of default or delay, by both the participating governmental entity and the selected proponent. The participating governmental entity shall not be responsible for unforeseeable, special, indirect or punitive damages. Unlike other government contracts, the agreements may not be unilaterally terminated by the participating governmental entity without cause with 30 days prior written notice, but shall instead be subject to the termination provisions of the Agreement;
- (viii) the circumstances under which the agreement may be modified to maintain economic equity among the parties, along with default provisions and remedies, including the imposition of penalties according to the circumstances. The agreement must also include certain clauses which must be literally transcribed, regarding the applicability of the "Code of Ethics for Contractors, Suppliers and Applicants for Economic Incentives from the Executive Agencies of the Commonwealth of Puerto Rico," that a default may be sufficient cause for the participating governmental entity to seek damages, that any contractor which defaults on an agreement which leads

to the termination of the agreement will be barred from contracting with any other governmental entity for a period of 10 years from termination of the agreement, and that the sanctions imposed by the Act do not preclude other sanctions set forth in the agreement or in other laws;

- (viii) the terms and conditions for the transfer of the services or the facility to the government once the agreement is terminated; and
- (ix) that the agreement shall be governed by the laws of the Commonwealth of Puerto Rico.

Contractors will have the power to set fees pursuant to the terms of the P3 agreement and will not be subject to the limitations imposed on the participating governmental entity by law. Contractors will not be responsible for the obligations or existing debts of the participating governmental entity, unless expressly provided in the P3 agreement. In addition, the contractor will not be liable for any benefits which have been accumulated by employees of the participating governmental entity which are hired by the contractor, except as set forth in the P3 agreement.

Employees that have accumulated more than ten (10) years of government service may continue to make their individual contributions to their government retirement plans. In such cases, the hiring contractor would have to make contributions to said plans as well. Alternatively, such employees may transfer their contributions to said plans, in whole, to the contractor's own retirement plan.

Contractors Obligations with respect to Government Employees

Contractors are not required to employ employees of the participating governmental entity, except as otherwise set forth in the P3 agreement. Although not explicitly stated, it appears that the participating governmental entity is expected to transfer any employees that are displaced to another position or dismiss such employees, if it is not prohibited from doing so by a union contract. However, if the participating governmental entity has an operational deficit, or has been certified by the Government Development Bank as being in a precarious fiscal condition, then any contractual provisions prohibiting the transfer of any government function, service or facility, or the transfer of any employee will be null and void. In this event, the Authority will require the contractor to give priority in hiring to employees of the participating governmental entity which are affected by the P3 and will not be transferred to another government position (and therefore presumably will be dismissed). The parties will develop a Transition Plan for Displaced Employees which will be paid in equal parts by the parties.

Tax Treatment of Contractors

A. Income Tax.

Contractors will be subject to a special fixed income tax rate of 10% on the net income derived from the operations provided in the P3 agreement, computed in accordance with the Puerto Rico Internal Revenue Code (the "Code"), in lieu of any other income tax, if any, provided by the Code or any

other law. In the case of contractors formed as regular corporations or partnerships, the distribution of income to the shareholders or partners will be subject to the current 10% tax provided in Section 1012(b) of the Code.

B. Property Tax.

Real and personal property tax exemption is granted upon the following properties for the period and percentages established by the Authority under the P3 agreement:

- (i) the facilities built by the contractor;
- (ii) the property used exclusively in or for the facilities, or for the services or functions: (a) owned by the participating governmental entity, and leased, licensed, financed or in any other manner which is placed at the disposition of the contractor, or (b) acquired, built, or held by the participating governmental entity and placed at the disposition of the contractor.

C. Municipal License Tax.

Contractors and municipalities may also agree to establish payment agreements or exemptions from municipal license, excise or municipal taxes, pursuant to the provisions of Act No. 81 of August 31, 1991, as amended, known as the “Autonomous Municipalities Act of the Commonwealth of Puerto Rico”.

D. Special Partnership Election.

The contracting corporations and partnerships will be able to elect special partnership treatment under the provisions of Subchapter K of the Code. In this case, the shareholder of the contracting special partnership will be subject to a fixed income tax rate of 20% on the net income derived from the operations provided in the P3 agreement. Said tax must be withheld at origin and deposited with the Puerto Rico Treasury Department, on or before the 15th day of the second month following the closing of the special partnership’s fiscal year. The provisions of Sections 6040 and 6041 of the Code regarding interest, penalties and surcharges will apply to late payments of this tax.

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