

(H.B. 3817)
(Conference)

(No. 265)

(Approved September 3, 2003)

AN ACT

To prohibit government entities from executing finance contracts, lease contracts, financial lease contracts, or any other type of personal property contracts covered by this Act without obtaining prior approval from the Government Development Bank for Puerto Rico; to direct the Government Development Bank for Puerto Rico to adopt regulations establishing the standards and requisites with which such contracts must comply; to establish the annulment of contracts that are executed in violation of the provisions of this Act and of the regulations adopted hereunder; to establish penalties in said regulations for violations to this Act; to exempt from said regulations the provisions of Act No. 170 of August 12, 1988, as amended; to exempt contracts approved under this Act from the provisions of Section 8 (b) of Act No. 230 of July 23, 1974, as amended; and for other purposes.

STATEMENT OF MOTIVES

During the past years various government and municipal agencies have executed financial lease contracts to finance the acquisition of equipment, computers, and other personal property. These contracts typically are for a term of more than one year, thus, they represent, in the case of those government agencies whose resources come from budgetary appropriations from the General Fund, an obligation that ties up their future budgetary appropriations. These include a component of interest within the lease payment.

Act No. 230 of July 23, 1974, known as the Government of Puerto Rico Accounting Act, prohibits government bodies from executing contract where they are forced to pay amounts that exceed the budgetary appropriations authorized by law for the fiscal year in which the obligation is contracted, unless such obligation is expressly authorized by law.

Pursuant to Act No. 272 of May 15, 1945, as amended, the Government Development Bank for Puerto Rico acts as fiscal agent of the Commonwealth of Puerto Rico, its agencies and municipalities for the issuance of bonds, promissory notes, or other proofs of debt. By executive Order 1993-20, all agencies, instrumentalities, or municipalities that were to subscribe financial lease contracts were required to submit said contracts for the consideration of the Government Development Bank for Puerto Rico for the latter, as fiscal agent, pass judgment on their costs, terms and conditions.

Pursuant to Section 11 of Act No. 64 of July 3, 1996, as amended, known as the Puerto Rico Municipal Financing Act of 1996, all obligations incurred by a municipality must receive the prior approval of the Government Development Bank for Puerto Rico, in its capacity as fiscal agent of the municipalities. Said Act requires the Government Development Bank for Puerto Rico, to establish by regulations the requirements that must be met by all bonds, promissory notes, and credit instruments executed or issued by a municipality.

Act No. 111 of June 30, 2000, known as the Uniform Procurement Standards Act for the Executive Branch of the Government of Puerto Rico, established in its Section 4 that government entities could execute financial lease contracts for the acquisition of personal property. Section 18 of said Act empowered the Government Development Bank for Puerto Rico to establish the guidelines and to approve the contracts that involve the

payment of interest by the Government, such as financial lease and installment payment contracts. Act No. 111 was repealed by Act No. 31 of May 21, 2001.

Recently, Standard & Poor's Rating Services, one of the main bond classification agencies, announced that it was placing its classification of the Commonwealth of Puerto Rico's bond on "credit watch" with negative implications, which might result in a reduction in the credit classification of Puerto Rico's bonds. The announcement indicated that this action by Standard & Poor's was the result of its concern as to the government of Puerto Rico's ability to apply adequate controls in its financial activities. This concern arose as a result of the failure of certain government entities to make their payments under certain financial lease contracts executed by them and subsequently placed with investors in the United States, which had not been evaluated by the Government Development Bank for Puerto Rico. The Standard & Poor's announcement also indicated that the latter might reduce the classification of the Commonwealth of Puerto Rico's bonds if the Government failed to take speedy action to resolve what they perceive as a lack of adequate controls to prevent government entities from being able to exceed their budgets or financial margins.

The purpose of this measure is to establish a mechanism to give greater control to the Government Development Bank for Puerto Rico over Government Entities the execution of financial lease contracts and other types of analogous contracts on personal property that encumber their future resources.

This measure prohibits carrying out the following acts without the prior written approval of the Government Development Bank for Puerto Rico: (i) that any government agency or municipality execute any financial lease

contract; (ii) that any government agency execute for more than one (1) fiscal year; and (iii) that the party contracting with the government agency assign, sell, or transfer said contract to third parties.

The principal benefit of this measure is to obtain greater control over the creation of fiscal commitments of government entities that may adversely affect the sound credit established by the Commonwealth of Puerto Rico in the financial markets. At the same time, by requiring the prior written approval of said contracts by the Government Development Bank for Puerto Rico, this Act offers the contracting entity a greater degree of security in the repayment of the obligations contracted.

BE IT ENACTED BY THE LEGISLATURE OF PUERTO RICO:

Section 1.- Short Title.-

This Act shall be known as the Act for Regulating Certain Government Financing and Personal Property Leasing Contracts.

Section 2.- Definitions.-

The following terms shall have the meaning stated bellow and the words used in singular shall include the plural, and vice versa:

- (a) Bank: Shall mean the Government Development Bank of Puerto Rico.
- (b) Lease Contract: Shall mean that contractual agreement between the lessor and the lessee in which the lessee is granted the right to use and enjoy personal property of the lessor, for a specific term in exchange for certain previously stipulated periodic payments.
- (c) Financial Lease Contract: Means a Lease Contract that complies with or contains one of the following requirement:

- (i) Ownership of the personal property leased is transferred to the lessee upon conclusion of the lease term;
 - (ii) Contains a purchase option for the leased personal property at a value substantially less than the fair market value of said personal property at the time the option is exercised;
 - (iii) The term is equal to or greater than seventy-five percent (75%) of the useful life of the personal property leased, or;
 - (iv) The present value of the minimum payments, excluding administrative expenses, is equal to, or greater than ninety percent (90%) of the fair market value of the leased personal property.
- (d) **Financing Contract:** Means a Financial Lease Contract and any other type of contract on personal property that, in the Bank's judgment, should be treated as a debt obligation of the lessee Government Entity for a period of more than one (1) fiscal year.
- (e) **Covered Contract:** Means, for purposes of this Act, any Lease Contract or Financing Contract that encumbers the budgetary resources of the Government Entity for a period of more than one (1) fiscal year.
- (f) **Personal Property:** Means property or properties that may be transferred because of their own nature, that may be transported from one point to another without impairing anything else that is attached, or those that by law are defined as personal properties and are the subject of the Covered Contract.

Excluded are properties that are assigned, sold, or transferred for a term of less than one (1) year.

- (g) Government Entity: Means the Commonwealth of Puerto Rico and all of its departments, agencies, boards, commissions, committees, instrumentalities, public corporations and municipalities.
- (h) Private Entity: Means any natural or juridical person other than a Government Entity.
- (i) Regulations: Means the regulations adopted by the Bank under Section 4 of this Act.

Section 3.- Approval of Contracts and Assignments.-

- (a) All Government Entities are hereby authorized to execute Covered Contracts, provided they comply with the requirements of this Act.
- (b) It is hereby prohibited for a Government Entity to execute a Covered Contract without obtaining the prior written approval of the Bank. To obtain such approval, the Government Entity must submit an application to be approved by the Bank on the form provided by the Bank in the Regulations. As part of the application, the Government Entity shall identify the specific resources it will use to comply with the corresponding payments and it shall certify that it will use those resources to comply with such payments.
- (c) Any Covered Contract executed by a Government Entity without the prior written approval of the Bank shall be voidable. This provision shall not be applicable to Covered

Contracts that the Bank exempts from the provisions of this Act under the Regulations.

- (d) All Covered Contracts subject to the approval of the Bank pursuant to this Act may not be assigned, sold, or otherwise transferred without the prior written approval of the Bank. This requirement shall be part of the Covered Contract so that all the contracting parties and third parties may be fully aware of the same. This requirement shall not be applicable to Covered Contracts that the Bank exempts from the provisions of this Act under the Regulations.
- (e) All assignments, sales, or other type of transfer of a Covered Contract subject to the provisions of this Act and of the Regulations, executed without the prior written approval of the Bank, shall be voidable. Should this provision be violated, the original Covered Contract with the Government Entity may be rescinded, at the Government Entity's and the Bank's option. In the event that the Covered Contract is rescinded, the monies paid by the Government Entity shall be returned to the latter and the personal property under said Covered Contract shall be returned to the lessor or financing provider.
- (f) All approval applications submitted by a Government Entity must include a certification by the chief executive officer of the Government Entity and of the internal or external legal advisor of said Government Entity to the effect that the contractual and purchasing requisites of the pertinent Government Entity have been met.

- (g) All Covered Contracts must include a clause expressly stating that, unless otherwise expressly authorized by law, said Covered Contract does not constitute a debt whose payment may restrict the good faith, credit, and tax-imposing authority of the Commonwealth of Puerto Rico.
- (h) All Covered Contracts must include a certification stipulating that the Bank reviewed and approved such Covered Contract.

Section 4.- Regulation and Registration of Contracts.-

- (a) The Bank is hereby directed to establish through Regulations the standards and requirement with which all Covered Contracts executed by a Government entity must comply and all assignments, sales, or transfers of such Covered Contracts to one or more third parties. Such Regulations must also establish the Covered Contracts that will be exempted from the provisions of this Act. The Regulations must be adopted on or before ninety (90) days as of the effective date of this Act.
- (b) The Regulations may include, without it being construed as a limitation, the following standards and requirement:
 - (i) the information and support documents that must be included in the application for approval of the Covered Contract or of the approval of the assignment, sale, or transfer of such Covered Contract;
 - (ii) the procedure for presenting evaluating and approving or denying the application;
 - (iii) the Covered Contract model or models that must be used by the Government Entities or the minimum criteria with

which the Covered Contract must comply, which may include;

- (A) the maximum interest rate;
 - (B) the term of the Covered Contract;
 - (C) the useful life of the personal property;
 - (D) the penalties or liabilities for the premature cancellation of the Covered Contract;
 - (E) the guarantees, if any;
 - (F) the ownership of the personal property, among others;
 - (G) the circumstances under which it must include a release from liability for the contracting Government Entity in the event that sufficient budgetary funds are not assigned to it to meet all the payment commitments under the Covered Contract; and,
 - (H) any other requirement provided in this Act;
- (iv) the criteria to approve an assignment, sale, or transfer; and,
- (v) the term the Bank will have to approve or deny any application, which shall not exceed sixty (60) days from the date on which the Bank receives the complete application as required by the Regulations and this Act.
- (c) Any application for approval that is not denied by the Bank within the term provided by the Regulations or sixty (60) days after having been received complete by the Bank, whichever is

less, shall be deemed to be approved for the purposes of this Act.

- (d) The approval of the Regulations and of any subsequent amendment shall be exempt from the requirements of Act No. 170 of August 12, 1998, as amended, known as the “Commonwealth of Puerto Rico Uniform Administrative Procedures Act”. Once the Regulations are adopted or amended by the Bank, they shall be filed with the Department of State and they shall be published on or before thirty (30) days after the filing of the approval of such Regulations or amendment through an advertisement published in two newspapers of general circulation in the Commonwealth of Puerto Rico.
- (e) The Bank is directed to maintain a register where all Covered Contracts, assignments, sales, or transfer of a Covered Contract approved by the Bank shall be recorded. All Covered Contracts must be registered with the Bank not later than thirty (30) days after their execution.
- (f) All Private Entities that upon the prior written approval of the Bank execute an assignment, sale, or transfer of a Covered Contract must notify the Bank within thirty (30) days of the effective date of such assignment, sale, or transfer.

Section 5.- Penalties.-

Any official of a Government Entity who knowingly executes a Covered Contract that is exempt from the application of the Regulations or of this Act may be penalized through sanctions that may include from a warning to removal from office. The Bank, at its discretion, may

recommend that the Governor apply the sanction that is appropriate to the circumstances of the unauthorized execution. Such official shall also be personally liable for the payment of all public funds disbursed under such Covered Contract that have not been recovered by the Government Entity when the public official has demonstrated gross negligence in his/her actions in executing the Covered Contract.

Section 6.- Exemption from Section 8(b) of the Government of Puerto Rico Accounting Act.-

All Covered Contracts approved by the Bank under the Regulations shall be exempt from compliance with the provisions of Section 8(b) of Act No. 230 of July 23, 1974, as amended, known as the “Government of Puerto Rico Accounting Act”.

Section 7.- Conflicting Provisions Are Set Aside.-

In cases in which the provisions of this Act are in conflict with the provisions of any other law of the Puerto Rico Legislature, the provisions of this Act shall prevail unless the provisions of said other law specifically amend or repeal some or all of the provisions of this Act, and the provisions of this Act shall prevail over the provisions of any other law that is aimed at the subject of this Act.

Section 8.- Standards of Interpretation of this Chapter.-

The provisions of this Act shall be liberally interpreted in such a manner as to achieve its purposes.

Section 9.- Severability Clause.-

If any provision of this Act or the application of such provision to any person or under any circumstance is declared unconstitutional, the rest of this Act and its application shall not be affected by such declaration of unconstitutionality.

Section 10.- Transitory Provisions.-

- (a) This Act shall be applicable prospectively and shall not affect any contract that, had it been executed when this Act was in effect, would have constituted a Covered Contract.
- (b) The Bank is hereby authorized to pay on behalf of a contracting Government Entity those sums owed under any contract that, had it been executed when this Act was in effect, would have constituted a Covered Contract.

Section 11.- Effectiveness.-

All the provisions of this Act, except for the provisions of Section 10(b), shall take effect immediately after their approval. The provisions of Section 10(b) shall be effective retroactive to December 1, 2002.

CERTIFICATION

I hereby certify to the Secretary of State that the following Act No. 265 (H.B. 3817) (Conference) of the 5th Session of the 14th Legislature of Puerto Rico:

AN ACT to prohibit government entities from executing finance contracts, lease contracts, financial lease contracts, or any other type of personal property contracts covered by this Act without obtaining prior approval from the Government Development Bank for Puerto Rico; to direct the Government Development Bank for Puerto Rico to adopt regulations establishing the standards and requisites with which such contracts must comply; to establish the annulment of contracts that are executed in violation of the provisions of this Act and of the regulations adopted hereunder; etc.,

has been translated from Spanish to English and that the English version is correct.

In San Juan, Puerto Rico, today 30th of September of 2003.

Elba Rosa Rodríguez-Fuentes
Director