



# **PUBLIC-PRIVATE PARTNERSHIPS IN PUERTO RICO: KEY POINTS**





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Historically, there has been vigorous debate among the residents of Puerto Rico for and against the privatization of public property and public services. The public-private partnership (P3 or P3s) model established by the Public-Private Partnership Act of 2009, as amended (the P3 Act) and its Regulation for the Procurement, Evaluation, Selection, Negotiation and Award of Public-Private Partnership Contracts are gaining acceptance as a tool for meeting Puerto Rico's infrastructure needs.

Several factors have strengthened this growing acceptance: not least, Puerto Rico's current liquidity crunch and lack of market access to finance its activities, coupled with the fact that P3s in Puerto Rico are typically structured not as an outright sale but as long-term leases or concessions, at the end of which the use of the asset is returned to the government. In seeking to finance infrastructure projects and provide multiple public services, the Government of Puerto Rico currently regards P3s as a sensible alternative.

Furthermore, the Puerto Rico Oversight, Management and Economic Stability Act, Pub. L. 114-187 (PROMESA – [see our alert](#)), adopted by the US Congress and signed into law by President Barack Obama on June 30, 2016, has strengthened the call for P3s on the island. Article V of PROMESA, titled "Puerto Rico Infrastructure Revitalization," is exclusively dedicated to establishing an expeditious way to promoting future infrastructure projects. Under PROMESA, a fiscal oversight board (the Oversight Board) was recently instituted. A Revitalization Coordinator was also appointed. The Revitalization Coordinator has been tasked with identifying and coordinating the expedited execution of "Critical Projects." Critical Projects are defined by PROMESA as "...those intimately related to addressing an emergency whose approval, consideration, permitting, and implementation shall be expedited and streamlined..." Critical Projects include energy and alternative energy projects. The new administration of Governor Ricardo Rosselló has also made it clear that it will prioritize P3 projects. In fact, the first law enacted by the Rosselló administration on January 11, 2017 was to amend the P3 Act to expand both the options available to submit proposals and participation in P3s.

It appears, in sum, that a number of P3 projects are on the horizon for Puerto Rico. For those considering participating in such projects, this handbook summarizes the applicable legal framework governing P3s in Puerto Rico and discusses why Puerto Rico is a favorable jurisdiction for entering into P3s.

## I. SUCCESSFUL P3 FRAMEWORKS

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The United Kingdom, Canada, Australia and Spain are often identified as models for how to run successful P3 programs. Their strong legal frameworks support these successes. While a P3 framework typically varies from jurisdiction to jurisdiction, the Public Private Partnerships Reference Guide, product of the staff of the World Bank, Asian Development Bank and Inter-American Development Bank, identifies five qualities that successful P3 programs should have:

- A. Public policy:** The government clearly articulates its intent to use P3s to deliver public services and the objectives, scope and implementing principles of the P3 program;
- B. Legal framework:** Strong legal framework that sets the rules and boundaries for how P3s are implemented;
- C. Transparent process:** Detailed, clear and consistent process by which P3 projects are identified, developed, appraised, implemented, and managed;
- D. Financial management:** Responsible public financial management that ensures P3s provide value without placing undue burden on future generations; and
- E. Oversight and compliance:** Governance arrangements that allow other entities, such as auditing entities, the legislature and the public, to participate in P3 programs.

The United States has increased its P3 activity in the last few years and has developed P3 activity in the same sectors as those countries generally recognized as having strong P3 programs. Notwithstanding the recent uptick in P3 activity, the US is generally not viewed as a country with a strong P3 market. Some consider this to be a product of a poor framework and blame the US's P3 standing on decentralized P3 regulations and other bureaucratic constraints, as well as the government's extreme reliance on tax-exempt municipal bonds to finance its infrastructure. Puerto Rico, notably, has been identified as one of the few US jurisdictions with an organized P3 program (Buttarazzi, John, *State of Public Private Partnerships in the US*, IP3, Public-Private Partnership White Paper Series).

## II. PUERTO RICO'S P3 FRAMEWORK

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The P3 Act and its regulation comprise one of the most robust legal frameworks for P3s in the Americas. The P3 Act created the Puerto Rico Public-Private Partnership Authority (the Authority) as a public corporation and affiliate of the Government Development Bank for Puerto Rico. The Authority is the government entity authorized and responsible for implementing the public policy on P3s and determining the public functions, services or facilities for which P3s will be established. In other words, public entities that wish to enter into a P3 contract with a private entity must have the Authority determine whether a P3 is the correct mechanism to advance the proposed project or provision of services; determine the type of P3 that will be procured; run the selection process; and approve the final contract. Once a contract is approved by the Authority and the government entity that will enter into the contract, with certain exceptions, the Governor shall also approve it. This system creates a uniform procurement process and ensures compliance with all five qualities identified in the World Bank P3 International Reference Guide.

### A. Public policy

The P3 Act expressly states that it is the public policy of the Government of Puerto Rico to favor and promote the establishment of P3s and further authorizes all departments, agencies, public corporations, and instrumentalities, as well as municipalities and the legislative and judicial branches of the Government of Puerto Rico, to use the establishment of P3s in accordance with the process specified therein. The P3 Act also establishes that the Commonwealth of Puerto Rico shall not legislate to limit the powers or rights granted to the Authority and partnering government entities under the P3 Act until the obligations under an executed P3 contract are satisfied.

The P3 Act also sets out the areas where P3s are expressly authorized as a matter of policy. These are defined as “Priority Projects.”

The Priority Projects are:

1. the development, construction or operation of sanitary landfill systems, including methane recovery operations, as well as facilities for the management and disposal of non-hazardous and hazardous solid waste, such as plants for recycling, composting and converting waste into energy
2. the construction, operation or maintenance of reservoirs and dams, including any infrastructure necessary for their operation to produce, treat, and distribute water and any infrastructure for the production of hydroelectric energy and for sewage and potable water treatment plants
3. the construction, operation or maintenance of existing or new plants for the production of energy
4. the construction operation or maintenance of transportation systems of any kind, thorough fare system or related infrastructure
5. the construction, operation or maintenance of educational, health, security, correctional and rehabilitation facilities. It is worth noting that when operating educational facilities, a P3 may only be established if the contract is executed with a worker-owned cooperative, a special employee-owned corporation or a nonprofit entity.
6. the construction, operation or maintenance of affordable housing projects
7. the construction, operation or maintenance of sports, recreational, tourist and cultural entertainment facilities
8. the construction, operation or maintenance of wired or wireless communication networks for communications infrastructure of any kind
9. the design, construction, operation or maintenance of high-technology, computer and automation systems and
10. the construction, operation or maintenance of any kind of activity or facility or service as may be identified from time to time as a Priority Project through legislation.

## B. Legal framework

The existence of the P3 Act and the regulation provide clarity, uniformity, and boundaries to the P3 selection process and contracting, underscoring the strength of Puerto Rico as a jurisdiction with certainty with respect to the legal framework for the development of P3s. Of particular significance are the following aspects of the P3 Act and Puerto Rico’s legal system:

- (i) **P3 contracts:** The Act broadly allows for creation of P3s, providing that P3 contracts may be design-build; design-build-operate; design-build-finance-operate; design-build-transfer-operate; design-build-operate-transfer; turnkey; long-term lease; surface right; administrative grant; joint venture; long-term administration and operation; and/or any other kind of agreement that separates or combines the design, building, financing, operation or maintenance phases of the so called Priority Projects. Furthermore, the P3 Act is clear about certain required clauses in a P3 contract, possible clauses to be negotiated between the parties, and boundaries with respect to other clauses. The P3 Act even discusses the issue of the possible transfer of public employees to the P3 entity when the government partner benefitting from the P3 is in a precarious fiscal condition. The P3 contracts may have an initial maximum term of 50 years and may be extended for an additional 25 years (75 year total) provided certain conditions are met.
- (ii) **Confidentiality:** The P3 Act establishes a balance between information that has to be disclosed publicly and confidential information. It provides for ways of protecting certain privileged or protected information disclosed by proponents to the Authority as a part of the P3 procurement process. The proponents shall have the duty of identifying the information that proponents consider confidential and, when presenting the proposal, request confidential treatment. The Authority will evaluate the requested confidential treatment in accordance with the procedure established in the Act and in the Regulation and then make a determination regarding the same; if it constitutes a trade secret, proprietary information or privileged/confidential information, all such information shall be protected. Also, Act 80 of 2011, known as the Trade Secrets Act of Puerto Rico, follows the Uniform Trade Secrets Act which classifies a trade secret as any confidential information that has economic value or that provides commercial advantage and is under reasonable security measures.
- (iii) **Taxes:** The Act provides property tax exemptions for facilities subject to a P3 contract and any property used exclusively in, or for, the facility subject to the P3 contract if it is acquired, built or owned by the partnering government entity and is made available to the operator. The private partner may enter into agreements with municipalities to establish exemptions from municipal license fees, excise taxes or municipal taxes.

In addition, the private partner that is taxed as a corporation is subject to a fixed preferential income tax rate of 10 percent over the net income derived from the operations provided in the P3 contract. Dividends distributed by a private partner that is taxed as a corporation to foreign institutional shareholders are subject to a withholding tax of 10 percent. As an alternative, the private partner may choose to be treated, for tax purposes, as a partnership. In this case,



the private partner is not subject to income tax and, in lieu thereof, the shareholders are subject to a fixed income tax rate of 20 percent over the net income derived from the operations provided in the P3 contract. Other provisions of the tax regime in Puerto Rico may be used to maximize exemptions and other incentives that may be applicable to the project or the private partner.

**(iv) Judicial review:** Puerto Rico is a territory of the United States. Therefore, it falls within the US. federal system and is subject to both US federal law and the laws of Puerto Rico. Subject to both Puerto Rico and the federal constitutions, Puerto Rico legislation must provide for due process and other rights applicable in the US, thus providing the private sector with judicial certainty and proper protection under rule of law.

Under the P3 Act, Article 20 allows for judicial review of (1) the non-qualification of proponents and (2) the approval of a P3 agreement. Those proponents who have not been qualified to participate in the bidding process or have not been awarded a P3 agreement after submitting all relevant information to the Authority are entitled to request judicial review of the Authority's decision with the Puerto Rico Court of Appeals. If the affected proponent is not satisfied with the court's determination, it may appeal to the Supreme Court through a writ of certiorari. The determination by the Court of Appeals or the Supreme Court to issue a writ of administrative review or a writ of certiorari shall not stay the procedures for qualification of petitioners, ongoing negotiations, approval processes or the effectiveness of the P3 contract, unless the court with jurisdiction so orders expressly. Stays may only be issued in cases meriting injunction. The proponent must post a bond or letter of credit sufficient to respond for all the damages caused as a consequence of such stay order. Judicial review as provided by the Act shall be the exclusive recourse for proponents.

### C. Transparent process

Once the Authority has determined that the project meets the public policy requirements of the Act and it is advisable to pursue the establishment of a P3, then the Act provides for two kinds of procurement procedures: (1) competitive negotiated procurement; and (2) negotiations without a request for proposal. The Act also provides for unsolicited proposals.

The first procurement procedure involves RFQs issued by the Authority to identify the persons that satisfy the minimum standards to enter into a P3 contract. The Act describes the qualifications to be a proponent. Among these qualifications, a proponent must: (i) be authorized to do business in the Commonwealth of Puerto Rico; (ii) have available corporate or equity capital or securities or other financial resources that are necessary for the construction and proper operation, as



applicable, of the P3; (iii) have a good reputation; (iv) have technical capacity and experience; and (v) certify that neither it nor any of its directors or officers have formally been convicted for acts of corruption in Puerto Rico, the US or any foreign country. Proponents may present proposals jointly under consortia. After the RFQ process, RFPs will be issued. Proponents who submit proposals for P3 contracts shall assume the risk of paying for all expenses related to the RFQ and RFP processes.

The second procedure is initiated by the Authority and allows the negotiation of a partnership contract without abiding by the RFQ and RFP procedure only when (1) there is only one source capable of providing the service required and (2) an RFP was issued and received no responses or the proposals submitted failed to meet the indicated requirements, and, in the Authority's opinion, issuing a new RFQ and RFP would cause such delay that a partnership contract may not be executed in the time required. Prior to executing a contract with proponents chosen pursuant to this second procurement alternative, the Authority must notify the legislature Public-Private Partnership Joint Commission.

Unsolicited proposals are also provided for under the P3 Act. Unsolicited proposals may be received by the Authority provided they include, at a minimum: (1) a summary of the proposed project; (2) a description of how the proposed project satisfies a government need; (3) how the proposal differs from other traditional or proposed approaches to develop the project; (4) the amount of public resources needed to complete the project and indirect and direct costs involved, including capital costs; (5) financial viability and financing mechanisms available; (6) commercial aspects of the project; (7) possible public benefit; (8) proposed method of execution; and (9) unique intellectual property involved, if any. If the Authority considers the

unsolicited proposal to be favorable to the public interest, it may either enter into talks directly with the unsolicited proponent or commence a process of open RFP, depending on various conditions indicated in the P3 Act.

#### D. Financial management

The Act recognizes the need for P3s to allow for the development of infrastructure and other projects by delegating the risks inherent to such development or service onto the party that is best capable of assessing and managing such risks, improving services, creating new jobs, and developing Puerto Rico's economy and competitiveness. Likewise, these partnerships enable the government to make infrastructure projects feasible when the funds needed to complete a project are not available in the public treasury. In order to make a sound and duly evaluated decisions in considering P3 proposals, the Authority is statutorily required to conduct a desirability study that looks into such matters as environmental effects, economic considerations, technical and functional feasibility and choice of procurement structure. The Act also contemplates the possibility of entering into pre-development agreements with private sector companies for the latter to conduct the technical and financial feasibility studies of a project. Once the Authority decides to establish a P3, the P3 Act provides that the government entity involved and the Government Development Bank are bound to provide technical, expert, financial, and human resource assistance to the Authority. Note that references to the role of the Government Development Bank (GDB) in the P3 Act as fiscal agent and

advisor of the government entities shall be deemed to refer to the new Puerto Rico Fiscal Agency and Financial Advisory Authority, created by law to substitute the fiscal agent and financial advisor roles of the GDB.

Furthermore, to ensure that P3s provide value without placing an undue burden on future generations, the Act provides that all revenue received by the government derived from a P3 contract may only be employed for the following uses: (i) to pay debts of any kind of the public entity entering into the P3 contract; (ii) to pay debts of any kind of the Commonwealth of Puerto Rico; (iii) to create a capital investment fund for the capital improvement program of the public entity entering into the P3 or the Commonwealth of Puerto Rico; (iv) to create a fund to repay any line of credit that may have been granted by the Government Development Bank to the public entity entering into the P3 contract; and (v) contribute to government retirement systems.

#### E. Oversight and compliance

The P3 Act allows for participation by the Legislature of Puerto Rico, various public corporations and the public. The following is a listing of different measures the Act takes to include outside opinion and oversight in the establishment of P3 in Puerto Rico:

- The Board of Directors of the Authority is composed of the President of the Government Development Bank, the Secretary of the Treasury, the President of the Planning Board and two representatives of the public interest selected by the Governor of Puerto Rico from candidate lists submitted by each legislative body, the Senate and the House of Representatives.
- The P3 Act creates the Joint Committee on Public-Private Partnerships of the Legislature of Puerto Rico. The Joint Committee shall have jurisdiction to examine, evaluate and recommend P3 projects and proposals and recommend the use of funds as well as evaluate the administration and compliance with executed contracts on an ongoing basis.
- There must be legislative approval to expand the list of Priority Projects.
- With the exception of smaller projects (with estimated costs of \$55 million or less) that constitutionally may not require approval by the Governor, the Governor must approve P3 contracts and the use of funds derived from P3 contracts.
- Desirability studies, documents generated by the Authority related to the RFQ and RFP process, and the reports prepared by the P3 Committee have to be published on the Authority's webpage.
- As with other government entities, the Comptroller of Puerto Rico has the authority to audit the activities, contracts and use of resources of the Authority and the government entity entering into the P3.



### III. THE PRACTICAL EXPERIENCE: P3s IN PUERTO RICO

Before the Act was adopted, Puerto Rico entered into a series of contracts with private entities similar to P3s. Examples include the Teodoro Moscoso Bridge Contract, and two contracts to operate and maintain the Puerto Rico Aqueduct and Sewer Authority. However, given the uncertainty associated with the lack of an established and strong framework, these processes fell victim to considerable complications and costs. In some cases, the P3 had undesired outcomes and other P3s were never completed. Enactment of the Act in 2009 eliminated most uncertainties by adopting a legal and administrative framework that promotes uniformity, fairness and transparency.

#### A. Modern P3s in Puerto Rico

Most completed P3s in Puerto Rico involve the operation of an existing public facility and follow a typical lease/concession model in which the public partner transfers responsibility for operation and maintenance, including related capital improvements and investments, to the private operator for the duration of the contract. Asset ownership remains with the public partner and possession reverts at the end of the lease/concession period. In a lease/concession, the private partner typically recovers its investment from revenues directly paid by end-users.

#### B. Successful P3s

The most recent P3s since the enactment of the Act are the P3 for the Luis Muñoz Marín International Airport and the P3 for highways PR-22 and PR-5 Toll Roads. These were procured and successfully implemented following the processes and requirements established in the P3 Act.

- **Airport P3:** This P3 was the first one completed for an international airport under the Federal Aviation Administration (FAA) Pilot Program. The Airport P3 is structured as a 40-year lease agreement between the Puerto Rico Ports Authority and Aerostar Airport Holdings LLC to operate the Luis Muñoz Marín International Airport. Aerostar made an initial \$615 million payment to the Puerto Rico Ports Authority; committed to make certain investments to upgrade the airport facilities; and is responsible for annual payments equal to a percentage of airport revenues. All other revenues related to the airport belong to Aerostar for the duration of the lease.
- **Toll Roads P3:** The Toll Roads P3 is structured as a 40-year concession agreement between Autopistas Metropolitanas de Puerto Rico LLC and the Puerto Rico Highway and Transportation Authority for the maintenance and operation of two highways, PR-22 and PR-5. Much like the Airport

P3, Autopistas Metropolitanas de Puerto Rico had to make an up-front payment to the Highway and Transportation Authority in the amount of \$1.08 billion and committed to make certain investments to upgrade the toll roads. Remaining revenues generated by the toll roads belong to Autopistas Metropolitanas de Puerto Rico.

#### C. More P3s are on the way

It was recently reported that the Authority is actively investigating the possibility of future P3 projects in the areas of infrastructure, education, health, and energy. Furthermore, the Oversight Board instituted under PROMESA issued a letter to Governor Rosselló on January 18, 2017 encouraging the government to focus on P3s as a viable avenue, under the current fiscal constraints, to ensure that Puerto Rico's infrastructure catches up to the global median. It is therefore anticipated that the Government of Puerto Rico will expeditiously activate the P3 Act to start developing P3s in key areas enumerated as Priority Projects.





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