

(H. B. 1922)

(No. 66-2014)

(Approved June 17, 2014)

AN ACT

To create the “Government of the Commonwealth of Puerto Rico Special Fiscal and Operational Sustainability Act,” in order to declare a state of fiscal emergency; devise a plan to deal with the consequences of the fiscal and economic crisis of the downgrading of Puerto Rico’s credit rating; establish a structured management to address this situation; provide for the supremacy of this Act and the applicability thereof; establish the fiscal sustainability tests set as goals and provide for the filing of quarterly reports; establish measures to cut back on spending in the Executive Branch such as reductions in the contracting of professional and purchased services, adjustments of purchased and professional service rates, cuts in trust employees payroll expenses, establish controls for filling vacancies, and to render the government’s authority to make transfers and details due to service needs more flexible, establish rules and restrictions on increasing economic benefits and special monetary compensations, provisions on the negotiation of collective bargaining agreements and forums to settle disputes, provisions on school transportation; a prohibition on budget overdrafts; provide for fiscal controls in government corporations; provide for the budget of the State Election Commission, the Office of Government Ethics, the Office of the Election Comptroller, and the Office of the Special Independent Prosecutor’s Panel; set forth prohibitions on protective detail, traveling, and contracting of services, among others; establish an expenditure and lease agreements reduction plan; provide for an energy and aqueduct and sewer service use reduction plan; provide budget measures for the Judicial Branch, the Legislative Branch, and other government entities; set forth plans for final and binding judgments pending payment; establish the prohibition on claims in relation to obligations temporally suspended under this Act; provide on the responsibilities, powers, and duties of the Office of Management and Budget; provide for immunity from lawsuits and forums; and for other related purposes.

STATEMENT OF MOTIVES

For the first time in our constitutional history, despite all the measures taken by the government to address the finances of the Island, the credit of the Commonwealth of Puerto Rico has been compromised due to the downgrade of the Commonwealth's general obligation bonds to speculative grade by the major credit rating agencies. *See, Credit Rating Reports on Commonwealth of Puerto Rico bonds of the Government Development Bank for Puerto Rico.*

This Legislative Assembly has the constitutional duty to “maintain public credit, which is necessary for the economic improvement of the people.” 4 *Journal of the Constitutional Convention* 2587 (1952). *See, also, Trías Monge, 3 Historia Constitucional de Puerto Rico* 224-225 (1982). Furthermore, this Legislative Assembly is duty bound to oversee the economic wellbeing of Puerto Rico [our translation]. *See, Domínguez Castro v. E.L.A.*, 178 D.P.R. 1, 15 (2010).

The loss of investment grade ratings of the public debt jeopardizes the fiscal and economic health of the people of Puerto Rico, unduly compromising the credit rating of the Island. Our economy has been severely damaged and adversely affected by such downgrading, thus resulting in the devaluation of outstanding bonds, losses in the investment portfolios of institutional and individual bondholders in the island, the difficulty in tapping into municipal bond markets to finance public works, and the contraction of economic activity in Puerto Rico, which has caused a marked reduction in the revenues of the Government, and, consequently, in the State's capacity to fulfill the needs of the Island. *See, Commonwealth of Puerto Rico Quarterly Report (February 18, 2014); Official Statement, Commonwealth of Puerto Rico General Obligation Bonds of 2014, Series A. See, also, Domínguez Castro v. E.L.A., supra*, p. 53-55.

Moreover, the downgrading of the Island's credit could result, and in some cases resulted in, the acceleration of certain Commonwealth obligations, the termination of lines of credit, or the need to pledge cash collateral to guarantee the payment of certain bonds that could amount to nearly \$900 million. See, Commonwealth of Puerto Rico Quarterly Report, pp. 4-6. There are also other obligations that are close to reaching their maturity date, thus limiting dramatically the liquidity of the State and its ability to fully defray all budget appropriations for this and the next fiscal year. *Id.* This means that the State needs sufficient liquidity to continue operating, that is, to have the necessary cash to meet its obligations as they become due. If the government does not have enough money to meet such obligations, the public employees' payroll, as well as other money disbursements that are essential to provide services to the people, will be in jeopardy.

The most recent credit ratings of Commonwealth General Obligations, issued by the three main credit rating agencies, Standard & Poor's Rating Services, Moody's Investors Service, and Fitch Ratings, have identified the extent of Puerto Rico's indebtedness, its lack of liquidity and difficult access, as well as the budget deficits of the last 7 years, as the reasons for the downgrading of its bonds. See, Standard & Poor's report on February 4, 2014, Moody's Investors Service report on February 7, 2014, and Fitch Ratings report on February 11, 2014.

However, such rating is not lower due to the efforts made by this Administration to reduce the size of the deficit, and its commitment to approve a balanced budget for Fiscal Year 2015. To such effects, Standard & Poor's stated the following in their February 4, 2014 report:

That the rating is not lower is due to the progress the current administration has made in reducing operating deficits, and what we view as recent success with reform of the public employee and teacher pension systems, which had been elusive in recent years. We view the reform as significant and could contribute to a sustainable path to fiscal stability. We view the current administration's recently announced intent to further reduce appropriations in fiscal 2014 by \$170 million and budget for balance operations in fiscal 2015 as potentially leading to credit improvement in the long run, but subject to near-term implementation risk that could lead to further liquidity pressure to the extent deficits continue.

Likewise, Moody's Investors Service stated in its February 7, 2014 report that:

The problems that confront the Commonwealth are many years in the making, and include years of deficit financing, pension underfunding, and budgetary imbalance, along with seven years of economic recession. These factors have now put the Commonwealth in a position where its debt load and fixed costs are high, its liquidity is narrow, and its market access has become constrained. In the face of these problems, the administration has taken strong and aggressive actions to control spending, reform the retirement systems, reduce debt issuance, and promote economic development. Despite these accomplishments, however, in our view the commonwealth's credit profile is no longer consistent with investment grade characteristics.

Lastly, Fitch Ratings noted in its February 11, 2014 report that:

FISCAL MANAGEMENT EFFECTIVE AND COMMITTED: The Commonwealth's management has responded quickly and decisively to challenges that have arisen in recent years and the current administration has made significant progress in addressing longstanding credit issues. Fitch believes the commitment of management to achieving fiscal balance and honoring commitments to bondholders remains strong, and the governor recently announced a plan to balance the budget next year, one year earlier than previously expected.

Since the Commonwealth of Puerto Rico made a commitment to credit rating agencies of taking affirmative action to face the fiscal issues and propose a balanced budget for Fiscal Year 2015, said agencies have resolved to downgrade our credit only to one level below investment grade. To such effect, the Investor Webcast of February 18, 2014, as well as the presentation made to investors on May 2, 2014, included representations on behalf of the Commonwealth of Puerto Rico stating that the proposed budget for Fiscal Year 2015 will be balanced.

In accordance with the foregoing, by virtue of the State's police power, and pursuant to Sections 18 and 19 of Article II, and Sections 7 and 8 of Article VI of our Constitution, a serious economic and fiscal emergency is hereby declared in Puerto Rico, which renders necessary the approval of this special Act of socioeconomic nature to provide the State with the tolls to meet both its liquidity needs and the payroll of public employees, as well as to cover the costs of essential services offered to the people. This will be attained through the implementation of measures to cut back on spending and provide fiscal stability to achieve the economic recovery of Puerto Rico, without resorting to the dismissal of career public employees or affecting critical functions of government agencies that provide security, education, healthcare, or other social work services; and most

importantly safeguarding the constitutional mandate for the payment of interest and amortization of the public debt. In fact, we are exercising such police power, as stated by the Supreme Court of Puerto Rico: “that power inherent to the State which is used by the Legislative Assembly to prohibit and regulate certain activities for the purpose of promoting and safeguarding the public peace, the morale, health, and general welfare of the community, which power can be delegated to the municipalities.” (Our translation) *Domínguez Castro v. E.L.A.*, *supra*, p. 36.

Furthermore, the Legislative Assembly exercises such power taking into account the most recent statements of the Supreme Court of Puerto Rico with respect to the use of the State’s police power at times of crisis. In this sense, said Forum held that the imminent fiscal crisis declared under Act No. 7-2009, known as the “Special Act Declaring a State of Fiscal Emergency and Establishing a Comprehensive Fiscal Stabilization Plan to Salvage the Credit of Puerto Rico,” was evidenced in the Statement of Motives. Said Act stated that the Island’s credit was “on the verge of downgrading to junk status,” which “would be catastrophic for Puerto Rico,” and its “impact would be massive at all levels of our society [...] dragging Puerto Rico into a deep economic depression never before seen in our history,” whose impact “would be unimaginable.” Statement of Motives, Act No. 7-2009. After evaluating the information furnished in said statement of motives, the Court validated said Act and held that the measures therein were necessary and reasonable to further the compelling government interest sought with the approval of Act No. 7-2009 of bringing said crisis to a halt. See, *Domínguez Castro v. E.L.A.*, *supra*, pp. 88-89. Likewise, it recognized that “our precarious economy is a reality that of necessity carries weight on the definition of the scope of governmental actions under the police power” and that, in exercising said power, “the Legislative Assembly is fully empowered to approve

economic regulations geared towards promoting the welfare of the community.” (Our translation) *Id.*, p. 37. The Court further stated that “it had taken judicial notice of the precarious economic situation of the Island and of how such economic situation is reflected thus producing a serious crisis in the Government’s finances”. *Id.*, p. 50.

Subsequently, in *Trinidad-Hernández v. E.L.A.*, 188 D.P.R. 828 (2013) our Highest Court validated Act No. 3-2013, which reformed the Retirement System for Employees of the Government, holding that the Legislative Assembly had exercised its police power to address the insolvency issue of the Retirement System for Employees of the Government. The Statement of Motives of said statute showed that the retirement system was on the verge of an imminent fiscal crisis to the extent that, if no action was taken, the net assets of the system will be in negative numbers and, for Fiscal Year 2018-2019, the retirement system would be left without sufficient funds to meet its obligations, such as the pension payments for the system’s retirees. *Id.*, pp. 836-837. Just as in *Domínguez Castro, supra*, the Supreme Court held that “the statement of motives... explains that the measures adopted are necessary and reasonable to properly address the financial crisis that threatens the actuarial solvency of this system.” Moreover, “this certainly is in the public interest since, by guaranteeing the economic solvency of the system, all of the participants will benefit therefrom and the Island’s fiscal crisis will be addressed, to some extent, thus safeguarding the welfare of the people of Puerto Rico.” *Trinidad Hernández, supra*, p. 837. The Court concluded that said statute is consistent with the Constitution in that “even though there is a substantial impairment of the contractual obligations in dispute, the measures implemented are reasonable and necessary to safeguard the actuarial solvency of the Retirement System, and there are no less burdensome measures to attain this goal.” *Id.*, p. 839.

Recently, in *Asociación de Maestros de Puerto Rico v. Sistema de Retiro de Maestros de Puerto Rico*, 2014 T.S.P.R. 58, the Supreme Court analyzed the measures approved through Act No. 160-2013 to address the crisis of the Teacher's Retirement System and determined that the said Act did not furthered the State's fundamental interest as required by our Constitution in the event of retirement system reforms: to guarantee the system's solvency. Hence, the Court held that Act No. 160-2013, in relation to the impairment of contractual obligations, is unreasonable and, therefore, unconstitutional. *Id.*, p. 12. On such occasion, the Court emphasized that the measures approved shall be deemed to be constitutional, provided that they are reasonable and necessary "to further the actuarial solvency and that there are no less burdensome measures to attain this goal." *Id.*, p. 8.

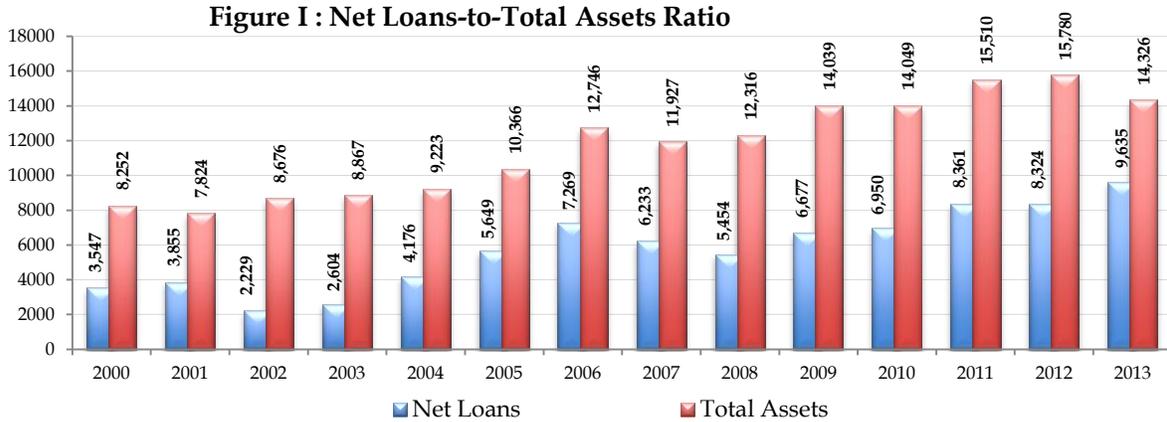
Certainly, the measures adopted up to that time were not sufficient to address the economic and fiscal issues of Puerto Rico. For such reason, we are once again required to exercise our police power to address this crisis, which has become more serious. As discussed further on, for years, the net income of the General Fund has not been sufficient to cover the recurring operating expenses chargeable thereto. In the past, money was taken on loan to make up any deficit between the revenues and the expenditures of the General Fund. At the same time, public corporations have experienced a similar situation and, consequently, most of them have reported annual million-dollar operating losses. Moreover, taking money on loan without a source of repayment therefor has also contributed to this situation.

The practice of financing operating expenses by taking money on loan is the reason why we are facing today a serious liquidity issue that is jeopardizing the resources of the government used to defray public employees' payroll, and its operating expenses. Hence, it is necessary to take measures to ensure that the government has the resources needed to defray the costs of the services provided to the people.

Liquidity of the Government Development Bank for Puerto Rico

The Government Development Bank for Puerto Rico (GDB or the Bank) is the fiscal agent of the Commonwealth that has traditionally provided internal financing to the government and its instrumentalities as it happened prior to the long-term debt issued in the municipal bond market. The GDB has also provided financing for the operating deficits of government agencies and public corporations, thus becoming the greatest short-term financing source for the government. For such reason, the liquidity and financial stability of the GDB is essential to guarantee its effectiveness as the government financing source and as the Island's economic development facilitator.

After evaluating the audited financial statements of the Bank for fiscal years ending between June 30, 2000, and June 30, 2013, it is evident that there was a substantial increase with respect to the outstanding loans and the total assets of the Bank, which is an indicator of how the liquidity of this institution has been compromised. Figure I shows this ratio for the last thirteen years (in millions).



As shown, outstanding loans and the net reserve for uncollectible loans, which included money lent to government agencies, public corporations, municipalities, and private entities significantly increased by \$6.088 billion in 13 years. The practice of lending money to make up the operating deficits of the General Fund and of public entities without a source of repayment has adversely affected the liquidity and financial stability of the Bank. An example of this situation was the pattern followed in the past of making up operating deficits of the Highways and Transportation Authority (HTA) with GDB advances. As of June 30, 2013, and according to the financial statements audited by Ernst & Young, LLP, the outstanding balance of HTA's line of credit with the Bank was \$2.043 billion. In addition to compromising the GDB's capital, this requires that future government administrations increase the rates and impose new taxes and fees to pay off debts incurred by past administrations. In addressing this issue, and aware of its responsibility to pay off the Commonwealth's debts, this Administration passed Act No. 30-2013 and Act No. 31-2013, which provided additional income for the HTA to pay off its outstanding debt with the GDB.

In detail, for Fiscal Year 1999-2000, GDB's loan portfolio amounted to \$3.547 billion or 43% of its total assets. For Fiscal Year 2000-2001, such amount increased by \$308 million and so did the balance, which totaled \$3.855 billion or 49% of its total assets. For Fiscal Year 2001-2002, there was a reduction of nearly \$1.6 billion. This reduction resulted from the trading in the capital market, in accordance with Act No. 164-2001, of loans granted to public corporations and agencies without sources of repayment. This transaction reduced the net loans-to-total assets ratio by 26%. Fiscal Year 2002-2003 ended with a \$2.604-billion loan portfolio or 29% of the GDB's total assets. Fiscal Year 2003-2004 saw an increase of nearly \$1.570 billion in the GDB's loan portfolio, thus the balance amounted to \$4.176 billion or 45% of the Bank's total assets. For Fiscal Years 2004-2005 and 2005-2006 the balance increased by \$1.472 billion and \$1.620 billion, respectively. These increases were mainly due to the loans granted by the Department of the Treasury. At the close of Fiscal Year 2004-2005, the total loan balance accounted for 57% of the Bank's total assets.

At the close of Fiscal Year 2006-2007, the loan balance was reduced by \$1.036 billion. This reduction was mainly due to the refinancing and repayments through bond issues, namely, \$580 million for the Aqueduct and Sewer Authority; \$301 million for the Ports Authority; and \$107 million for the Electric Power Authority. As of June 30 of Fiscal Year 2007-2008, there was an additional \$835 million reduction in the public sector; however, the municipal loan item increased as a result of the creation of the Municipal Redemption Fund which, in turn, increased the borrowing margin for municipalities. Fiscal Years 2008-2009 and 2009-2010 showed a significant increase in the municipal loan item of \$174 million and \$291 million, respectively.

There was a significant \$1.411-billion increase in Fiscal Year 2010-2011. In said fiscal year, the (net) loan portfolio reached \$8.360 billion or 54% of the Bank's total assets. Even though (net) loans remained virtually stable in Fiscal Year 2011-2012, there was a \$1.311-billion balance increase during Fiscal Year 2012-2013. As of June 30, 2013, the loan total amounted to \$9.635 billion out of the \$14.326 billion of the Bank's total assets, or 67% thereof.

During Fiscal Year 2013-2014, the GDB has granted the Commonwealth nearly \$1.2 billion in loans for the payment of financial obligations that came due this fiscal year. As of April 30, 2014, there is still an outstanding \$623-million loan debt. Furthermore, the Commonwealth has a \$1.2 billion debt in Tax Revenue Anticipation Notes, of which \$900 million will mature this fiscal year, and \$300 million will mature early in Fiscal Year 2014-2015. The renewal of most of such notes is expected, in order to provide liquidity to the Central Government for the upcoming fiscal year.

The Authorized Public Accountants firm, KPMG LLP, audited the GDB's financial statements for the fiscal year ending on June 30, 2013. In its report, auditors stressed that, according to the financial statement as of June 30, 2013, the total amount of outstanding loans granted by GDB to the Commonwealth and its public corporations is \$6.9 billion or 48% of the GDB's total assets. Moreover, the outstanding loans of the municipalities amounted to \$2.212 billion or 15% of the GDB's total assets. The information shown in Table 1 was gathered from note 7 of the GDB's audited financial statements as of June 30, 2013. This table shows a detailed account of outstanding loans (in thousands):

Table 1: Statement of Outstanding Loans

	<u>Operating Fund</u>	<u>Tourist Development Fund</u>	<u>Housing Finance Authority</u>	<u>Development Fund</u>	<u>Total</u>
Public Corporations and Agencies	\$6,889,134				\$6,889,134
Municipalities	2,212,481				2,212,481
Reserve	<u>(4,000)</u>				<u>(4,000)</u>
Sub-Total	<u>9,097,615</u>				<u>9,097,615</u>
Private Sector	39,935	376,361	360,014	21,259	797,569
Reserve	(264)	(178,721)	(37,742)	(16,937)	(233,664)
Deferred Income	-	-	<u>(26,430)</u>	-	<u>(26,430)</u>
Sub-Total	<u>39,671</u>	<u>197,640</u>	<u>295,842</u>	<u>4,322</u>	<u>537,475</u>
Total	<u>\$9,137,286</u>	<u>\$197,640</u>	<u>\$295,842</u>	<u>\$4,322</u>	<u>\$9,635,090</u>

Note 4 of the audited financial statements shows that the loans granted to the Commonwealth and its public entities account for a large portion of the Bank's assets. Consequently, the liquidity and financial situation of the Bank greatly depends on the repayment capacity of the Commonwealth and its public corporations.

However, most public corporations are facing great challenges, both fiscal and financial. Hence, any situation that prevents these entities from generating the resources needed to repay their loans will ultimately have an adverse effect on GDB's liquidity and financial stability. Not to mention the fact that the bank's liquidity has been significantly affected, as a result of the limited market access, and significantly reduced in the local capital market.

The notes of the GDB's financial statements even define "liquidity risk" as the ability to generate funds when necessary to meet obligations as they become due, at a reasonable cost and with minimum losses.

As a result of the credit downgrading, the cost of issuing debt has increased thus limiting the capacity to tap into the market. These situations have hindered GDB's capacity to generate cash, thus affecting its liquidity. At the same time, said situations will adversely affect the Commonwealth and its corporations, since they

will impair the Bank to provide internal financing to such agencies and instrumentalities.

On that same topic, this Administration took several measures to improve GDB's liquidity. For instance, a historic issue of Commonwealth general obligation bonds in the amount of \$3.5 billion was made in March 2014. The net proceeds of such bond issue were used mainly for the repayment of Commonwealth obligations to the GDB. Act No. 24-2014 was also enacted to enable the GDB to require certain government entities to transfer the balance in their cash accounts from private institutions to the Bank. Furthermore, such Act bans the GDB from granting loans to public corporations that are unable to prove to have sufficient sources of income to pay the debt service of the new financing. Thus, this Act seeks to establish financial discipline on public entities and maintain the liquidity and financial stability of the GDB. Even though these measures, coupled with other efforts, have proven to be successful in increasing the Bank's liquidity, the latter has yet to regain the necessary financial stability to satisfy by itself the current financial needs of the Government of the Commonwealth and its public corporations, even more so when these entities' access to the market is limited.

GDB's adverse condition also affects the Island's banking industry in general by imposing serious restrictions on the granting of loans to the Government. Both local and international private financial institutions, which in the past have served as temporary sources of liquidity for the government, have significantly reduced and continue reducing the credit granted to the Commonwealth and other public instrumentalities. Consequently, they are no longer a temporary financing option. Interest rates have also experienced some increase which, in turn, have risen the cost of capital for the Commonwealth, thus reducing the government's capacity to issue new debt. The limitation in the access

to capital markets and credit granted by private financial institutions has also limited the volume of debt that can be issued; therefore, the government is forced to depend on financing to defray its operations.

Even though the recent issue of general obligation bonds improved GDB's liquidity since it generated \$3.2 billion net proceeds, said transaction was used mainly for the refinancing of short-term debt with private institutions and the GDB. For such reason, the net proceeds thereof are not available to provide temporary financing to the government without affecting once again the Bank's liquidity. This issue prevented a potential noncompliance with certain financial obligations and provided the Commonwealth with some room to finish and implement its fiscal adjustment plan aimed at balancing the budget, without resorting to financing the deficit or refinancing the debt. Such issue was possible thanks to the significant steps taken by this Administration as of today to close the budget gap and, particularly, to its commitment to approve a balanced budget for Fiscal Year 2014-2015. It is important to stress that capital markets do not regard very well that the General Fund's budget has been balanced by incurring more debt. Also, the bonds of the Commonwealth or its instrumentalities lack market appeal, including the bonds of the Dedicated Sales Tax Corporation (COFINA, Spanish acronym), which is a vehicle used by the past Administration to refinance the General Fund's deficits, unless the appropriate measures are taken to mitigate the burden that the General Fund's deficit represents to the Department of the Treasury and the GDB.

After said bond issue on March 11, 2014, in the amount of \$3.5 billion, Standard & Poor's, in a report dated on March 14, 2014, stated that: "In our opinion, the sale will relieve near-term liquidity pressure on the Commonwealth"; and added:

While we have removed the CreditWatch designation, we have assigned a negative rating outlook, reflecting long-term economic and financial trends we see over the next two years. These include the potential for a larger deficit in fiscal 2014 than the \$650 million that Puerto Rico now projects after passage of \$170 million of mid-fiscal 2014 budget adjustments, and the potential for general fund operating deficits in fiscal 2015. There also remain potential ongoing working-capital liquidity needs for fiscal 2015 and plans by the commonwealth for additional bond sales in fiscal 2015. Puerto Rico will also need to start paying interest on the 2014 bonds in fiscal 2016.

Credit rating agencies are aware of and have consistently recognized that Puerto Rico's Treasury has a persistent liquidity problem which can only be addressed with the implementation of aggressive measures aimed at making up the budget deficit that repeats every year. The Island has made a commitment to do this before the global market and, as shown in the comments made by credit rating agencies, the efforts made to face this crisis are helping us to establish credibility. The improvement in Puerto Rico's credit rating depends on these efforts. This Act is a fundamental step towards achieving financial stability and a balanced budget, as well as to restore the credibility of the Island. But this is not our last challenge. As noted by Fitch Ratings on the report dated April 15, 2014, there are still challenges that need to be addressed regarding the budget for Fiscal Year 2015 and the recent decision of the Supreme Court on Act No. 160-2013, and they reminded us:

In the coming weeks the governor is expected to release his budget proposal for the fiscal year beginning July 1, which he has announced will be balanced. The court decision has no direct negative impact on the near-term budget, but the commonwealth has stated in the past that

without reform the teachers' retirement system would confront an annual cash flow deficit beginning in ...

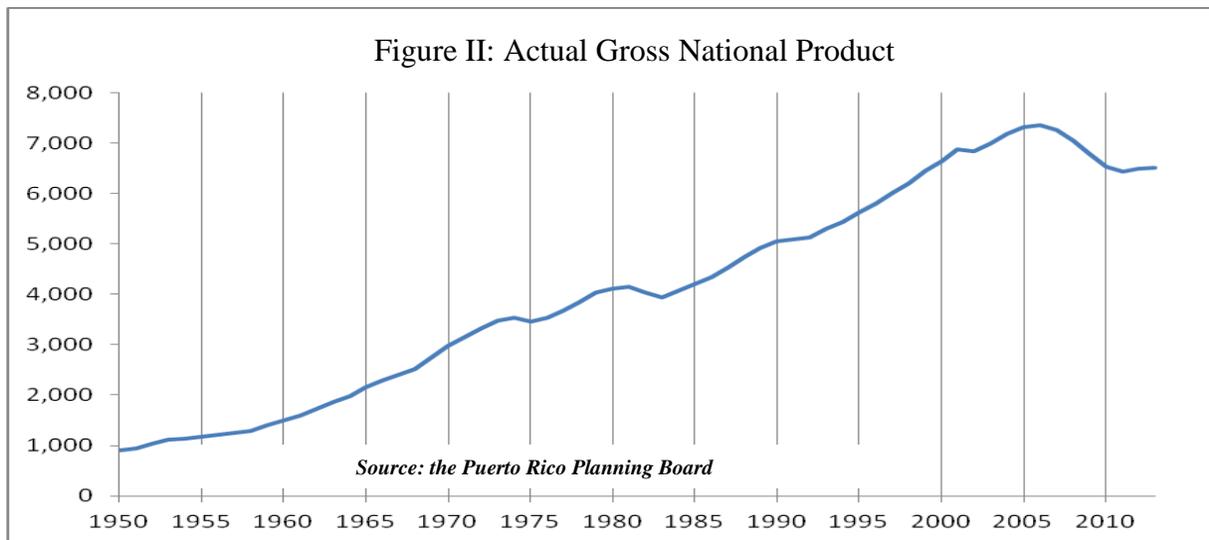
The recent transaction of general obligation bonds of the Commonwealth used a significant portion of the Commonwealth's constitutional margin, thus limiting the use of this mechanism in the near future. Our Constitution sets forth that the Commonwealth's public debt shall never exceed 15% of the average income from State sources during the two immediately preceding fiscal years. According to the Official Statement, Commonwealth of Puerto Rico General Obligation Bonds of 2014, Series A, after the aforementioned bond issue, the constitutional limit is 14.2%. Moreover, the resistance from capital markets to make up the deficits of the General Fund also limits GDB's financing capacity because it will remain in its loan portfolio and will, eventually, hinder its ability to fulfill its institutional role as a temporary or last-resource creditor.

In summary, the Commonwealth needs to approve a budget where revenues equal expenditures, not only because a balanced budget is an indicator of sound public administration and our responsibility to future generations, but because the mechanisms that the Commonwealth has used in the past are no longer available. Capital markets are not willing to finance budget deficits; neither does the private banking, because they do not have the capacity or the will to do so, and the liquidity of the GDB is compromised. In view of this situation, the Commonwealth has a strong interest in cutting back on public spending immediately, significantly, and conclusively in order to defray the expenditures of the General Fund without resorting to using debt as a source of income. Given the seriousness of this situation, it is necessary to explain the economic background that brought us to this situation.

Puerto Rico's Economic Condition

The Island's economic situation must be the starting point to determine the type of fiscal measures that are to be taken and the impact that such measures will have on macroeconomic terms. In order to understand this legislative piece, Puerto Rico's current historical juncture and history must be evaluated. We must bear in mind that the current fiscal situation not only reflects the lack of caution of past administrations in managing the State's resources, but also the inability of the Island's economy to increase production, create jobs, and generate income. The State's capacity to collect revenues is limited by the Island's unemployment rates. Taxes and other levies paid by individuals and business are directly related to the level of economic activity and the amount of income and profit that such economic agents may generate.

The Island's economy experienced the longest and most serious recession in its recent history during Fiscal Years 2006 to 2011. As shown in Figure II, this period of economic constraints was by far worse in length and severity, than the four recessions that took place between 1974-75, 1981-83, 1990-91, and 2001-03.



This last recession lasted six years and the Actual Gross National Product (AGNP) showed a 12.5% accrued reduction, while the worst recessions, 1974-75 and 1981-83, lasted between 1 to 2 years and the AGNP was reduced only by 1.91% and 5.13%, respectively. Moreover, the AGNP average annual growth rate was -2.1% during the recession of 2006-11, and 1.91% and 2.60% in the recessions of 1974-75 and 1981-83, respectively. These recessions were mainly the result of factors related to the economic cycle of the U.S. economy and the world's economy, as well as the impact of the increase in the price of oil on our economy.

Our first recession in recent times was from 1974-75 when the oil embargo of the Organization of the Petroleum Exporting Countries (OPEC) caused a global recession that adversely affected the Island, as previously stated. The Government of Puerto Rico commissioned a study to James Tobin, a well-known economist and Nobel laureate in economics. Many recommendations were made in this study, both economic and fiscal. However, some of them were implemented and others were not. If the recommendations regarding the economy and the management of fiscal issues had been implemented, it is very likely that the current fiscal situation of the Island would have never happened. It is worth noting that during such time, the Government had difficulty in accessing capital in the market and meeting its obligations. However, the approval of Section 936 of the U.S. Internal Revenue Code helped the Island overcome this crisis.

The 1982-83 recession was the result of the contraction of the U.S. economy, the increase in the oil price, and the decrease in Federal transfers. All these factors combined to cause our economy to fall into a serious recession.

The 1990-91 recession has been the shortest one thanks to the buffering effect of the funds that the Island received for the damages caused by hurricane Hugo. Between FEMA funds and the compensation money paid by insurance companies, the Island received nearly \$5 billion. This injection of funds prevented the recession from extending or aggravating.

Until now, it is evident that the economic recessions experienced by the Island prior to Fiscal Year 2006 coincided with the periods of contraction of the U.S. economy and the oil price increase worldwide. The close relation between our economy and that of the U.S.A. and our vulnerability to the changes in the oil price are the reasons why recessions have a particularly deep impact on the Island. However, once the U.S. economy and the oil price stabilized our economy experienced a growing trend. Furthermore, the recession that started in Fiscal Year 2006 had some specific internal causes such as:

- The end of the Section 936 phase out which entailed the loss of more than 150,000 direct and indirect jobs in the manufacturing sector;
- The government shutdown during the Fiscal Year 2006 crisis; and
- The negative effects of Act No. 7-2009 which aggravated the recession during Fiscal Years 2009, 2010, and 2011.

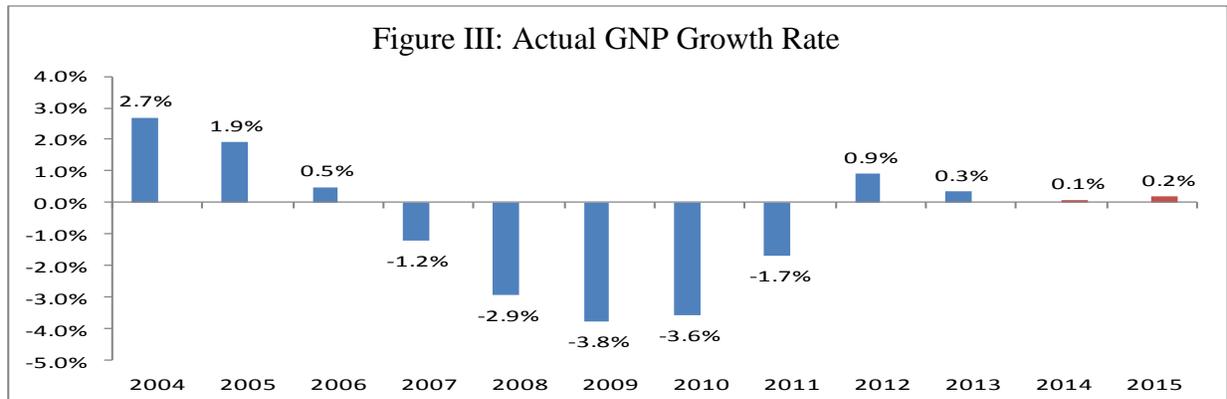
Table 2 shows a comparative analysis of Puerto Rico's economic recessions from 1974-1975 to 2006-2011.

Table 2: Comparative Analysis of Economic Recessions in Puerto Rico

Period	Duration	Accrued AGNP Growth Rate	Annual AGNP Growth Rate
1974-75	1 year	-1.91%	-1.91%
1981-83	2 years	-5.13%	-2.60%
1990-91	7 months	+0.9%	+0.9
2001-02	1 year	-0.3%	-0.3
2006-11	6 years	-12.50%	-2.1%

Source: the Puerto Rico Planning Board

For Fiscal Years 2012 and 2013, the AGNP showed positive values, 0.9% and 0.3%, respectively (See Figure III). Recently, the Puerto Rico Planning Board presented its economic forecasts for Fiscal Years 2014 and 2015 where the projections for the AGNP show minor increases, that is, 0.1% and 0.2%, respectively. Figure III shows a very weak stabilization.



Source: the Puerto Rico Planning Board

This laggardly recovery of Puerto Rico's economy is mostly due to the effect that an injection of nearly \$7 billion of funds appropriated under the American Recovery and Reinvestment Act of 2009 (ARRA) had during the last 3 years. However, this source of income was depleted just as other sources of income from the issue of government and public corporations bonds, which translated into public investment. This means that the Island's possibility of economic growth for the coming years will depend exclusively on private investment and the export of goods and services.

Therefore, the apparent recovery of Puerto Rico's economy that began in Fiscal Year 2012 will continue to be too slow to confidently state that we have overcome the crisis. The situation worsens even more when the Economic Activity Index (EAI) published by the GDB, as of now, shows negative values for Fiscal Year 2014. As shown in Table 3, the average EAI value from July 2013 to April 2014 was 127.1. This information shows a 4.3 point reduction from the 131.4

points reported for the same period in Fiscal Year 2013, and constitutes a 3.3% reduction in such indicator.

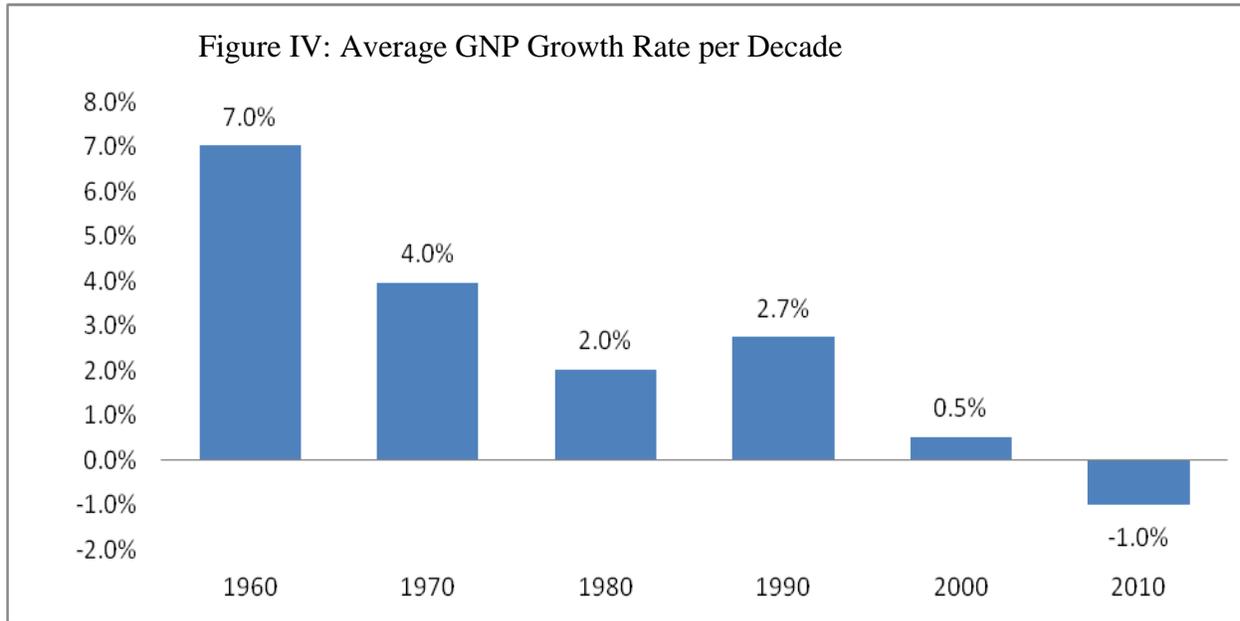
Table 3: Economic Activity Index (EAI)

Fiscal Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Annual Average	154.6	155.0	152.9	149.1	141.7	134.7	130.8	130.9	130.8	
Difference	2.4	0.4	-2.1	-3.8	-7.4	-7.0	-4.0	0.2	-0.1	
% Change	1.6	0.3	-1.3	-2.5	-4.9	-4.9	-2.9	0.1	-0.1	
July-April Annual Average	154.3	155.3	155.3	149.6	142.6	135.1	131.0	130.8	131.4	127.1
Difference	2.1	1.2	-2.0	-3.6	-7.0	-7.5	-4.1	-0.2	0.6	-4.3
% Change	1.4	0.6	-1.3	-2.4	-4.7	-5.2	-3.1	-0.1	0.5	-3.3

Source: the Government Development Bank

In view of this situation, there is major concern about the possibilities of having a steady economic recovery process in Puerto Rico that provides for the generation of substantial additional income for the treasury and allows the government to improve its liquidity. Consequently, the most recent trends shown by the Island's economy prove that there is still a lack of activity and production capacity.

In analyzing the economic performance of the Island within a historical context, it can be noticed that the 7% growth rate seen in the 1960s has turned into negative numbers. Our economy has experienced a structural change whereby it has lost its competitive capacity and that, coupled with the instability of Section 936, have limited its economic growth capacity. For example, during the last four decades, the local economy has been losing its capacity to grow and create jobs. The reduction in the investment rate (Total Gross Investment/GNP), from 30% in the 1970s to 13% in recent years, is the best indicator of how our economy has lost its future productive capacity, as shown in Figure IV.



Source: Puerto Rico Planning Board

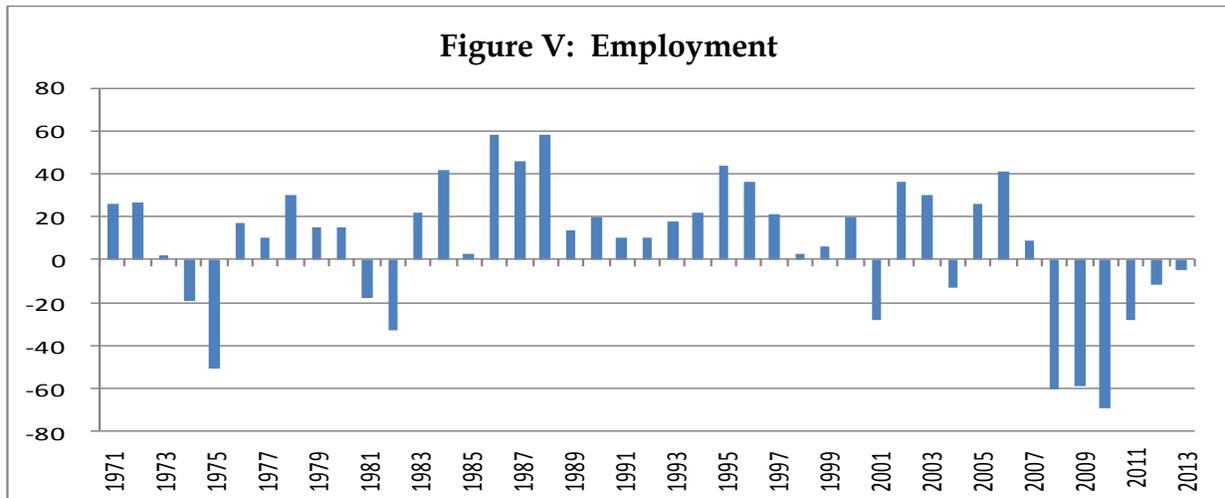
The moderate growth rates reported in the 1980s and 1990s, and part of the 2000s were due to the following factors:

- The activity generated by the 936 Corporations manufacturing sector, mainly by the chemical and pharmaceutical industries.
- The flow of Federal government payment transfers.
- The compensating effect of public jobs.
- The excessive use of debt issue to finance public investment projects and government spending.
- The impact of the housing bubble on the construction sector.
- The indebtedness of Puerto Rican consumers.
- The expansion of the U.S. economy.

Undoubtedly, the elimination of Section 936 aggravated the structural issues of the Island's economy which began to show in the 1970s.

Employment

The total employment indicator specifically reflected the seriousness of the economic recession that affected Puerto Rico from 2006 to 2011. As shown in Figure V, Fiscal Years 2008, 2009, and 2010 had the largest job loss in the recent history of the Island's economy. Since Fiscal Year 2006, Puerto Rico's economy has lost a total of 207,000 jobs, which represents a 16.6% aggregate loss.



Source: Department of Labor and Human Resources: Housing Survey

Table 4 shows a summary of the employment status among persons 16 years of age or older during the last 10 years. After analyzing this data, it is noticeable that total employment values have steadily decreased from 2006 to 2013. The slight economic recovery shown since 2012 has yet to be translated into a decreasing trend within the total employment variable.

Table 4: Employment Status Among Persons 16 Years of Age or Older: Fiscal Years (in thousands).

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Persons 16 years or older	2,884	2,886	2,899	2,906	2,908	2,910	2,914	2,920	2,921	2,906
Working Group	1,339	1,357	1,410	1,413	1,355	1,325	1,285	1,249	1,221	1,197
Employed	1,187	1,213	1,254	1,263	1,203	1,144	1,075	1,047	1,035	1,030
Unemployed	152	144	156	150	152	181	210	202	185	167
Participation Rate	48.4	47.0	48.6	48.6	46.6	45.5	44.1	42.8	41.8	41.2
Unemployment Rate	11.4	10.6	11.0	10.6	11.2	13.7	16.3	16.2	15.2	14.0
Employment Rate	41.2	42.0	43.3	43.5	41.4	39.3	36.9	35.9	35.4	35.4

Source: Department of Labor and Human Resources, Labor Statistics Bureau, Housing Survey

On the other hand, the unemployment rate has shown some improvement and has remained unchanged at 14%. However, persistent factors such as the reduction in labor participation and the increase in the population older than 65 years of age affect the Island's capacity for economic recovery.

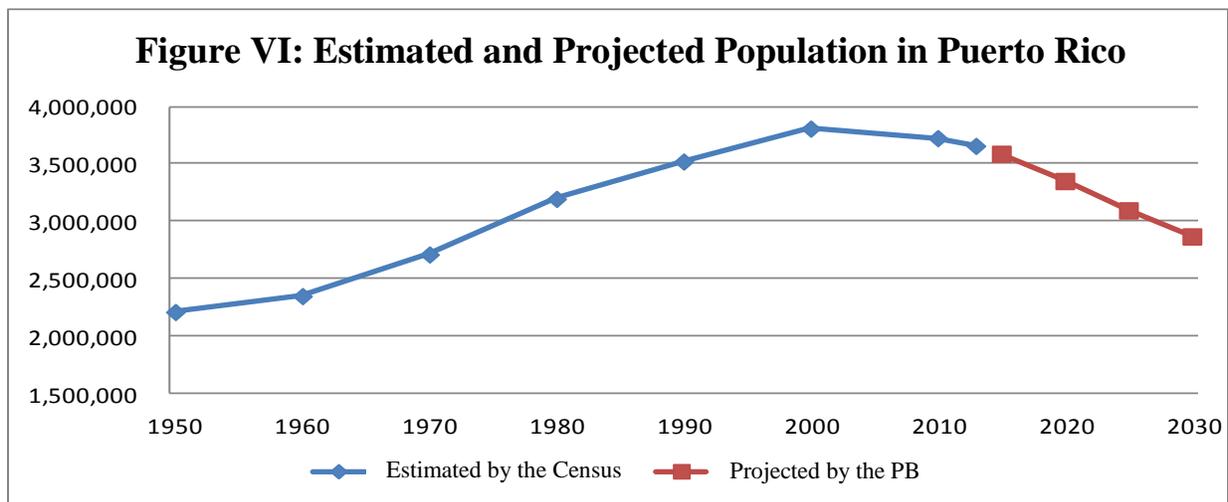
Demographic Trends

Puerto Rico is experiencing for the first time an absolute population loss. According to the United States Census Bureau, the population of Puerto Rico decreased by 2.2% from 2000 to 2010. However, the projections of the Planning Board show that this decreasing trend in population shall continue through at least 2030. The estimated reduction in population from 2000 to 2013 was of 150,442 individuals, which constitutes a nearly 4% decrease of the population residing in the Island. As shown in Table 5 and Figure VI, the projected reductions in population for 2020 and 2030 constitute a 10.0% and 14.4% decrease, respectively.

Table 5: Estimated and Projected Population in Puerto Rico

Year	No. of Persons	% of Change per Decade
1950	2,210,703	18.3%
1960	2,349,544	6.3%
1970	2,712,033	15.4%
1980	3,196,520	17.9%
1990	3,522,037	10.2%
2000	3,808,610	8.1%
2010	3,725,789	-2.2%
2020	3,352,315	-10.0%
2030	2,869,462	-14.4%

Source: United States Census Bureau, Population Division



Source: United States Census Bureau, Population Division; and the Planning Board, Census Office

As shown in Table 6, the reported reduction in the population has a demographic component since it comes as a result of the reduction in births for every one thousand inhabitants, and a decrease in deaths for every one thousand inhabitants. The combination of these factors is translated into an ongoing reduction in the natural population increase rate, which in 2013 was estimated at 2.5 persons for every one thousand inhabitants.

Table 6: Selected Demographic Statistics (Fiscal Years)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Population as of July 1st (in Thousands)	3,827	3,821	3,805	3,783	3,761	3,740	3,722	3,687	3,652	3,615
Births (in Thousands)	51	51	49	47	46	45	42	42	41	39
Deaths (in Thousands)	30	30	29	29	29	29	29	29	30	30
Births for every 1,000 inhabitants	13.4	13.3	12.8	12.4	12.1	12.0	11.4	11.4	11.2	10.8
Deaths for every 1,000 inhabitants	7.7	7.8	7.5	7.8	7.7	7.8	7.9	7.9	8.2	8.3
Natural increase for every 1,000 inhabitants	5.7	5.4	5.3	4.6	4.4	4.2	3.5	3.5	3.0	2.5

Source: United States Census Bureau, Population Division; Puerto Rico Department of Health; and the Planning Board, Census Office

However, this factor alone does not explain the population decrease between 2000 and 2010. The trend needs to include the impact of the massive migration of Puerto Ricans who relocate abroad in search for better economic opportunities.

This situation brings to the table the issue of talent flight, the loss of working-age human resources, and the negative impact thereof on the treasury revenues. No reduction in the cost of the services rendered by the Government to these citizens can compensate for such revenues in the short- or long-term.

Table 7: Selected Population Data

	Total Population	Population 65 Years or Older		Median Age
		Number of Persons	%	
1950	2,210,703	85,578	3.9%	18.4
1960	2,349,544	122,207	5.2%	18.5
1970	2,712,033	177,077	6.5%	21.6
1980	3,196,520	252,569	7.9%	24.6
1990	3,522,037	340,884	9.7%	28.5
2000	3,808,610	425,137	11.2%	32.1
2010	3,725,789	541,998	14.5%	36.9

Source: United States Census Bureau, Population Division

On the other hand, the impact of the population challenge worsens as a result of our increasingly aging population. As shown in Table 7, the number of persons age sixty-five (65) or older has both in absolute terms and in its proportion to the total population continued its growing trend. The 2010 Census reported more than half a million people within this age bracket, which represents 14.5% of the total population. An interesting fact is that the median age of our population has increased rapidly, from 18.5 years in 1960 to 36.9 years in 2010.

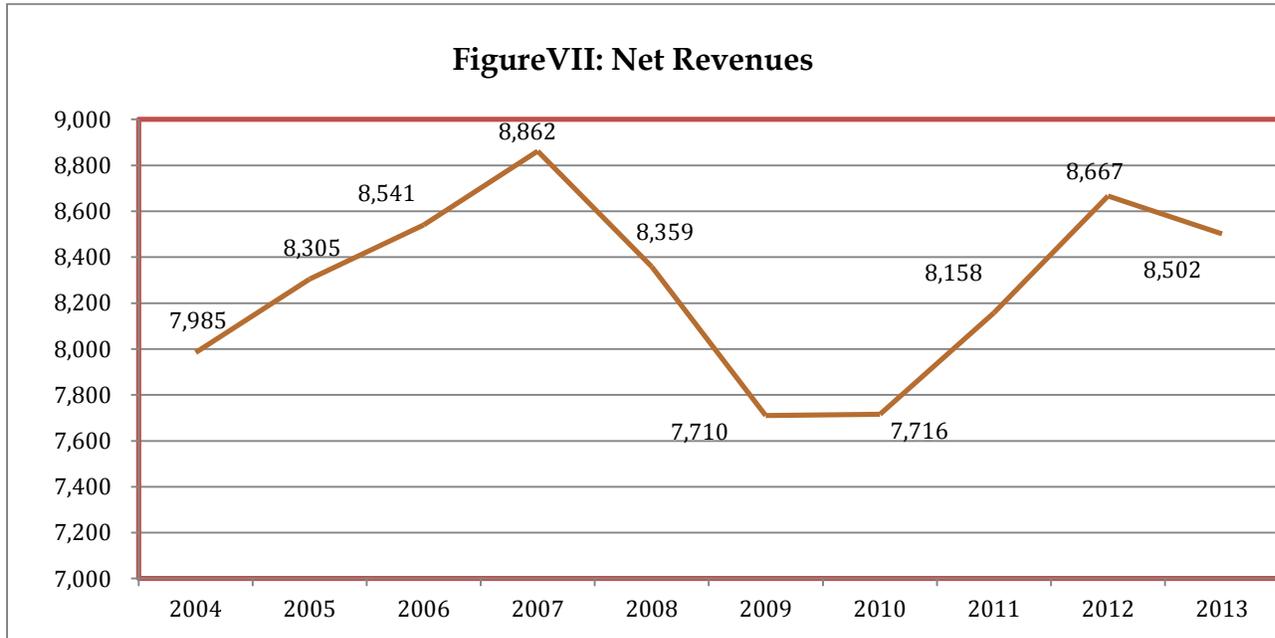
The aforementioned demographic dynamics show an imminent increase in the demand for healthcare services and other services necessary to provide older persons with the adequate care. Inevitably, this situation would eventually require increasing public spending and poses an additional challenge to the attainment of a balanced budget.

As shown below, the population trend, the reduction in labor participation, and the Island's difficult economic situation adversely affect the net revenues of the General Fund.

General Fund Net Revenues

An analysis of the report of the General Fund Net Revenues drafted by the Department of the Treasury for Fiscal Years 2003-2004 to 2012-2013, shows that for Fiscal Year 2003-2004, the General Fund net revenues amounted to \$7.985 billion. Meanwhile, for Fiscal Year 2012-2013 (9 years later) such amount totaled \$8.502 billion. This means that resources from State sources, such as income taxes, sales and use tax, and excise taxes, among others, increased only by \$517 million in almost one decade.

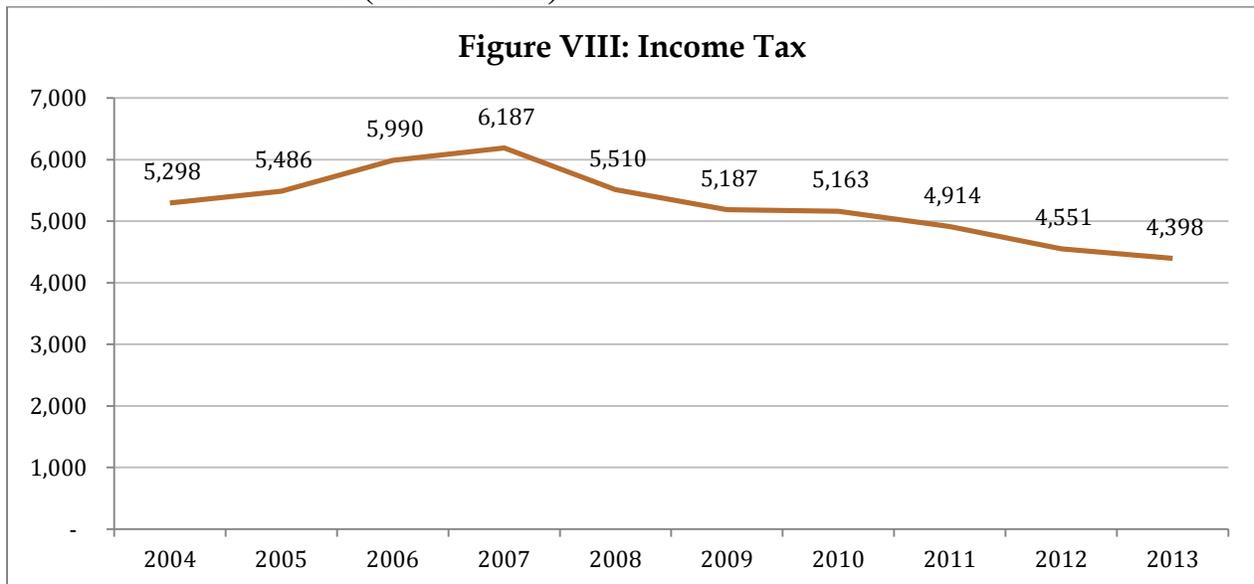
Figure VII shows the General Fund net revenues from Fiscal Year 2003-2004 to 2012-2013 (in millions).



Source: Department of the Treasury: General Fund Net Revenues Report

The analysis below shows the net revenues of the General Fund according to its main sources, as included in the aforementioned report:

Income Tax Revenues (In Millions)



Source: Department of the Treasury: General Fund Net Revenues Report

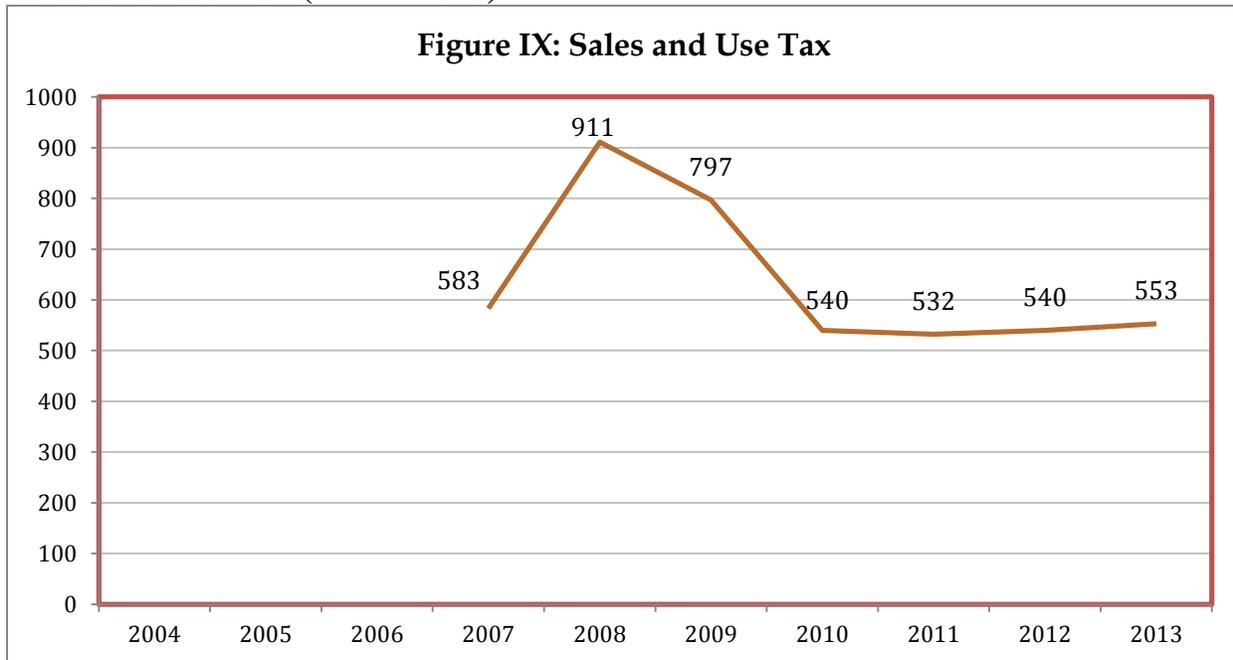
As shown in Figure VIII, the income item that includes income taxes on individuals, corporations, partnerships, withheld to nonresidents, taxes on interest, dividends, and tollgate taxes experienced an annual increase from 3% to 9% during Fiscal Years 2003-2004 to 2006-2007. Since then, it had been spiraling down, but in Fiscal Year 2007-2008, it was more evident with an 11% reduction compared to the previous fiscal year. The second steepest reduction was reported in Fiscal Year 2011-2012 with a 7% reduction.

There are several factors that influence the behavior of this important item of General Fund net revenues. Some of these factors are the economic recession, which began in late 2006, and the reduction in the working-age population. Moreover, as part of the tax reform resulting from the enactment of Act No. 1-2011 tax rates on individuals and corporations were reduced, thus worsening the decrease in income tax revenues. The tax rates approved under Act No. 154-2010 sought to somehow compensate this decrease; this issue will be discussed further on.

This Administration enacted Act No. 40-2013 and reestablished the maximum 39% tax rate on corporations and introduced a surtax on gross income (National Fee) with the intent to increase revenues from income taxes on corporations by Fiscal Year 2013-2014. However, as of April 30, 2014 such revenues fell short of the expected amount by nearly \$380 million.

The economic projections of the Planning Board, as well as the Island's population trends, provide no basis to foresee a significant increase in income tax revenues in the near future.

Sales and Use Tax (In Millions)



Source: Department of the Treasury: General Fund Net Revenues Report

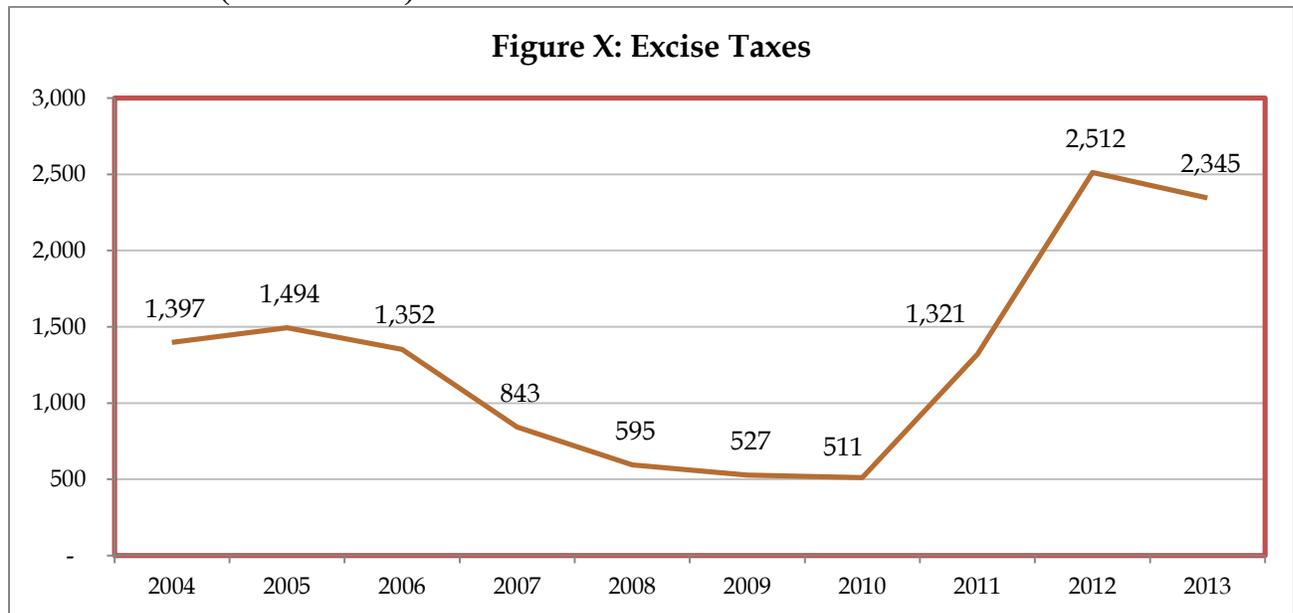
In November 2006, in accordance with Act No. 117-2006, the new 5.5% state sales and use tax took effect. This tax substituted the 5% general excise tax. By Fiscal Year 2006-2007, the revenues from the collections of such tax amounted to \$583 million. Fiscal Year 2007-2008 represented the first full year of revenues which amounted to \$911 million. As seen in Figure IX, after this, revenues dropped to \$797 million and \$540 million for Fiscal Years 2008-2009 and 2009-2010, respectively. Ever since, revenues have kept a lineal pattern.

The main reason for the reduction in the revenues on account of the sales and use tax covered into the General Fund is that, as a result of the enactment of Act No. 1-2009 and Act No. 7-2009, the portion of this tax allocated to the Dedicated Sales Fund was increased in order to pay the debt to COFINA. Likewise, Act No. 91-2006 must be considered since it provided for an automatic 4% annual increase in the monies covered into the Dedicated Sales Fund until reaching the sum of \$1.850 billion by 2041. This means that if the total revenues

on account of such taxes remain stable and do not increase, the portion of such revenues that is covered into the General Fund shall be lower every year.

Act No. 40-2013, as amended by Act No. 117-2013, modifies the way in which the sales and use tax is collected and remitted to the Department of the Treasury. According to the estimates of the Department of the Treasury, it is expected that revenues on account of said tax increase to nearly \$170 million by Fiscal Year 2014-2015. However, because of the economic situation of the Island and the automatic 4% increase in the sales and use tax covered into the Dedicated Sales Fund for the payment of debt, it is not reasonable to conclude that revenues on account of such tax shall have a significant increase in the near future.

Excise Taxes (In Millions)



Source: Department of the Treasury: General Fund Net Revenues Report

This source of funds includes excise taxes on alcoholic beverages, tobacco products, oil products, motor vehicles, horse races, insurance premiums, concrete, and slot machines. Likewise, it included the general 5% excise tax (substitute for the sales and use tax) until Fiscal Year 2006-2007. Moreover, it included the tax on foreign corporations and partnerships imposed under Act No. 154-2010 since Fiscal Year 2010-2011. As seen in Figure X, revenues on account of excise taxes

show a \$552 million or 32% reduction from Fiscal Year 2005-2006 to Fiscal Year 2006-2007 mainly as a result of substituting the sales and use tax for the general excise tax. Fiscal Year 2007-2008 shows an additional \$258 million or 23% reduction, given that this was the first year that experienced the full effect of the change between income sources.

The substantial increase seen in Fiscal Year 2010-2011 is mainly a result of the new excise tax on foreign corporations and partnerships (Act No. 154-2010) which totaled \$678 million in revenues for such Fiscal Year. This new excise tax generated revenues amounting to \$1.876 billion and \$1.667 billion for Fiscal Years 2011-2012 and 2012-2013, respectively. The main reason for the increase or decrease in excise tax collections for such fiscal years was the imposition of this new excise tax.

It must be noted that Act No. 154-2010 represented a substitution and redistribution of the sources of income of the General Fund with the aggravating circumstance that the collections on account of the enactment of such Act for Fiscal Year 2012-2013, which constituted nearly 20% of the General Fund's income, originated from 27 groups of affiliates, out of which 6 groups were responsible for 75% of such income. The special temporary excise tax that expires in 2017 must be added to the number of risks ran by the General Fund's income. The modified source of income rule takes effect in 2017. The form in which this new rule will be finally implemented is yet to be determined. For such reason, it cannot be estimated nor guaranteed whether the current level of revenues will be achieved. We must also consider the actions taken by the U.S. Treasury with respect to tax treatment that affects the credit currently available at the Federal level on account of the excise tax paid in Puerto Rico. Another challenge faced by Act No. 154-2010 is that some patents of products manufactured in Puerto Rico will expire within the next years.

This Administration approved Act No. 2-2013 to amend Act No. 154-2010 establishing a four percent (4%)-tax and extending it to 2017. Some sectors have stated that the possibility of increasing this excise tax and making it permanent should be considered. However, there are determining factors surrounding it that cannot guarantee a level of revenues on account of this excise tax since the decision depends mainly on the Federal government (tax treatment) or on business decisions of the group of affiliates that paid such tax and some of which have patents expiring within the next years.

Net Income Summary

Revenues from income taxes, the sales and use tax, and excise taxes account for nearly ninety percent (90%) of the General Fund's net income. As previously stated, these three sources of income are facing great challenges, to wit, the Island's prolonged economic recession, the decline in the working-age population, the amount of income derived from the sales and use tax that is allocated to the payment of debt, and the fact that nearly twenty percent (20%) of the General Fund's income derives from Act No. 54-2010, specifically from 27 affiliate companies. In addition, such excise tax is temporary and expires in 2017. These challenges increase the level of uncertainty as to the amount of resources that the Commonwealth will have available to continue providing services to its People.

Audited Financial Statements

Table 8 shows the General Fund's revenues and expenditures for Fiscal Years 1999-2000 to 2011-2012, as stated in the audited financial statements of the Commonwealth, specifically in the "Statement of Revenues and Expenditures-Budget and Actual Budget Basis-General Fund" (in millions).

Table 8: General Fund's Revenues and Expenditures for Fiscal Years 1999-2000 to 2011-2012

<u>Fiscal Year</u>	<u>Revenues</u>	<u>Expenditures</u>	<u>Loan Payments and other Transfers</u>	<u>Total</u>	<u>Deficit</u>
1999-2000	\$7,003	\$5,346	\$2,231	\$7,577	(\$574)
2000-2001	6,872	5,302	2,820	8,122	(1,250)
2001-2002	7,186	8,542	584	9,126	(1,940)
2002-2003	7,341	7,366	677	8,043	(702)
2003-2004	7,834	7,942	981	8,923	(1,089)
2004-2005	8,603	8,908	809	9,717	(1,114)
2005-2006	8,423	9,461	936	10,397	(1,974)
2006-2007	8,718	8,786	921	9,707	(989)
2007-2008	8,207	8,809	515	9,324	(1,117)
2008-2009	7,584	9,927	963	10,890	(3,307)
2009-2010	7,593	9,640	728	10,368	(2,775)
2010-2011	7,994	9,075	1,548	10,623	(2,360)
2011-2012	<u>8,573</u>	<u>9,911</u>	<u>2,055</u>	<u>11,966</u>	<u>(3,393)</u>
Total	<u>\$101,929</u>	<u>\$109,105</u>	<u>\$15,768</u>	<u>\$124,783</u>	<u>(\$22,854)</u>

As shown, expenditures exceeded the General Fund's net revenues in every fiscal year. The total deficit for these 13 years amounted to \$22.854 billion. The average net revenues of the fund for the period between Fiscal Year 1991-2000 and Fiscal Year 2011-2012 were \$7.841 billion, whereas average expenditures (including debt payment) were \$9.559 billion. This means that, on average, the expenditures chargeable to the General Fund exceed its revenues by \$1.758 billion. It is worth mentioning that, since Fiscal Year 2008-2009, the total amount of expenditures consistently exceeded \$10 billion, nearing \$12 billion in Fiscal Year 2011-2012.

As shown in Table 9, to make up the deficits for such years \$8.256 billion were borrowed from the GDB and \$8.521 billion from COFINA between Fiscal Years 2008-2009 and 2011-2012. This means that, in 13 years, \$16.777 billion were borrowed to make up budget deficits. Moreover, there were \$4.954 billion on account of non-tax income and other transfers, which resulted in an uncovered net deficit of \$1.123 billion.

Table 9: Loans to Make up Deficits from Years 1999-2000 to 2011-2012.

<u>Fiscal Year</u>	<u>Deficit</u>	<u>Loans</u>	<u>COFINA Loans</u>	<u>Lottery and other Transfers</u>	<u>Net</u>
1999-2000	(\$574)	\$55	\$-	\$574	\$55
2000-2001	(1,250)	662	-	462	(126)
2001-2002	(1,940)	1,932	-	268	260
2002-2003	(702)	424	-	263	(15)
2003-2004	(\$1,089)	695	-	286	(108)
2004-2005	(1,114)	756	-	433	75
2005-2006	(1,974)	1,345	-	168	(461)
2006-2007	(989)	340	-	145	(504)
2007-2008	(1,117)	290	-	152	(675)
2008-2009	(3,307)	172	3,328	127	320
2009-2010	(2,775)	148	2,688	350	411
2010-2011	(2,360)	560	1,552	862	344
2011-2012	<u>(3,393)</u>	<u>877</u>	<u>953</u>	<u>864</u>	<u>(699)</u>
Total	<u>(\$22,854)</u>	<u>\$8,256</u>	<u>\$8,521</u>	<u>\$4,954</u>	<u>(\$1,123)</u>

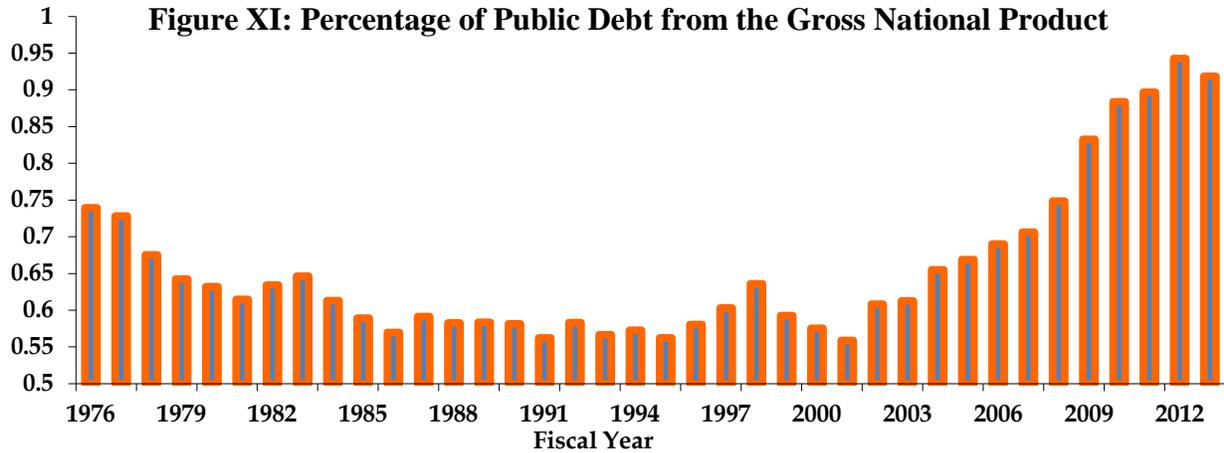
It can be concluded that the level of expenditures and obligations of the General Fund has been consistently higher than the net income it generates. This gap has been narrowed with loans from both the GDB and COFINA. As previously explained, the issue of GDB's liquidity and the Island's level of indebtedness

prevented the use of this strategy to balance the General Fund. Furthermore, said practice is inconsistent with the public policy of sound and responsible fiscal administration.

Public Debt

The Island's total public debt reached \$64.957 billion in Fiscal Year 2013. This level of public debt accounted for ninety one point eight percent (91.8%) of the Gross National Product in Fiscal Year 2013 (see Figure XI). The rapid growth of the public debt during the last years was mainly a result of debt issues made by past government administrations, specifically the previous one. From 2009 to 2012, the total debt increased by \$17.828 billion, that is, by 38%. This debt increase included nearly \$9 billion in COFINA bond issues to finance government operating costs. Needless to say that this amount does not include around \$5 billion in GDB notes issued to also finance government operations. In considering the notes issued by the previous Administration, public debt increased by nearly \$23.828 billion.

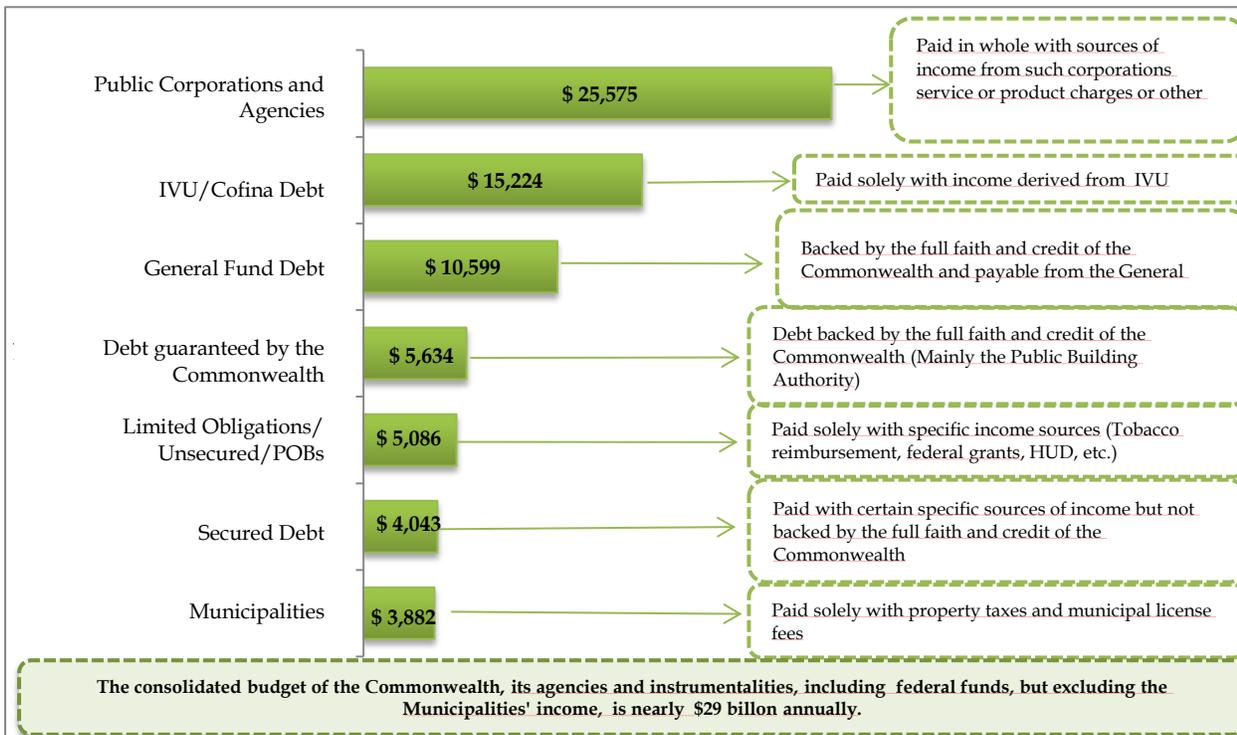
Hence, the historical increase in the public debt during the past four-year term caused the level of debt to account for 94.3% of the GNP for Fiscal Year 2012, compared to 74.8% in Fiscal Year 2008. There is no doubt that the level of indebtedness of the Island for which the previous Administration is responsible, significantly contributed to the downgrading of Commonwealth bonds to junk status, as well as to the economic and liquidity crisis currently undergone by the Island.



Source: Government Development Bank and Planning Board

Figure XII includes in the total of the public debt the \$5.086 billion in debt that does not encumber the public treasury. At present, the sources of payment for this debt come from specific income sources such as the tobacco tax refund and Federal grants, among others. If such sum is taken into consideration, the total amount of the public debt reached \$70.043 billion in Fiscal Year 2013.

Figure XII: Total Outstanding Debt in Puerto Rico as of June 30, 2013 (In millions)



Source: Government Development Bank

As shown in the above figure, the Central Government's debt accounts for 15.1% of the total debt for Fiscal Year 2012-2013. However, public corporations and COFINA debts account for 36.6% and 21.7% of the total debt, respectively.

Public Corporations

It is well known that the fiscal crisis of the Island directly and indirectly affects all sectors, including public corporations. Several public corporations carry over million-dollar deficits given that their operating expenses exceed the revenues generated on account of the services they render. In the past, money was taken on loan from the GDB, regardless of whether sources of repayment were identified to make up their operating deficit.

Today, some of these corporations lack the cash flow needed to meet their obligations, including the repayment of the GDB debt. An example of this, and as stated before, is the case of the HTA whose line of credit with the Bank has an unpaid balance of \$2.045 billion according to its financial statements as of June 30, 2013, audited by Ernst & Young LLP.

Likewise, the financial statements of the Medical Services Administration (MSA) as of June 30, 2013, audited by FPV & Galíndez, PSC, show that MSA's line of credit with the Bank has an unpaid balance of \$273 million. In the case of the Health Insurance Administration (ASES, Spanish acronym), its financial statements as of June 30, 2013, also audited by FPV & Galíndez, PSC, show that the line of credit with the Bank has an unpaid balance of \$171 million.

Furthermore, the Aqueduct and Sewer Authority (ASA) has an outstanding debt with the Bank. According to ASA's financial statements as of June 30, 2013, audited by the public accountants firm Ernst & Young LLP, ASA's line of credit with the Bank has an unpaid balance of \$90 million. Moreover, the financial statements of the Ports Authority as of June 30, 2013, audited by Nieves Velázquez

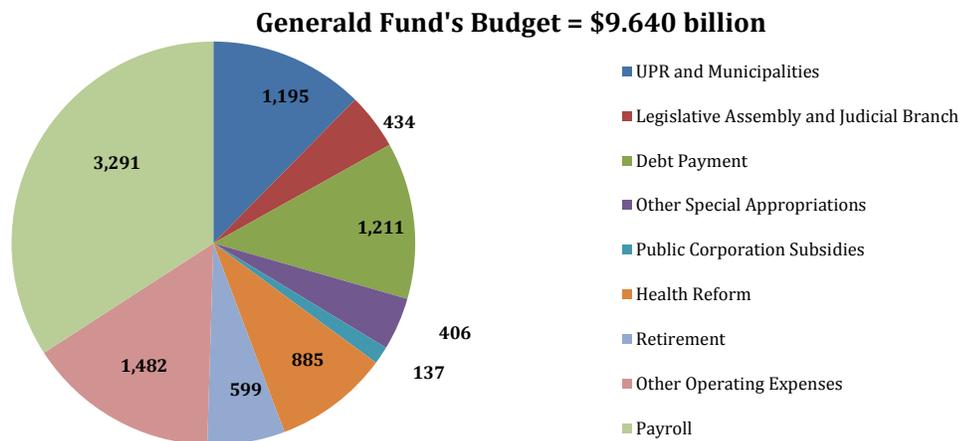
& Co, PSC, show that the Authority's line of credit with the Bank has an unpaid balance of \$216 million.

The outstanding debt of these five public corporations on account of lines of credit with the Bank amounts to \$2.795 billion as of June 30, 2013. This amount accounts for forty-one percent (41%) of the \$6.889 billion in loans pending payment from public corporations, as shown in the audited financial statements of the Bank.

2014-2015 BUDGET

Figure XIII shows the recommended General Fund's budget for Fiscal Year 2014-2015 which amounts to \$9.640 billion and are allocated as follows:

Figure XIII



Source: Office of Management and Budget

It is evident that the main areas of expenditure in the Government's budget chargeable to the General Fund are the budget formulas for the University of Puerto Rico, the Municipalities, and the Judicial Branch; the debt payment; Retirement Systems' contributions and special laws; and Health Reform contributions. Budget allocations under these items amount to \$4.213 billion or 44% of the recommended budget.

The other portion of the recommended budget is allocated primarily to cover payroll and other operating expenses such as rents, utilities, transportation, and procurements for the Department of Education, the Puerto Rico Police Department, the Department of Corrections, and the Department of the Family. It also includes subsidies for public corporations related to healthcare and public transportation.

Our challenge is to achieve a balanced budget for Fiscal Year 2014-2015, when the current fiscal year deficit is significantly high. This deficit is a result of automatic increase in budget items, namely the appropriation formulas for the University, Municipalities, and the Judicial Branch; pre-negotiated collective bargaining agreements; the increase in the amortization of general obligations; and the increase in interest rates; the increase in employer contributions to retirement systems; government lawsuits; and others that will significantly increase the expenditures and obligations chargeable to the General Fund. Table 10 below shows the changes in the budget for Fiscal Year 2014-2015 if measures are not taken to adjust the obligations chargeable to the General Fund to the resources that the Commonwealth has available to meet them (in millions):

Table 10: Changes for the Budget of Fiscal Year 2014-2015

Current Budget (fiscal year 2013-2014)	\$9,770
Increase in debt service	648
Increase in collective bargainings	181
Increase in the formulas for the UPR, Judicial Branch, and Municipalities	132
Increase in legislated and new appropriations	35
Increases in Retirement System special laws	29
Increases in Education, Corporations, and others	202
Total	\$10,997

Source: Office of Management and Budget

Note that the increase in the General Fund would exceed \$1.2 billion and the budget of expenditures will near \$11 billion. For such reason, the Commonwealth is bound to seek mechanisms to cutback on spending and have a budget that is consistent with its level of income.

As previously explained, the alternative of increasing the income is limited. This Administration has been consistent with its fiscal policy of not increasing taxes that directly affect taxpayers. Said fiscal policy was set forth recognizing the impact that it could potentially have on our economy's already slow recovery. An increase in the taxes imposed on individuals will reduce their personal income and, therefore, their level of consumption. According to the Planning Board, the economy will indirectly lose around \$0.92 for every dollar reduction of total consumption. For such reason, should the Government decide to increase Puerto Rico income taxes by \$100 million the economy could lose around \$192 million, either directly or indirectly. The Government needs to increase its revenues in order to overcome its fiscal challenges. However, the alternative of increasing taxes will adversely affect the Island's economic growth and, in turn, medium- and long-term revenues. Hence, the measures to be implemented to improve the Commonwealth's cash flow must consist of cutting back on spending.

The corrective measures considered within the recommended budget for Fiscal Year 2014-2015 to reduce the budget deficit and the criteria used for the adoption thereof are stated below.

Savings Measures for the Non-Operating Budget Debt Payment

The item allocated for debt payment in the recommended budget for Fiscal Year 2014-2015 amounts to \$1.211 billion or 12.6% of the total recommended budget. The amount allocated to debt payment should not be reduced, since it is precisely the practice of refinancing the constitutional debt that has led Puerto Rico

to its current situation. Of Fiscal Year 2012-2013's budget, the sum of \$775 million was refinanced through general obligation bonds of the Commonwealth and the Public Buildings Authority, which are guaranteed by the Commonwealth and mostly paid out of the rent paid by the Central Government to the Authority. In the budget of Fiscal Year 2013-2014, this practice was reduced and the sum of \$575 million was refinanced through general obligation bonds of the Commonwealth. The recommended General Fund's budget for Fiscal Year 2014-2015 halts the practice of refinancing through general obligation bonds of the Commonwealth. The recommendations for this fiscal year include an increase of \$745 million for debt payment, the elimination of the refinancing practice, the increase in GDB's debt, and the general obligation bonds amortization, higher rates for short-term TRANs, and other effects.

Retirement System Payments

Special Laws Acts and other appropriations to the Retirement System, beyond the basic employer contribution, amount to \$599 million or 6.2% of the recommended budget for Fiscal Year 2014-2015. The Retirement System's situation is uncertain and reducing the additional employer contribution would affect the basis of the Reform established under Act No. 3-2013. The recommended budget takes into account a 1% increase in the State's employer contributions, for both the Retirement System for Employees of the Government and the Teacher's Retirement System, in accordance with Acts No. 114-2011 and 116-2011. Regarding the Uniform Additional Contribution of \$120 million granted in Fiscal Year 2013-2014, and established under Act No. 3-2013, the recommended budget includes an approximate \$90 million reduction. Considering the short-term crisis of the General Fund and the importance of having liquidity to carry out the basic operations of the State, this Legislative Assembly

believes that a further reduction would compromise even more the fiscal health of both retirement systems in the medium- and long-term.

Mi Salud Program Grants (“Health Reform”)

The General Fund’s appropriation for the Health Reform amounts to \$885 million in the recommended budget for Fiscal Year 2014-2015 and remains unchanged at 9.2% of the total. The fiscal situation of the Health Reform is uncertain. No proposals were received in the Request for Proposals to select the insurance companies that shall render services for Fiscal Year 2014-2015, since there were no providers willing to offer services in all the regions and under the terms, including costs, deemed acceptable by the ASES and its Board of Directors. The current contract was extended until April 30, 2015, with the consent of the Federal government, when an increase in the cost of the Health Reform is expected. For the next fiscal year, ASES currently projects a \$37.3 million deficit and it is already devising a plan to take corrective action. The cost of the Health Reform is somewhat discretionary, since 89% of the population served participates in highly regulated Federal programs. The Health Reform program has projected to use a substantial amount of nonrecurring funds from the American Affordable Care Act of 2010. Once those funds are depleted, and the United States Congress takes no further action, the Health Reform will have to reduce costs and increase income to compensate for the loss of such nonrecurring funds. In view of this situation, this Legislative Assembly does not deem it wise to reduce the appropriation of the Health Reform and implement legislation to reduce Health Reform expenditures.

Special Appropriations – Subsidies to Public Corporations

Subsidies to public corporations in the fields of healthcare and mass transportation services amounted to \$137 million or 1.4% of the budget, and accounts for a \$47 million increase compared to the budget for the previous fiscal year. This increase seeks to reduce the operating deficit of said public corporations

as part of the process to render their operations more efficient. It is worth noting that there have been substantial cutbacks in the Maritime Transport Authority, the Metropolitan Bus Authority, and the Medical Services Administration. For such reason, the scope of action to carry out further cutbacks in this area is limited.

Contributions to the University of Puerto Rico and Municipalities

The operating expenses of the University of Puerto Rico have remained at \$834 million, that is, 8.7% of the recommended budget for Fiscal Year 2014-2015. The operating expenses of municipalities remain at \$228 million for the Matching Fund, established under Act No. 80-1991, and at \$133 million for the Exoneration Fund established under Act No. 83-1991; these two funds combined account for 3.8% of the recommended budget for Fiscal Year 2014-2015. This Act freezes the formulas that would otherwise determine the budget of these autonomous entities.

Even though the University of Puerto Rico would have been entitled to a \$70-million budget increase, such amount is hereby frozen as a result of the Island's fiscal crisis. However, this Legislative Assembly believes that an additional reduction in the net budget of the University of Puerto Rico, consistently with the reductions in the three Government Branches, would cause an irreparable harm to the University, including its enrollment, the discharge of its educational duty, and above all, to its fiscal soundness. Our recent experience with the latest budget reductions and higher costs imposed on students, which has had serious consequences on the institution, has led us to arrive at such conclusion. Considering the particularities of the University, this Legislative Assembly understands that a reduction in the budget thereof would be financially counterproductive and detrimental to the economy of the Island. For such reason, this Act does not include the University of Puerto Rico in the uniform cut that includes the three Government Branches.

Although the Municipalities would have been entitled to a \$13-million budget increase (\$10 million for the Exemption Fund and \$3 million for the Matching Fund), such amount is hereby frozen as a result of the Island's fiscal crisis. However, this Legislative Assembly believes that an additional reduction in the net budget of the Municipalities would place them in a precarious financial situation that would eventually lead to layoffs, partial shifts, and deficit financing, which is precisely what this Act is attempting to prevent. Municipalities have taken drastic measures, in many cases, to reduce their operating expenses, but they do not have the same tools as the Central Government. The bankruptcy of a significant number of Municipalities would adversely affect the Island's economy, the treasury, and the services offered to the people.

Appropriations to the Legislative Assembly, the Judicial Branch, and Autonomous Entities

Special appropriations for the operations of the Judicial Branch total \$323 million or 3.4% of the recommended budget for Fiscal Year 2014-2015; recommended appropriations for the General Budget of the Legislative Assembly amount to \$110 million or 1.1% of the recommended budget. In both cases, this Act freezes any increase and provides for a 7.4%-reduction in its budget for Fiscal Year 2014-2015. This cut is equal to a reduction in the total budget of the General Fund between Fiscal Year 2013-2014 and the recommended budget for Fiscal Year 2014-2015, if the repayment of the constitutional debt and the budget of autonomous entities, such as the State Election Commission, the Office of the Comptroller, the Office of Government Ethics, the Office of the Special Independent Prosecutor's Panel, and the Office of the Ombudsman are excluded from both years. In this manner, the budget autonomy is observed —i.e., the form in which each entity administers its budget resources— but budgets are adjusted to the fiscal reality of the government in general. Moreover, this does not entail a

discretionary evaluation of the total budget of each entity whose favorable or unfavorable result may be understood as an attempt to exert some sort of influence on said entities. It must be noted that the operating expenses of the Executive Branch, once nonoperational elements, such as the Payment of the Debt, Retirement Contributions, Health Reform Contributions, and Contributions made according to Formula are excluded, are progressively reduced by a higher percentage of approximately 10.5%.

Other Special Appropriations

All other Special Appropriations total nearly \$406 million or 4.2% of the recommended budget for Fiscal Year 2014-2015. This represents a \$177-million or 30%-reduction in relation to Fiscal Year 2013-2014. These appropriations include different items, to wit, contributions to third parties such as foundations and museums, legal contingency funds, and government agencies' programs. The cuts in this item were substantial, emphasizing on those appropriations that do not affect the direct services to the people.

Savings Measures in the Operating Budget

The operating expenses of the Government amount to \$4.773 billion or 50% of the General Fund's budget. The payroll paid directly from the accounting system accounts for nearly \$2.471 billion of said expenses, and the payroll paid from the resources of the Schoolwide Program of the Department of Education accounts for \$820 million and is shown as "Global Appropriations" in the budget's accounting.

Payroll

As a starting point, it is important to mention that during Fiscal Year 2013-2014, the number of employees in agencies whose operating expenses are defrayed in whole or in part from the General Fund was substantially reduced. From December 2012 to April 2014, the number of employees in these agencies

was reduced by 9,607 or 8.45%, mainly through the practice of rehiring employees. If we only consider the payroll of those employees that is directly defrayed from the General Fund —excluding those defrayed from Federal funds, special funds, or own income— the net reduction would be 7,849 or 7.92%. The practice of rehiring employees was one of the main reasons that made possible a mid-year (in February) \$170 million budget amendment for Fiscal Year 2013-2014, and, if we continue doing this, next year's budget appropriations may be adjusted by an estimated \$116 million.

This Administration has thoroughly analyzed the alternatives available to promote cutbacks on government spending. The measures implemented under Act No. 7-2009 that included the layoff of Central Government employees, which, at that time, was estimated to generate \$30,000 in savings per dismissed employee, were included as part of the analysis. The effect on the government operations of the massive layoff of government employees under Act No. 7-2009 resulted in serious harm to the government services offered to the people in sectors such as: child protection, the elderly, social welfare programs, services of the Department of Transportation and Public Works, and the internal revenue collections centers of the Department of the Treasury, to name a few. Not to mention the adverse impact that the layoff of over 20 thousand government employees had on our already weak economy; this situation is analyzed further on. We cannot repeat past mistakes and resort to massive layoffs as a mechanism to cut back on spending without considering the consequences of such action from all aspects.

Since the beginning, this Administration has been clear that laying off employees is not an option given the serious consequences resulting from the implementation of Act No. 7-2009.

Impact of the Employee Layoff under Act No. 7-2009.

Studies conducted by a Retired Professor of the University of Puerto Rico, Dr. Ángel Ruiz in 2009, and by Dr. José I. Alameda in 2012, showed that if the Government decides to implement the public employee layoff mechanism as a basic strategy to balance the budget of the Central Government, it would have to layoff more than 30,000 employees.

According to Dr. Ruiz's analysis, the layoff of 30,000 employees would result in an initial loss of over \$1.002 billion in wages, the loss of \$2.796.7 billion in direct, indirect, and induced intersectoral production; of 55,764 direct, indirect, and induced jobs (30,000 direct jobs and 25,764 indirect and induced jobs) as well as the loss of \$1.384.8 billion in wages (of which \$1.002 billion are direct and the difference are indirect and induced). Of the total direct and indirect jobs, the manufacturing sector would lose 3,379 employees; the trade and the business service sectors would lose 4,304 and 1,604 employees, respectively; and other professional services sector would lose 6,157. The government would experience the greater loss, that is, 36,245 employees, as a result of the initial impact caused by the layoff of 30,000 public employees. It is important to point out that, in estimating induced impacts, the wholesale and retail trade sectors suffer a significant job loss.

Even though all the estimates included in Dr. Ruiz's report date back to 2009, they are still in effect, because his methodology was based on the Island's economic structure as of said date, which has not experienced significant changes as of recently.

On the other hand, Dr. Alameda's study revealed that the impact was based on the layoff of 17,147 employees and a payroll reduction of \$647.9 million, which caused a 0.7%-reduction in the Gross National Product for Fiscal Years 2009 and 2010. In addition, the effect of Act No. 7-2009 increased the unemployment rate

by 3.1% in Fiscal Year 2010. This represented a total of 37,000 additional unemployed individuals. A reduction of 30,000 employees and a payroll reduction of over \$1 billion are expected to have a greater impact on the economy and unemployment rates.

Loss in Tax Revenues

With regard to fiscal impact, Dr. Ruiz states the following in his study: The significant loss in tax revenues is worrisome, since it tends to reduce any positive impact on any savings that the government may have achieved with the layoff of public employees. The study estimates reveal that a reduction of 30,000 employees would result in a total tax revenue loss of \$317.8 million. That is, for every job lost in the government there will be a \$10,600 loss in tax revenues. This reduction in tax revenues would aggravate even more the government's fiscal situation thus adversely affecting public services. [Our translation] See: *Boletín de Economía, Unidad de Investigaciones Económicas, Departamento de Economía, Universidad de Puerto Rico, Recinto de Río Piedras, Vol. X, Núm. 1, enero-junio 2009*, p. 4.

Dr. Ruiz concludes his study by stating that:

The policy of laying off employees has both direct and indirect adverse economic impacts. These impacts exacerbate even more in times of recession. These impacts not only affect the economy, but also society. These impacts entail tax revenues losses. Implementing such policy without first conducting a careful and thorough analysis jeopardizes the rendering of critical public services, as well as the social and political stability. With regard to society, unemployment

strongly affects the emotional stability and the health of unemployed individuals and their families. Lastly, it is important to note that, under the current economic situation, this kind of policy worsens the recession phase of the economic cycle, thus delaying the recovery period and affecting the depth of the cycle.

In light of the fiscal crisis, work-shift reduction has been proposed as an alternative. However, the effects of a partial shift may have adverse consequences on the economy and the services offered to the people. For such reason, less burdensome measures such as those proposed herein and that are consistent with the public policy of this Administration must be implemented.

Other Measures to Reduce Payroll Expenses

This Act establishes corrective measures in the area of important payroll.

First, payroll expenses on account of employees in trust positions are reduced by an additional 10% through provisions that shall strengthen the existing restrictions that prohibit the hiring of additional employees until payroll expenses are reduced by 20% compared to December 2012.

Second, hiring is froze and limited mainly to critical positions that render direct services that are defrayed with own income or Federal funds, and in response to a judicial order, among others.

Third, increases of economic benefits are hereby prohibited. This includes increases in salary or contributions to all groups of employees, including those holding trust positions. The first action to be taken is to freeze any increase in payroll costs. It must be mentioned that this determination has a less burdensome impact on employees, the services rendered by the government, and the economy.

Fourth, special economic benefits are hereby prohibited. These include: a Christmas Bonus in excess of \$600 (private sector cap); a Summer Bonus in excess of \$200, and other bonuses. These bonuses are granted by virtue of law or

regulations, but are not part of the employee's basic salary. This Legislative Assembly believes that the basic salary of employees must be protected over any fringe benefit, particularly those that are atypical of the labor sector in general.

Fifth, a reorganization of the teaching staff of the Department of Education is hereby contemplated. The student population of the public education system has decreased from 730 thousand in the 1980s to 430 thousand at present; it is expected to continue decreasing to 300 thousand in the next 5 years. The teacher-to-student ratio, however, has not remained even. The restructuring of the Department of Education, including the consolidation of approximately 80 schools, as well as the retirement of a significant number of teachers, will provide the opportunity to reduce the total number of teachers, without layoffs, and reinforce direct services provided to students.

This Act clearly recognizes the value of public employee's labor unions and the legal framework that applies to them. For such reason, a mandate is hereby established to provide for an alternative negotiation process aimed at achieving comparable savings and at modifying the legal provisions regarding incremental economic benefits and special compensations.

In general, these payroll-related measures are less burdensome than the layoff of public employees and even the reduction of work-shifts; these measures however, achieve savings that, along with the set of measures contemplated herein, correct next year's operating deficit.

Other Operating Expenses

This Act establishes several measures aimed at reducing operating expenses, including payroll expenses. These constitute \$1.482 billion or 31.0% of the operating budget and 15.4% of the total General Fund's recommended budget for Fiscal Year 2014-2015. This item includes not only services, but also the payment of utilities and rents to public corporations such as the Aqueducts and Sewers

Authority, the Electric Power Authority, and the Public Buildings Authority, among others.

The measures aimed at reducing operating expenses are focused on reducing service rates and fees.

First, a reduction in purchased and professional services rates without the need to execute a bilateral written agreement is hereby authorized. Most purchased and professional services in the General Fund are geared toward offering essential services to the people. For example, the top five programs with the highest budget appropriations for purchased and professional services are, in order: Community Schools of the Department of Education (\$82 million); Healthcare Services to the Penal Population (\$24 million); Integral Educational Services for Persons with Disabilities (\$19 million); Inmate Services including food (\$19 million); and Mental Disabilities Healthcare Services (\$16 million). Given this concentration of essential direct services, we are compelled to develop mechanisms to expedite the renegotiation of rates.

Second, the regulatory and fiscal structure of school transportation programs is hereby modified. School transportation programs are governed by a geographic monitoring and regulatory structure that impairs dynamic competition among suppliers. School transportation expenditures have risen from approximately \$120 million in Fiscal Year 2010-2011 to a projected \$185 million in Fiscal Year 2013-2014, mainly due to rate agreements revised in calendar year 2012. Given the essential nature of this service, and the costs and regulatory structure thereof, the Department of Education needs additional tools to achieve cost efficiency promptly.

Third, new management-related measures are hereby implemented to achieve a sound fiscal administration in expenditure control and financial management areas. This includes new budget rules such as prohibition on budget overdrafts, certification of funds in projected overdrafts, transactions not authorized by the Office of Management and Budget, or the Office of the Governor, and others. It also includes a plan to achieve savings in energy use and leasing of facilities. The reduction in expenses that have a minor impact, such as protective detail, traveling, and use of electronic devices, shall be required by law. This will prove the government's commitment to lead by example. In general, the Legislative Assembly considers this Act to be a vehicle not to provide additional flexibilities in public administration, but to reinforce fiscal control structures.

Lastly, this Act provide spending control measures such as limiting hiring, reducing service-related expenses, and budget management measures, among others, that shall apply to public corporations. There is no doubt that public corporations' decentralized governance model, particularly in infrastructure, has resulted in unsustainable cost structures and in the corresponding deficits and financing of the GDB that have aggravated the General Fund's situation due to the fiscal interconnection of the Government.

During the last two years, budget appropriations for purchased and professional services were reduced by \$103 million, that is, from a \$447-million appropriation in Fiscal Year 2012-2013 to \$344 million in Fiscal Year 2014-2015. Although the measures contemplated herein will result in savings, the size of the gap and the limited operating expenses basis after excluding the payroll and payments to public corporations, call for a broad and comprehensive reduction program, including the impact on the payroll, appropriations by formula, and all those actions that may be taken without affecting essential healthcare, security and welfare services provided to the people.

Other Savings Measures

A wide range of spending cutbacks have been considered but were not included in this Act because they do not require any action by the Legislative Assembly or because they have been addressed in other legislations. This includes (i) the consolidation of schools in the Department of Education; the reduction in the number of agencies and public corporations to improve the effectiveness and cost-efficiency of the public sector; (iii) the reduction in special appropriations from the General Fund to defray the operating or programmatic expenses of public corporations (e.g. the reduction in the Tourism Company of incentives granted to the cruise industry); (iv) contributions from Special State Funds and from financially solvent public corporations, with sufficient balance, so that it does not affect the programs or operations of the corresponding agencies; and others.

Table 11 summarizes the corrective actions, which amount to \$1.357 billion:

Payroll expenses, including the no increase in economic benefits or special compensation; reduction in the payroll expenses on account of employees in trust positions and no recruiting to fill vacancies.	\$337
Freeze pay raises based on formulas in the UPR, the Judicial Branch and the Municipalities	132
Reduction in the Department of Education, including a reduction in school transportation expenses, payroll savings on account of teacher's retirement system and no contracting to fill vacancies other than for essential positions and the reduction of operating costs by relocating students to schools with broader services, better physical facilities, and academic achievements.	296
Reduction of special appropriations	100
Reduction in the budgets of the Judicial Branch, the Legislative Assembly, and autonomous entities	45
Reduction in professional and purchased services expenses	26
Reduction in utility costs, including consumption savings	37
Modifications to additional contributions to the Retirement System	92
Reallocation of Special State Funds to Government Agencies for the payment of lawsuits against the Commonwealth	59
Adjustments in public corporations, including a reduction in payroll, professional service contracts, and procurement expenses; the reallocation of the resources of public corporations to meet similar obligations in the General Fund; the elimination of certain subsidies to programs or operations; and additional measures to generate income and achieve savings in ASEM.	233
Total	\$1,357

Employees and public corporations in general are included in this Act because they are part of the Commonwealth, thus its fiscal health affects the fiscal health of the Central Government. Therefore, whether its is because this Act improves the unstable situation typical of corporations or because it enables corporations to directly or indirectly contribute to the General Fund's situation, it is necessary to include them within the scope of this Act. In order for the Island to continue achieving its social and economic objectives, it is necessary for the whole government to be fiscally sustainable.

Moreover, this Act includes provisions that change how the lawsuits against the Commonwealth are billed. The number of judgments and lawsuits against the Commonwealth at a late stage amount to hundreds of millions of dollars and the code of laws in effect does not provide for an orderly payment system that allows for the matching of the sums to be paid with the available resources, always bearing in mind that there are obligations to be met. The recommended budget for Fiscal Year 2014-2015 only includes an \$84 million fund to pay for judgments, settlements, and stipulations, an additional appropriation of nearly \$16 million to payoff the fines imposed in the Morales-Feliciano Federal case, and nearly \$18 million for the repayment of a line of credit to pay for judgments. The State is committed and willing to pay, but it is of utmost importance that an orderly and structured payment process is established therefor.

In view of the fund insufficiency, the Office of Management and Budget Organic Act, Act No. 147 of June 18, 1980, as amended, establishes that the Governor or the Director of the OMB shall act, pursuant to Section 8, Article VI of the Constitution of the Commonwealth of Puerto Rico, according to the following priority guidelines for the disbursement of public funds, when the available funds for a specific fiscal year are not sufficient to cover the appropriations approved for that year.

(1) Direct the payment of interest and amortizations corresponding to the public debt.

(2) Direct that the commitments entered into by virtue of legal contracts in force, judgments of the courts in cases of condemnation under eminent domain, and binding obligations to safeguard the credit, reputation and good name of the Government of the Commonwealth of Puerto Rico, be met.

(3) Order that preference be given to disbursements charged to appropriations for regular expenses connected with the:

(A) Conservation of public health,

(B) Protection of persons and property,

(C) Public education programs,

(D) Public welfare programs,

(E) Payment of employer contributions to retirement systems and payment of pensions to individuals granted under special statutes; and then, the remaining public services in the order of priority determined by the Governor; provided that the disbursements related to the services listed hereunder shall not have preference among themselves but shall be handled simultaneously; provided, further, that any adjustments due to reductions may be made in any of the appropriations for regular expenses, including the service areas indicated in this subparagraph.

(4) Order the construction of capital works or improvements with duly executed contracts; provided that priority shall be given to emergency works caused by catastrophes or acts of nature, acts of God; and then, to those works that are most responsive to the development of the normal and economic life of Puerto Rico.

(5) Order that the payment of contracts and commitments contracted under special appropriations for operations be honored, and then, that special preference be given to those phases of the programs that are in the process of development or in a stage of planning which, if postponed, would affect the interests of the clients served by the program, directly or indirectly.

In accordance with this constitutional mandate, public debt has absolute priority; this means only for general obligation bonds and debt expressly guaranteed by the Commonwealth. It does not include, for instance, the debt of public corporations, municipalities, or debt contingent on legislative appropriations. The second priority includes, among others, “the binding obligations to safeguard the credit, reputation, and good name of the Government of the Commonwealth of Puerto Rico.”

If the expenditure control measures introduced in this special law are not adopted, the operating costs of the Government will exceed the economic resources available. The mandatory order of priority prescribed under the Constitution will render the government inoperative. This would result in an even more burdensome situation for the Island. After careful analysis of this foreseeable reality, and given the fact that there are no less burdensome alternatives to obtain the resources needed by the government, it can be concluded that the measures adopted herein are the less onerous alternatives to guarantee the continuity of operations and prevent a government shutdown that will result in the loss of wages for public employees and sink us deeper into recession. Taking more money on loan to finance the deficit is not an option at this time, since capital markets do not trust that Puerto Rico will be able to straighten out its finances (let’s not forget that, for over ten years, Puerto Rico has been claiming that it will make up the structural deficit in two years). Moreover, increasing taxes is not an option either since such action will worsen the recession.

For all of the foregoing, this Legislative Assembly deems it necessary to approve this Act in order to guarantee the continuity of government operations and the general well-being of the Island, thus ensuring that essential services are provided to the people regardless the fiscal emergency undergone by the Island. Furthermore, it is hereby stated that these are the least burdensome measures to attain this goal. With regard to measures that promote the legitimate interest of safeguarding general well-being, the Supreme Court of Puerto Rico has recognized that our precarious economy is a reality that of necessity carries weight on the definition of the scope of governmental actions under the police power. *See, Domínguez Castro v. E.L.A., supra.* Therefore, this Legislative Assembly is fully empowered to adopt the socioeconomic measures herein in order to cut back on spending and, thus, prevent a government shutdown and guarantee essential services to the people.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF PUERTO RICO:

CHAPTER I.- INITIAL PROVISIONS

Section 1.- Title.

This Act shall be known as the “Government of the Commonwealth of Puerto Rico Special Fiscal and Operational Sustainability Act.”

Section 2.- Declaration of Public Policy.

A state of emergency is hereby declared to attain Puerto Rico’s fiscal and economic recovery after the downgrading of its credit rating and decrease in revenues that affect the Commonwealth’s liquidity, thus safeguarding the constitutional mandate for the payment of interest and amortization of the public debt. Furthermore, a plan is hereby devised to deal with the consequences thereof and to establish a structured management that allows the Island to meet its obligations. This shall guarantee the continuity of public efforts in essential areas such as health, security, education, social work, and development, among others,

as well as the provision of necessary and essential services for the people. The public policy set forth in this Act is aimed at restoring the credit of the Commonwealth of Puerto Rico by eliminating the General Fund's deficit within a short timeframe and improving the fiscal condition of public corporations, without resorting to the layoff of career or regular employees, affecting critical functions of government agencies that provide security, education, healthcare, or social work services. This structured plan is necessary to protect the cash availability of the Commonwealth of Puerto Rico without affecting essential services provided to the people. This plan considers the challenges faced by Puerto Rico to restore public credit rating and address the uncertainty as to the length, magnitude, and cost of tapping into capital markets absent an investment-grade rating.

Thus, in the exercise of the State's police power, the Legislative Assembly has the authority to adopt measures to preserve the health, safety, and welfare of the people in a structured manner while addressing the fiscal crisis faced by the Island. To such purposes, the Legislative Assembly is empowered to enact statutes to address social and economic issues, as well as emergency situations. Section 19 of the Bill of Rights of the Constitution of the Commonwealth of Puerto Rico provides that the enumeration of rights in Article II shall not be construed as to restrict "the power of the Legislative Assembly to enact laws for the protection of the life, health, and general welfare of the people." Likewise, Section 18 of the Bill of Rights grants the Legislative Assembly the power to enact laws to deal with grave emergencies that clearly imperil the public health or safety or essential public services.

Section 3.- Supremacy of this Special Law.

This Special Law is hereby enacted by virtue of the State's police power and the constitutional authority conferred on the Legislative Assembly under Article II, Sections 18 and 19 of the Constitution of the Commonwealth of Puerto Rico to

enact laws for the protection of the life, health, and general welfare of the people”; as well as under Sections 7 and 8 of Article VI of the Constitution of the Commonwealth of Puerto Rico. Therefore, this Act shall have supremacy over any other law.

Section 4.- Fiscal Sustainability Tests and Quarterly Reports.

In order to promote the public policy set forth in this Act, the measures provided in Chapters II and III shall be in effect through July 1st, 2017, or if accomplished before, through July 1st of any fiscal year for which, as part of their respective recommendation process of the General Expense Budget submitted by the Governor to the Legislative Assembly, a certification signed by the corresponding official has been included, and whereby:

(a) The Chair of the Planning Board certifies that the actual growth of the Gross National Product projected for said fiscal year is equal to or higher than one point five percent (1.5%);

(b) The President of the Government Development Bank certifies that a credit rating agency in capital markets has rated, as of the certification date, the creditworthiness of the general obligations of the Commonwealth of Puerto Rico as investment grade; and

(c) The Secretary of the Treasury and the Director of the Office of Management and Budget certify that, the fiscal year ending before the date on which the certification is submitted, closed, or is estimated to close without refinancing general obligations of the Commonwealth of Puerto Rico or public or private financing used to cover gaps between projected income or expenditures in excess of the corresponding appropriations.

Every Entity of the Executive Branch shall have the ministerial duty to draft and file with the Governor and with the Secretary of the Senate and the Clerk of the House of Representatives a quarterly report within ninety (90) days after the approval of this Act and during the effective term thereof, stating in an itemized and detailed manner the measures taken, as well as the results and any other pertinent information to show and assess compliance with the provisions of this Act.

CHAPTER II.- MEASURES TO CUT BACK ON SPENDING IN THE EXECUTIVE BRANCH

Section 5.- Applicability.

The provisions of this Chapter shall apply to every Entity of the Executive Branch of the Commonwealth of Puerto Rico. For purposes of this Chapter, “Entity of the Executive Branch” shall be deemed to include all agencies, instrumentalities, and public corporations of the Commonwealth of Puerto Rico, notwithstanding their degree of fiscal or budget autonomy otherwise conferred to them under their organic act or any other applicable legislation. However, the provisions of this Chapter shall not apply to the State Election Commission, the Office of Government Ethics, the Office of the Special Independent Prosecutor’s Panel, and the Office of the Election Comptroller unless otherwise expressly provided. For purposes of this Chapter, the University of Puerto Rico, its branches, and the Municipalities shall not be deemed to be Entities of the Executive Branch.

Section 6.- Reduction in the Contracting of Professional and Purchased Services of the Executive Branch.

The annual expenditures incurred in purchased or professional services by each Entity of the Executive Branch shall be reduced by at least ten percent (10%) *vis-à-vis* the expenditures incurred in Fiscal Year 2014, and shall remain below said level during the effectiveness of this Chapter.

This reduction shall apply to all purchased and professional services, contracted through all sources of funds, and apply independently to the total annual expenditure incurred in purchased or professional services chargeable to the General Fund. The implementation of this measure may be carried out through any of the following options or a combination thereof:

- (i) the renegotiation of rate structure, costs, or sum of existing contracts or to be renewed, with the appropriate documentation;
- (ii) limiting the award of contracts for essential services;
- (iii) the cancellation or nonrenewal of nonessential contracts;
- (iv) the reduction in the scope or service hours included in contracts.

Purchased or professional services shall include, but are not limited to, liability insurance, property insurance, or other type of insurance that is not related to the rendering of medical or healthcare services; technological support services; technical support services; professional services requiring State-issued licenses such as engineers, attorneys, certified public accountants, architects, surveyors, appraisers, among others; technical services requiring license such as expert electricians, master plumbers, auto technicians, among others; consulting or advisory services; advertising services; public relations or representation services; payment of advertisements or spots in mass media; communications and telecommunications services; customer or subscriber services; billing or collection services; lobbying services; security services; cleaning or maintenance services; infrastructure repair or maintenance services; public buildings or structures repair or maintenance services; landscape maintenance services; human resources or management consulting services; and miscellaneous services. Purchased or professional family or healthcare services geared to provide direct services to children and the elderly and to children with special education needs, among other essential services of this kind are hereby excluded. The Entities of the Executive

Branch and the Office of Management and Budget shall implement the necessary safeguards to ensure that the provisions of this Section do not result in a loss of Federal funding.

Every Entity of the Executive Branch shall be required to submit within ninety (90) days a report to the Legislative Assembly including and itemizing any executed purchased or professional services contracts to which the expenditure reduction provided for in this Section shall apply, including contracts that are not under said category, but the services provided thereunder include professional and purchased services. Every Entity of the Executive Branch shall annually certify to the Office of Management and Budget, on or before July 31st, 2014, and every subsequent July 31st, the expenditures incurred in purchased or professional services; expenditure shall be understood as the sums of the contracts entered into or purchases made during the preceding fiscal year, regardless of the amount billed or paid for such services, including an itemization per source of funds, to wit, Federal, special, own income, General Fund, or other. On July 31st, 2014, expenditures incurred in both Fiscal Year ending on June 30th, 2013 and in Fiscal Year ending on June 30th, 2014 shall be certified.

On or before August 30th, 2014, and every August 30th thereafter, the Office of Management and Budget shall file with the Legislative Assembly and the Office of the Governor a report of the certifications received. If the head of an Entity of the Executive Branch fails to submit the required certification as of the corresponding July 31st, the Office of Management and Budget shall issue a notice of noncompliance in an amount that shall be equal to an expenditure of twenty-five percent (25%) over the preceding year level. The Office of Management and Budget shall send a letter stating the over-expenditure to the head of those Entities of the Executive Branch whose reports show a noncompliance in the previous year. For those Entities of the Executive Branch whose operating expenses are covered

under the Operating Expenses Joint Resolution, the Office of Management and Budget shall transfer, on or before September 30th, 2014, or every September 30th thereafter, from the operating expenses account, the amount overspent in the previous year, which shall be covered into the Budget Fund to be used as provided in this Act. The Entities of the Executive Branch that have their own budget, the appointing authority or his/her representative shall be authorized and required to make a payment to the Secretary of the Treasury in the amount of the notified over-expenditure to be covered into the Budget Fund. Said payment may be made on equal installments for the remainder of the fiscal year; however, the first payment shall be made not later than thirty (30) days after the date of the Office of Management and Budget notice. Entities of the Executive Branch shall not deduct any valuable consideration or obligation that the State may owe to them or that they have in their favor from the payment of the amount of the over-expenditure stated in the notice.

Notwithstanding the foregoing, the Office of Management and Budget may deduct any State's debt from the over-expenditure notified to an Entity of the Executive Branch in accordance with this Act.

The Office of Management and Budget shall issue the rules that shall govern this requirement.

Section 7.- Adjustment of Purchased or Professional Service Rates.

Pursuant to the public policy set forth in this Act, the Entities of the Executive Branch shall have the authority to reduce on their own motion purchased or professional service rates within the effective term of an agreement or other acquisition document. To exercise said authority, the appointing authority or the authorized representative of the Entity of the Executive Branch shall notify the contractor or supplier, in writing, within at least ten (10) days in advance, about the following: its intent to modify the financial terms, the effective date, and the

modifications to be made. The contractor or supplier shall have ten (10) calendar days to accept the modifications or terminate the agreement in writing. Once such term elapses, the appointing authority or the authorized representative of the Entity of the Executive Branch at his/her discretion may make the reduction so notified. If, once said term has elapsed, the contractor or supplier continues providing services, it shall be deemed that the contractor or supplier has accepted the proposed reduction and shall not be required to submit a written acceptance or take additional steps. The modification of the terms of the contractual obligation shall be notified, once it takes effect, by letter and signed only by the appointing authority or the authorized representative of the Entity of the Executive Branch, to the Office of the Comptroller, which shall attach the same to the contractor's hard copy and electronic files. In addition, a copy thereof shall be sent to the contractor or supplier, the Governor or the person to whom he/she delegates, and the Director of the Office of Management and Budget. Reductions under this Section shall not require an additional authorization of the Governor, the person to whom he/she delegates, or the Office of Management and Budget; however, said reduction shall not be deemed to waive, relieve, or exempt from, the filing of the initial authorization of the agreement or other document subject to the modification.

Reductions authorized under this Section shall not be retroactive, that is, applicable to services that have already been rendered on the effective date of the modification. The provisions of this Section do not provide the contractor or supplier with the unilateral, independent, and separate right to terminate an agreement. Notices to contractors or suppliers in accordance with this Section shall be delivered by certified mail return receipt requested or personally to an agent of the contractor or supplier or to the address of record included in the agreement or acquisition document.

The provisions of this Section shall also apply to the State Election Commission, the Office of Government Ethics, the Office of the Special Independent Prosecutor's Panel, and the Office of the Election Comptroller.

The Office of Management and Budget shall implement regulatory provisions as are necessary to enforce the provisions of this Section.

Nothing provided in this Section shall apply to purchased and/or professional services defrayed by Federal funds, including the matching thereof with State funds.

Section 8.- Reduction of Payroll Expenses in Connection with Employees Holding Trust Positions.

Every Entity of the Executive Branch shall reduce payroll expenses on account of employees in trust positions by twenty percent (20%) effective June 30th, 2012, and keep such reduction for subsequent fiscal years.

Every appointing authority or the authorized representative of the Entity of the Executive Branch shall submit, within sixty (60) days, beginning on July 1st, 2014, a report to the Office of Management and Budget stating on detail the number of employees holding trust positions as of June 30th, 2014 *vis-à-vis* the number of employees holding such positions as of June 30th, 2012, including salaries, job classification and other information.

The Office of Management and Budget shall issue rules setting forth the format of the information to be provided, and the manner in which such information shall be considered by comparing elements such as the officials who were or are rendering services in detail; changes in job classifications from trust to career positions, and vice versa; the granting of salary differentials; and any other element that is relevant to make a fair and equitable comparison between the levels of expenditures.

The Office of Management and Budget, based on the rules thus issued, shall send a letter to the appointing authority or authorized representative of the Entity of the Executive Branch stating their compliance with this Section. Any appointing authority or authorized representative of the Entity of the Executive Branch that fails to comply with this Section, as notified in their corresponding communication, shall receive a letter directing it to make the necessary adjustments to its payroll of employees holding trust positions to comply with this Section. In addition, no appointing authority or authorized representative of the Entity of the Executive Branch shall hire employees to hold trust positions, including replacements, while such noncompliance persists. Any appointment to a trust position inconsistent with these provisions shall be null. Notwithstanding the provisions of this paragraph, an official may be appointed regardless of the payroll grade established in this Section, if he/she, for the same or lower salary, replaces another official holding a trust position who has resigned, ceased duties, or been dismissed, and: (i) provides, within the organizational structure of the Entity of the Executive Branch, direct supervision to two or more career employees; (ii) directs an operational area that is critical to the agency's operations, such as Legal, Human Resources, or Technology; or (iii) is critical to the agency services or operations, as stated in detail by the appointing authority of the Entity of the Executive Branch. The exceptions of individual appointments provided under this paragraph shall require the specific authorization of the Governor or the person to whom he/she delegates, regardless of the proposed compensation.

Section 9.- Filling of Vacancies.

No Entity of the Executive Branch shall appoint regular or career, transitory or irregular employees after July 1st, 2014 and during the effective term of this Act. Excepted from this prohibition are appointed employees that: (i) provide essential services directly to the people; (ii) are essential and indispensable to assure

compliance with the ministerial duties of the agency; (iii) directly generate revenues for the Government; (iv) replace services provided by subcontractors as of June 30th, 2014, when it may prove to achieve net savings, taking into account all relative costs between the two options; (v) hire transitory employees to carry out duties in the same position; (vi) fifty percent (50%) or more are defrayed by Federal funds or its own income; (vii) are necessary for the matching of Federal funds or a requirement to obtain such funds; or (viii) respond to a specific and direct requirement of a competent court or administrative forum to fill the position. Furthermore, in the event it is necessary to fill a vacancy, the first option would be to transfer or detail regular and transitory employees. New appointments shall, including those subject to exception, require the authorization of the Office of Management and Budget prior to filling the position. Appointments with a proposed salary higher than seventy thousand dollars (\$70,000) shall also require the authorization of the Governor or person to whom he/she delegates. Requests to fill vacancies made to the Office of Management and Budget shall include a certification signed by the appointing authority attesting to the existence and applicability of the exception under which such request is being submitted, a detailed statement of the basis thereof, and a confirmation of the inability to fill the position by means of transfer or detail. In the case of appointments defrayed solely by Federal funds, the Office of Management and Budget shall obtain an authorization within a term that shall not exceed thirty (30) days after the date of the request to fill a vacancy.

Any provision or rule of an agreement, law, regulation, or administrative provision that is contrary to or inconsistent with the provisions of this Section shall be deemed to be suspended. The foregoing includes, but is not limited to, any provision or rule requiring or seeking to require the filling of additional vacancies, the conditions under which employees are replaced, and the classification of filled

positions; or impairing or seeking to impair in any way, the power of the Government to determine the number or type of employees needed to operate and provide services to the people.

In their appointment process, the Entities of the Executive Branch shall include as part of the documents required to execute the same, in addition to the appointment affidavit and letter, an additional document whereby the head of the Entity of the Executive Branch or delegated official authorized to make appointments shall certify compliance with the provisions of this Section, and the candidate to be appointed recognizes the risk of nullity for noncompliance and his/her right to demand a copy of the authorizations required under this Section. The Office of Management and Budget shall establish by rules the format of the document to be completed by the parties, the contents and format of which shall be reproduced and used. Every appointment made in contravention with the provisions of this Section shall be null.

Public corporations whose operating expenses are defrayed, in whole or in part, from the General Fund shall follow the same procedure and require the same authorizations as those agencies or instrumentalities whose operating expenses are defrayed from the General Fund including the authorizations of the Office of Management and Budget and the Governor or his/her authorized representative. Public corporations whose operating expenses are defrayed in whole from their own funds or other sources shall follow the same procedure and require the same authorizations, except that, as a prerequisite for submitting a request for the approval of an appointment with the Office of Management and Budget, of the Governor or his/her authorized representative, as the case may be, such corporations shall obtain a written endorsement from the Government Development Bank.

Section 10.- Transfers and Administrative Details.

In order to ensure the continuity, cost efficiency, and quality of government services, during and until the effective term of this Act, upon previous authorization of the Office of Management and Budget, the transfer and administrative detail of regular and transitory employees between positions, job classifications and levels, group of employees, appropriate units, union units and nonunion units and vice versa, among Entities of the Executive Branch shall be allowed; provided, that employees on detail or transferred shall meet the minimum requirements of education and experience needed to hold the position; moreover, details and transfers under this Section shall not be used as a punitive measure, be made arbitrarily, or be burdensome for the employee. Details and transfers within the same Entity of the Executive Branch shall be made by the appointing authority or his/her authorized representative without the previous or subsequent authorization of the Office of Management and Budget.

These personnel actions shall entail a reduction of the employees' salaries or fringe benefits. Any provision of law, regulation, covenant, agreement, or precept that is contrary to the provisions of this Chapter shall be suspended during the effective term thereof; provided that there shall be full flexibility to make transfers and administrative details.

The Office of Management and Budget may implement regulatory provisions as are necessary to enforce the provisions of this Section.

Section 11.- Increase of Economic Benefits or Special Monetary Compensations.

(a) As of the effective date and during the effectiveness of this Act, the economic benefits or special monetary compensations granted to the employees of the Entities of the Executive Branch shall not be increased, except as provided in subsection (d) of this Section.

- (b) An increase of economic benefits shall be deemed to be the following:
- (i) Salary raises for years of service, merit pay, additional compensation for skills or competency, and general raises.
 - (ii) Increase of employer contributions for fringe benefits such as health, life, and other insurance.
 - (iii) Increase of retirement plan contributions beyond those provided by law for government retirement systems.
 - (iv) Increase of Christmas, summer or other bonuses.
 - (v) Raises for promotions or transfers, unless such promotion or transfers results in net savings for the Entity of the Executive Branch, thus satisfying the need to recruit an additional net employee; provided that such recruitment meets the requirements to fill vacancies provided in Section 9 of this Chapter.
 - (vi) Raises for reinstated employees.
 - (vii) Payment of salary differentials due to special circumstances or due to acting assignments, unless said differential results in net savings, thus satisfying the need to recruit an additional net employee; provided that such recruitment meets the requirements to fill vacancies provided in Section 9 of this Chapter.
- (c) A special monetary compensation shall be deemed to be the following:
- (i) Cash liquidations of vacation leave accrued in excess in the case of final liquidations upon the employee's separation from public service. Provided, that during the effectiveness of this Act, the maximum of days subject to liquidation upon separation from service shall be sixty (60) days. Likewise, during the effectiveness of this Act, any public employee who accrues more than sixty (60) days at the end of each calendar year shall use such excess within the nearest

date on or before the next six (6) months of the following calendar year. Provided further that every Entity of the Executive Branch shall pay, on or before August 31st of each year, any excess accrued as of the effective date of this Act and during the effectiveness thereof, when the employee has been unable to use such leave within the term provided herein due to special service circumstances beyond his/her control. All that pertains to vacation leave, in the case of public corporations, shall be addressed as provided in Section 17 of this Act.

(ii) Cash liquidations for sick leave accrued in excess in the case of liquidations upon the employee's separation from public service. Provided, that during the effectiveness of this Act, the maximum of days subject to liquidation upon separation from service shall be ninety (90) days. The employee shall keep the balance accrued as of the effective date of this Act, but accrual over such maximum balance shall be eliminated during the effective term of this Act. Provided further that, during the effectiveness of this Act, any excess annual accrual not used on or before December 31st of the corresponding year shall be forfeited. All that pertains to sick leave, in the case of public corporations, shall be addressed as provided in Section 17 of this Act.

(iii) Christmas Bonus in excess of six hundred dollars (\$600).

(iv) Summer Bonus in excess of two hundred dollars (\$200).

(v) Payment of bonuses in any amount due to productivity, performance, attendance, punctuality, retirement, special holiday, ratification or anniversary of ratification of collective bargaining agreements, or any other payment of bonuses for any other reason or account other than the Christmas or Summer bonus within the limits of this Section.

(vi) Paid leaves and time off without charge to any leave.

(vii) Paid leaves that are not statutorily established.

(d) The following shall not be deemed as an increase of economic benefits or special monetary compensation:

(i) Paid leaves to pursue education, attend seminars, courses, or workshops, provided that an agreement is executed whereby the benefited employee commits to provide services for twice the time it takes him/her to complete education, seminars, courses, or workshops and to return any paid leave in the event of noncompliance;

(ii) Employee Scholarship Programs;

(iii) Employee Assistance Programs;

(iv) Child care programs;

(v) Training, skill-building, and development plans up to a maximum of six hundred dollars (\$600) per employee.

Notwithstanding the foregoing, except for the Employee Assistance Programs and the training provided by the Training and Labor Affairs Advisory and Human Resources Administration Office (OCALARH, Spanish acronym), the appointing authority or his/her authorized representative shall consider that the aforementioned situations constitute an increase of economic benefits or special monetary compensation when they are necessary to adjust the expenditures of the Entity of the Executive Branch to the approved budget or to deal with a projected operating deficit.

(e) If the Entity of the Executive Branch has questions as to whether or not the granting or continuance of an economic benefit or special monetary compensation constitutes an increase of economic benefits or special monetary compensation, the appointing authority or authorized representative of the Entity of the Executive Branch shall submit a consultation to the Office of Management and Budget, which shall reply to the same within sixty (60) days or less; the reply to

the consultation shall be binding for the Entity of the Executive Branch submitting the same.

(f) The limitations established in this Section shall apply to all employees of the Entities of the Executive Branch, regardless of their classification as a trust, regular, career, transitory or irregular employee; and regardless of their specific duties within the Entity of the Executive Branch.

(g) The limitations established in this Section shall apply to all employees of the Entities of the Executive Branch, regardless of any provision to the contrary of any law, standard, regulations, collective bargaining, policy, employee handbook, circular letter, contract letter, certifications, regulations, employment rules and conditions, policy letters, classification, or compensation plans. This includes, but is not limited to, Act No. 184-2004, as amended, known as the “Public Service Human Resources Administration Act”; and the regulations issued and adopted in the case of public corporations, by the corresponding board of directors or appointing authority; or in the case of other public entities, by the corresponding board of governors or appointing authority.

(h) The Office of Management and Budget may implement regulatory provisions as are necessary to enforce the provisions of this Section.

(i) Recognizing the importance of public employees union affiliation, not only in representation of the economic wellbeing of workers, but also in taking public service to its highest level and keeping labor peace, an alternative and uniform participatory process is hereby established to achieve the goals of the public policy set forth in this Act, including the necessary savings within the parameters set forth in subsections (j) and (k), as the case may be, following collective bargaining as guiding principle. The agreements reached by the authorized representatives of union employees, and ratified in writing by the members of the corresponding labor union and the authorized representative of the

Entity of the Executive Branch through and in accordance with the collective bargaining parameters allowed herein, shall replace the provisions of subsections (a), (b), (c), and (d) of this Section and any other pertinent provision of this Act and that have been object of the bargaining. For every alternative participatory process recognized under this Act leading to a bargaining between Entities of the Executive Branch and labor unions, any necessary information, such as a report of audited financial statements of the Entity of the Executive Branch, a report of all contracts and the sums thereof, a report of all trust positions and the sums thereof, among other pertinent data shall be provided. The Entities of the Executive Branch shall agree to a labor union's request to begin the alternative participatory process.

Once the period of the participatory process provided in this Act concludes, the Entity of the Executive Branch and the labor union shall notify the Secretary of Labor and Human Resources of any impasse reached, if any, during the bargaining process. The Secretary shall grant the parties fifteen (15) additional days to conclude the bargaining efforts.

(j) In the case of Entities of the Executive Branch subject to Act No. 45-1998, as amended, the Governor or the person to whom he/she delegates, and the Director of the Office of Management and Budget and the Secretary of the Department of Labor and Human Resources are hereby authorized to enter into, beginning on or before July 1st, 2014, one or various negotiations, personally or through their authorized representatives, to amend by mutual agreement the collective bargaining agreements in effect establishing modifications to the financial job conditions that replace the provisions of subsections (a), (b), (c), and (d) of this Section, but that achieve an average savings per union employee comparable to the savings that would have been achieved should the aforementioned subsections had been applied, as estimated at the discretion and in the judgment of the Office of Management and Budget. The negotiated

amendments shall take effect only for appropriate units that adopt and ratify the same and, in any case, shall take effect retroactively to July 1st, 2014. The provisions of subsections (a), (b), (c), and (d) of this Section shall apply retroactively to July 1st, 2014 and be final and binding for any appropriate unit that fails to adopt and ratify any amendment under this subsection on or before August 31st, 2014. The appointing authority or authorized representative of an Entity of the Executive Branch is hereby authorized to make the corresponding payroll adjustments to enforce this subsection.

(k) In the case of Entities of the Executive Branch with union employees that are not subject to Act No. 45-1998, as amended, the appointing authority or authorized representative of an Entity of the Executive Branch may negotiate amendments to collective bargaining agreements in effect establishing modifications to the financial job conditions that replace the provisions of subsections (a), (b), (c), and (d) of this Section, provided that such amendments are approved and ratified by all the parties on or before July 31st, 2014; that are retroactive to July 1st, 2014; and that the average savings achieved per union employee by implementing said amendments are comparable to the savings that would have been achieved should the aforementioned subsections had been applied.

The savings goal of the negotiation, as well as the achievement thereof as a result of the proposed amendments, shall be determined by the Board of Directors or other governing body of the Entity of the Executive Branch concerned, whose final approval shall be necessary to prevent subsections (a), (b), (c), and (d) of this Section from being applied. If the amendments are not signed and ratified by August 31st, 2014, the provisions of subsections (a), (b), (c), and (d) of this Section shall apply retroactively to July 1st, 2014. The appointing authority or authorized

representative of an Entity of the Executive Branch is hereby authorized to make the corresponding payroll adjustments to enforce this subsection.

Section 12.- Expired Collective Bargaining Agreements.

The non financial clauses and other clauses of the collective bargaining agreements that have not been affected by this Act, but which have expired as of the effective date of this Act or shall expire during the effective term of this Chapter II, shall be extended until the expiration of the effective term of this Chapter. Said extension shall impair the presentation and holding of representative's elections.

Once the effective term of this Chapter II expires, labor unions that as of July 1st, 2014 represented union employees of every Entity of the Executive Branch may begin to negotiate new collective bargaining agreements, including financial and non financial clauses, and the Entities of the Executive Branch shall negotiate the same in accordance with the applicable rules and law, taking into account the realities of the economic and financial conditions of the Entity of the Executive Branch and the Government in general.

Section 13.- Unlawful Practices.

The implementation of any measure authorized under this Chapter, whether by the Office of Management and Budget, the Entities of the Executive Branch and their respective officials, the Governor, or any representative thereof, shall not constitute a violation of the existing collective bargaining agreements nor constitute an unlawful practice.

The provisions of this Section shall also apply to the State Election Commission, the Office of Government Ethics, the Office of the Special Independent Prosecutor's Panel, and the Office of the Election Comptroller.

Section 14.- Forum to Settle Disputes.

The Public Service Appellate Commission (PSAC) or its successor, in all that pertains to labor or that would otherwise be under the jurisdiction of PSAC, shall have exclusive primary jurisdiction to address appeals arising as a result of actions taken or decisions made in accordance with this Chapter filed by employees covered or not covered by the provisions of Act No. 45-1998, as amended, known as the Public Service Labor Relations Act, as well as those filed by nonunion employees of the Entities of the Executive Branch excluded from the application of the provisions of Act No. 184-2004, as amended, known as the Public Service Human Resources Administration Act of the Commonwealth of Puerto Rico, and employees of the Entities of the Executive Branch that do not have labor unions, but to whom the provisions of Act No. 184-2004 apply.

Furthermore, the Labor Relations Board, or its successor, shall have exclusive primary jurisdiction to address appeals arising as a result of actions taken or decisions made in accordance with this Chapter filed by employees covered by Act No. 130 of May 8, 1945, as amended. Provided, that pursuant to the provisions of this Act, no action taken hereunder shall constitute a violation of existing collective bargaining agreements, or a refusal to negotiate in good faith, or an unlawful practice.

Section 15.- School Transportation.

The Secretary of Education is hereby authorized and directed to establish alternative measures and strategies to maximize the efficiency and cost effectiveness of school transportation, particularly in connection with the direct or indirect subcontracting with the Municipalities, as well as with any Entity of the Executive Branch or private entity that guarantees savings in the cost of providing such services. Likewise, the Secretary of Education is hereby directed, in conjunction with the Office of Management and Budget, to devise a plan for the

adequate control of the payments made for rendered services and for the evaluation of documents that validate the rendering thereof. Said control plan shall be promulgated within a term that shall not exceed sixty (60) days after the approval of this Act, and filed with the Secretary of the Senate and the Clerk of the House not later than thirty (30) days after the adoption thereof. The Department of Education shall not spend, on account of school transportation, an amount of Commonwealth funds exceeding the amount set aside therefor in the General Budget Joint Resolution or, if such Joint Resolution does not specifically provide for such allocation, the amount budgeted and accounted for at the beginning of the fiscal year in its approved budget. Neither the Secretary of Education nor the Office of Management and Budget may transfer additional funds during a fiscal year to cover expenditures that exceed the budget or potential overruns on this account. The Secretary of Education is hereby authorized and empowered to take the necessary measures to renegotiate, restructure, or modify contracts with carriers in order to comply with the mandate of austerity and expenditure control, as provided above. Notwithstanding the provisions of any other law, the Secretary is hereby empowered to execute, modify, or cancel the service contract or legal agreement entered into with any carrier to provide school transportation services in the service zones and under the conditions that he/she may determine. Likewise, the Secretary is hereby empowered to either recover the money paid, or to not pay, for school transportation services charged for an enrolled student, but not rendered due to absenteeism, transfers, or dropouts.

Section 16.- Prohibition to Overspend Budget.

The provisions of Section 8 of Act No. 103-2006, as amended, which prohibit spending in excess of budget appropriations is herein reasserted. Every public employee who, knowing that the Entity of the Executive Branch is projected to overspend its appropriations chargeable to the General Fund, certifies or

provides incorrect information to be incorporated in such certification to the Governor, or the person to whom he/she delegates, or to the Office of Management and Budget, about the availability of the funds to carry out a transaction, including appointments or the execution of contracts; or carries out said transaction without the appropriate authorizations, shall be subject to a fine of two hundred dollars (\$200) per incident, and up to a maximum of five thousand dollars (\$5,000), in the aggregate for all the incidents that take place within the same calendar year. The official may rely on amended projections that make up for such over-expenditures, provided that said projections are sent to the Governor or to the person to whom he/she delegates, or to the Office of Management and Budget, together with or prior to the request for authorization. Provided, that prior to imposing the aforementioned sanction on a public employee, the latter shall be guaranteed due process of law, whether through an informal hearing or any other administrative procedure, or as provided in a collective bargaining agreement. The Office of Management and Budget shall be responsible for regulating and implementing the provisions of this Section, including all that pertains to the imposition of administrative fines.

The provisions of this Section shall also apply to the State Election Commission, the Office of Government Ethics, the Office of the Special Independent Prosecutor's Panel, and the Office of the Election Comptroller.

Section 17.- Fiscal Control in Public Corporations.

During the effective term of this Act, all public corporations shall suspend the financial terms negotiated under collective bargaining agreements in effect having a direct or indirect economic impact on the operations of the public corporation that aggravate the budget situation thereof or whose suspension is warranted to improve its budget situation. The non financial terms that could have a direct or indirect economic impact include, but are not limited to, the following:

(a) Training, skill-building, and development plans, except for those circumstances in which it is extremely necessary, and in accordance with the criteria established in this Chapter II;

(b) Paid leaves to pursue education, attend seminars, courses, or workshops that are inconsistent with the criteria established in this Chapter II;

(c) Paid leave and time off without charge to any leave;

(d) Any provision that prevents assigning or reassigning tasks to employees, group of employees, job classification, level or appropriate unit in order to render the administration and operation of the public corporation more cost efficient and meet the criteria of this Chapter II;

(e) Any provision that prevents the subdivision of tasks or assignment of work schedules to employees, group of employees, job classification, level or appropriate unit in order to render the administration and operation of the public corporation more cost efficient and meet the criteria of this Chapter II;

(f) Any provision that prevents the subcontracting of tasks assigned to employees, group of employees, job classification, level or appropriate unit in order to render the administration and operation of the public corporation more cost efficient and meet the criteria of this Chapter II;

(g) Provisions regarding the limitations on management or administrative rights of the employer in order to render the administration and operation of the public corporation more cost efficient and meet the criteria of this Chapter II;

(h) Provisions or terms compelling the employer to faithfully comply with what has been agreed or accepted, regarding matters that are in conflict with the provisions of this Chapter II;

(i) Requirements to use seniority, to the extent the provisions on seniority are contrary to the provisions of this Chapter II or constitute a limitation to change duties, promotions, demotions, relocations, transfers, details, or other transactions

needed to prevent services from being affected, in order to render the administration and operation of the public corporation more cost effective and meet the requirements of this Chapter II.

If any questions arise as to whether a specific provision of a collective bargaining agreement has a direct or indirect economic impact on a public corporation that aggravates its budget situation or that must be suspended to improve the budget situation, a consultation shall be submitted to the Government Development Bank, which shall reply to the same within a term not to exceed sixty (60) days. The reply to said consultation shall be binding for the public corporation submitting the same.

Provided, further, that public corporations shall recognize to both union and nonunion employees their vacation leaves accrued as of the effective date of this Act; however, the excess thereof accrued before and during the effective term of this Act shall not be liquidated in cash. Public corporations shall establish a plan whereby both union and nonunion employees shall exhaust the leaves accrued in excess so that no excess is carried over after the effective term of this Act.

Provided, further, that sick leaves accrued in excess by union or nonunion employees of the public corporations before the effective date of this Act shall be frozen at the pay rate in effect as of June 30th, 2014, and the liquidation thereof in cash shall only be made in the event of separation from public service. Any sick leaves accrued in excess after the effective date of this Act, as well as that accrued as of December 31st of each year, shall be used on or before June 30th of the year following the year in which it was accrued; after said date such balance shall be forfeited.

Beginning on the first year of the effectiveness of this Act, and annually for the next three (3) years, every public corporation shall establish a process whereby the Executive Director of the Entity and the representatives of their respective

unions shall assess, in a transparent manner, the financial situation and the fiscal reality of their respective public corporation. If, in light of the assessment, in accordance with the mechanism adopted, it is established that the public corporation does not have an operating deficit, but a stable financial situation, and does not depend on the General Fund for its operation, it may begin negotiating the terms of the collective bargaining agreement that had been frozen under the provisions of this Section. Once the effective term of this Act expires, the collective bargaining agreement in effect at the time of the approval of this Act shall be reestablished for the remainder of its effective term, if any, and shall apply prospectively.

Section 18.- Contribution of Savings of Public Corporations in Health-related Fields to the General Fund's Deficit.

The savings generated by the Automobile Accidents Compensation Administration and the State Insurance Fund Corporation as a result of the implementation of the provisions of Section 11 of this Chapter, shall be contributed to the "Special Education Student Services and Therapies Fund," under the custody of the Department of Education, created through special legislation specifically for said purposes. This would reduce the General Fund's fiscal burden, which requires the rendering of adequate services to the special education population, in accordance with Federal legislation, the public policy, and the existing legal framework.

On or before July 31st, 2014, both entities shall certify to the Office of Management and Budget the number of employees on their payrolls as of June 30th, 2014, and the sums paid during the fiscal year ending on said date to cover the following items: Christmas Bonus; Summer Bonus; other general bonuses, including, but not limited to, ratification of collective bargaining agreements, attendance, punctuality, productivity, or retirement; liquidation of sick

and vacation leaves accrued in excess. In the case of the Christmas Bonus and the Summer Bonus, the certification of the sums paid shall be reduced by an amount equal to the number of employees who received the Christmas Bonus, multiplied by six hundred dollars (\$600), plus the number of employees that received the Summer Bonus, multiplied by two hundred dollars (\$200). The information to be provided shall separate union employees from nonunion employees.

The corresponding amounts certified by June 30th, 2014, shall be considered conclusively as the savings generated under this Act for the following Fiscal Year 2015, and shall be transferred to the Department of the Treasury by the Automobile Accidents Compensation Administration and the State Insurance Fund Corporation beginning on or before July 31st, 2014. The funds thus transferred shall be deemed allocated to the Special Education Student Services and Therapies Fund. Said transfers may be made in equal installments for the remaining months of the fiscal year, but must be completed before June 30th, 2015. The Automobile Accident Compensation Administration and the State Insurance Fund Corporation shall continue to make their respective additional transfers in an amount equal to that paid during Fiscal Year 2015, beginning on July 31st, 2015; for Fiscal Year 2016 and every July 31st thereafter, during the effective term of this Act.

Section 19.- Contribution of Savings of Public Corporations in Economic Development-related Fields to the General Fund's Deficit.

The savings generated by public corporations related to the promotion of economic development, and some other corporations designated in this Section, as a result of the implementation of the provisions of Section 11 of this Chapter, shall be deposited in the "Employment Promotion and Economic Activity Fund," under the custody of the Puerto Rico Trade and Export Company, created through special legislation specifically for such purposes. This would reduce the burden

currently imposed on the General Fund by the appropriations for job promotion and business incentives.

For purposes of this Section, public corporations related to the economic development promotion field are the following: the Land Administration, the Lands Authority of Puerto Rico, the Puerto Rico Convention Center District Authority, the Puerto Rico Infrastructure Financing Authority, the Housing Financing Authority, the Puerto Rico Economic Development Bank, the Government Development Bank for Puerto Rico, the Development [sic] and Export Company, the Industrial Development Company, the Tourism Company, the Agricultural Insurance Corporation, and the Public Corporation for the Supervision and Insurance of Cooperatives in Puerto Rico. Furthermore, instrumentalities not directly related to economic development shall also contribute to the Employment Promotion and Economic Activity Fund, to wit: the Governing Board of the 9-1-1 Service and the Puerto Rico and the Caribbean Cardiovascular Center Corporation.

On or before July 31st, 2014, each one of these entities shall certify to the Office of Management and Budget the number of employees on their payrolls as of June 30th, 2014, and the sums paid during the fiscal year ending on said date to cover the following items: Christmas Bonus; Summer Bonus; other general bonuses, including, but not limited to, ratification of collective bargaining agreements, attendance, punctuality, productivity, or retirement; liquidation of sick and vacation leaves accrued in excess. In the case of the Christmas Bonus and the Summer Bonus, the certification of the sums paid shall be reduced by an amount equal to the number of employees who received the Christmas Bonus, multiplied by six hundred dollars (\$600), plus the number of employees that received the Summer Bonus, multiplied by two hundred dollars (\$200). The information to be provided shall separate union employees from nonunion employees.

The corresponding amounts certified by June 30th, 2014, shall be considered conclusively as the savings generated under this Act for the following Fiscal Year 2015, and shall be transferred to the Department of the Treasury by each of the corresponding public corporations, beginning on or before July 31st, 2014. The funds thus transferred shall be deemed to be allocated to the Employment Promotion and Economic Activity Fund. Said transfers may be made in equal installments for the remaining months of the fiscal year, but must be completed before June 30th, 2015. Public corporations required to make contributions under this Section shall continue to make their respective additional transfers in an amount equal to that paid during Fiscal Year 2015, beginning on July 31st, 2015 for Fiscal Year 2016, and on every July 31st thereafter during the effective term of this Act.

Section 20.- Budget of the State Election Commission, the Office of Government Ethics, the Office of the Election Comptroller, and the Special Independent Prosecutor's Panel.

For any fiscal year ending during the effective term of this Chapter, the budget of the State Election Commission, the Office of Government Ethics, the Office of the Election Comptroller, and the Special Independent Prosecutor's Panel shall be equal to their respective budgets for the previous fiscal year adjusted by the reduction percentage or global increase in the General Budget of Expenses chargeable to the General Fund, included in the budget recommended by the Governor. Said adjustment shall be calculated excluding the proposed appropriations to service the constitutional debt chargeable to the General Budget of Expenses of both the basis of the previous year and the recommended amount for the fiscal year under consideration. Likewise, said adjustment shall exclude from both basis for comparison the budgets corresponding to the Judicial Branch, the Legislative Assembly, the Office of the Comptroller, the Ombudsman, the

Civil Rights Commission, the State Election Commission, the Office of Government Ethics, the Office of the Election Comptroller, and the Special Independent Prosecutor's Panel.

Section 21.- Prohibitions on the Use of Protective Detail, Traveling, and Contracting of Services, Among Others.

(a) The use of public funds for the payment of protective detail for the heads of the Entities of the Executive Branch is hereby prohibited. As an exception, and due to the nature of the functions they perform, this prohibition shall not apply to the Secretary of State, the Secretary of Justice, the Secretary of Corrections and Rehabilitation, and the Police Superintendent. Likewise, the Governor of Puerto Rico may authorize protective detail when necessary to protect the health, safety, and welfare of any government official who is affected as a result of decisions made in the performance of his/her duties.

(b) The use of public funds for traveling outside of Puerto Rico by the heads of the Entities of the Executive Branch or officials in trust positions is hereby prohibited, except when said trips are essential for the performance of their official duties and have been previously approved by the Governor or by the person to whom he/she delegates. In the case of officials other than employees holding trust positions or heads of the Entities of the Executive Branch, the authorization of the Governor or of the person to whom he/she delegates shall be required in the event that: (i) more than two employees are traveling for the same purpose at the same time; or (ii) the cost of accommodations per night exceeds two hundred fifty dollars (\$250).

(c) The contracting of professional or purchased services in Entities of the Executive Branch in excess of one hundred thousand dollars (\$100,000) within the same fiscal year is hereby prohibited without the previous written authorization of the Governor or the person to whom he/she delegates. Any contract executed in

violation of this requirement shall be null. This authorization requirement is in addition to, and does not substitute any other applicable rules, including those set forth by the Governor or the person to whom he/she delegates pursuant to the Executive Orders to cut back on spending or rule of the Office of Management and Budget.

(d) The use of public funds for the payment of cellular phones, personal digital assistants (PDAs), personal Internet service devices or other technological services for the exclusive use of heads of agencies, employees and officials of the Entities of the Executive Branch of the Commonwealth of Puerto Rico is hereby prohibited. As of the approval of this Act, all contracts for the aforementioned services shall be cancelled. The Governor or the person to whom he/she delegates may grant waivers to this requirement.

Section 22.- Expenditures and Lease Agreement Reduction Plan.

Within a period of thirty (30) days as of the approval of this Act, the Entities of the Executive Branch shall submit to the Office of Management and Budget a list of all their lease agreements in effect, the amount thereof, and a summary of the reason for the execution thereof. Those lease agreements that must be kept by mandate of law or to meet an obligation not subject to discretion, or to preserve an essential service for the citizenry shall be specified.

The Office of Management and Budget may direct not to renew or modify said leasing agreements upon their expiration and subsequent execution, except when such action is detrimental to an essential service or entails a greater financial burden. In said analysis, the Office of Management and Budget may also consider the possibility of consolidating some operations of several agencies in the same location and renegotiate the terms and amount of the lease agreements in order to attain more favorable conditions.

Furthermore, all lease agreements or lease letter of intent shall adhere to the following guidelines:

(a) No agreement may be renewed nor a new agreement may be executed, nor the amount paid for a lease may be increased without the previous authorization of the Office of Management and Budget.

(b) Every Entity of the Executive Branch, with the assistance of the Office of Management and Budget, shall analyze the alternative of not renewing lease agreements upon their expiration, when it is feasible for such entity to consolidate the operations of the activities conducted in a leased building within their existing facilities or in any other available public facility.

(c) Every Entity of the Executive Branch that has a lease agreement in effect and is considering the renewal thereof, or that intends to execute a lease agreement, shall request a lease proposal from the Public Buildings Authority and/or any other Entity of the Executive Branch, municipalities, or other Government Branch that could have space available in order to evaluate the cost-effectiveness of entering into a new agreement with the government entity. It shall be deemed to be cost-effective to enter into a new lease agreement with a government entity when:

(i) a constant and continuous reduction for such operating expense greater than fifteen percent (15%) is projected;

(ii) moving the operations of the agency is not detrimental to the rendering of the services; and

(iii) there is no legal impediment therefor.

(d) Every lease agreement entered into in contravention with these provisions shall be null.

The Office of Management and Budget shall have discretion to make exceptions to the provisions herein in all lease agreements, when so required by Federal or State law or a court order; it is essential to protect the health, safety, and welfare of the citizenry and/or public employees; and when it is necessary to carry out a ministerial duty of the agency in question to prevent any impairment to the public service.

Section 23.- Energy Consumption Reduction Plan and Provision on the Consumption of Aqueduct and Sewer Services.

The Entities of the Executive Branch shall promote the wise and efficient use of public utilities. In order to achieve the objectives and meet the requirements of the current fiscal emergency which demands the responsible and effective use of the limited government resources, the duty of all the Entities of the Executive Branch of reducing the consumption of public utility services such as electric power, as well as aqueduct and sewer, is hereby reasserted.

Regarding the efficient use of electric power, it is hereby provided that all the Entities of the Executive Branch shall faithfully meet the energy conservation requirements established in Sections 4.1, 4.2, and 4.3 of Act No. 57-2014, known as the “Puerto Rico Energy Transformation and Relief Act.” The Entities of the Executive Branch are hereby authorized to request to the Commonwealth Energy Public Policy Office (CEPPO) an adjustment in the energy baseline consumption, according to the consumed kilowatt-hour, in light of the additional burden entailed by new facilities or buildings, or improvements to existing buildings, provided that CEPPO certifies that the additional burden entailed by new facilities or buildings or improvements has been certified as efficient in accordance with the parameters established by CEPPO through regulations. CEPPO shall adopt regulations as are necessary to enforce these requirements.

During the effective term of this Chapter, with respect to the Entities of the Executive Branch whose operating expenses are defrayed totally or partially from the General Fund, the base rate of aqueduct and sewer services in effect on July 1st, 2014, shall not be increased, unless modified by subsequent legislation. The rate provided in Section 8 of Joint Resolution No. 16-2013, whose terms are hereby reasserted and ratified retroactively to the effective date thereof, shall be deemed to be the rate in effect as of July 1st, 2014.

Furthermore, with respect to aqueduct and sewer consumption, the Entities of the Executive Branch whose operating expenses are defrayed totally or partially from the General Fund, shall reduce their expenditures in connection with aqueduct and sewer consumption costs by five percent (5%) annually for the years 2014-15, 2015-16, and 2016-17 to show a total reduction of fifteen percent (15%) in those three (3) years. The reduction percentage shall be computed using as a basis the aqueduct and sewer consumption for 2012-13. The Office of Management and Budget shall oversee faithful compliance with the reduction of aqueduct and sewer spending established for the Entities of the Executive Branch. For those Entities of the Executive Branch that fail to comply with the percentage rate reduction of aqueduct and sewer spending, the Office of Management and Budget may reduce their operating expense budget for the following fiscal year, which shall be equal to the monetary value of the consumption in excess of the reduction rate established.

CHAPTER III.- BUDGET MEASURES FOR THE JUDICIAL BRANCH, LEGISLATIVE BRANCH AND OTHER GOVERNMENT ENTITIES

Section 24.- Budget of the Judicial Branch.

For any fiscal year ending during the effective term of this Chapter, the budget of the Judicial Branch shall be equal to its respective budget for the previous fiscal year, adjusted by the reduction percentage or global increase in the

General Budget of Expenses chargeable to the General Fund, stated in the budget recommended by the Governor. Said adjustment percentage shall be calculated excluding the proposed appropriations to service the constitutional debt of the General Budget of Expenses chargeable to the General Fund, both on the basis of the previous year and on the recommended amount for the fiscal year under consideration. Likewise, said adjustment shall exclude from both basis for comparison the budgets of the Judicial Branch, the Legislative Assembly, the Office of the Comptroller, the Ombudsman, the Civil Rights Commission, the State Election Commission, the Office of Government Ethics, the Office of the Election Comptroller, and the Special Independent Prosecutor's Panel.

For the fiscal year immediately beginning upon the expiration of the effective term of this Chapter, the recommendation and approval of the budget of the Judicial Branch shall be once again governed by the regularly applicable legislation. No debt, obligation, or pledge for future appropriations or payments whatsoever shall be issued for any gap existing between the budget actually appropriated during the effective term of this Act, and what would have been the budget resulting from the application of formulas or other rules established in the laws that would otherwise have governed the drawing up of the budget.

The Judicial Branch, in the exercise of the powers conferred thereto by the Constitution of the Commonwealth of Puerto Rico, may adopt any of the spending reduction and/or control measures provided in this Act as may be necessary to address any budget deficit projected during the effective term of this Act.

Section 25.- Budget of the Legislative Assembly and Attached Entities.

For any fiscal year ending during the effective term of this Chapter, the budget of the Legislative Assembly and each one of its attached entities, to wit, the Office of the Comptroller, the Ombudsman, and the Civil Rights Commission shall be equal to its respective budget for the previous fiscal year, adjusted by the

reduction percentage or global increase in the General Budget of Expenses chargeable to the General Fund, stated in the budget recommended by the Governor. Said adjustment percentage shall be calculated excluding the proposed appropriations to service the constitutional debt of the General Budget of Expenses chargeable to the General Fund, both on the basis of the previous year and on the recommended amount for the fiscal year under consideration. Likewise, said adjustment shall exclude from the basis for comparison the budgets of the Judicial Branch, the Legislative Assembly, the Office of the Comptroller, the Ombudsman, the Civil Rights Commission, the State Election Commission, the Office of Government Ethics, the Office of the Election Comptroller, and the Special Independent Prosecutor's Panel.

For the fiscal year immediately beginning upon the expiration of the effective term of this Chapter, the recommendation and approval of the budget of each entity affected by this Section shall once again be governed by the regularly applicable legislation. No debt, obligation, or pledge for future appropriations or payments whatsoever shall be issued for any gap existing between the budget actually appropriated during the effectiveness of this Act, and what would have been the budget resulting from the application of formulas or other rules established in the laws that would otherwise have governed the drawing up of the budget.

The Legislative Assembly and its attached entities, in the exercise of the powers conferred to them by the Constitution of the Commonwealth of Puerto Rico, may adopt any of the spending reduction and/or control measures provided in this Act as may be necessary to address any budget deficit projected during the effective term of this Act.

Section 26.- Budget of the University of Puerto Rico and Certain Appropriations for the Operation of Municipalities.

For any fiscal year ending during the effective term of this Chapter, any operating subsidy of government entities that are not part of the Central Government shall be equal to their respective operating subsidy for Fiscal Year 2013-2014. For purposes of this Section, the term government entities that are not part of the Central Government, refers to the University of Puerto Rico and the Municipalities. For purposes of this Section, the term operating subsidy with respect to the University of Puerto Rico, refers to the appropriation provided in subsection (a) of Section 3 of Act No. 2 of January 20, 1966, as amended; and with respect to the Municipalities, it refers to the appropriations provided in Section 2.06 of Act No. 83-1991, as amended (Exoneration Fund), and in subsection (c) of Section 16 of Act No. 80-1991, as amended (Matching Fund).

For the fiscal year immediately beginning upon the expiration of the effective term of this Chapter, the recommendation and approval of the budget of each entity affected by this Section shall once again be governed by the regularly applicable legislation. No debt, obligation, or pledge for future appropriations or payments whatsoever shall be issued for any gap existing between the budget actually appropriated during the effective term of this Act, and what would have been the budget resulting from the application of formulas or other rules established in the laws that would otherwise have governed the drawing up of the budget.

Section 27.- Energy and Aqueduct and Sewer Services Consumption Reduction Plan in the Legislative Branch, the Judicial Branch, and the University of Puerto Rico.

No electric power service special or preferential rates shall be established for the Entities of the Legislative Branch, the Judicial Branch, and the University of Puerto Rico. They shall promote the wise and efficient use of public utilities. In order to achieve the objectives and meet the requirements of the current fiscal emergency which demands the responsible and effective use of the limited government resources, the duty of all the Entities of the Legislative Branch, the Judicial Branch, and the University of Puerto Rico of reducing the consumption of public utilities services such as electric power, as well as aqueduct and sewer, is hereby reasserted. The term Entities of the Legislative Branch and the Judicial Branch shall include every agency or body attached thereto or that is part of the Legislative Branch or the Judicial Branch, respectively.

Regarding the efficient use of electric power, it is hereby provided that all Entities of the Legislative Branch, the Judicial Branch, and the University of Puerto Rico shall faithfully meet the energy conservation requirements established in Sections 4.1, 4.2, and 4.3 of Act No. 57-2014, known as the “Puerto Rico Energy Transformation and Relief Act.” The Entities of the Legislative Branch, the Judicial Branch, and the University of Puerto Rico are hereby authorized to request to the Commonwealth Energy Public Policy Office (CEPPO) an adjustment in the energy baseline consumption, according to consumed kilowatt-hour, in light of the additional burden entailed by new facilities or buildings, or improvements to existing buildings, provided that CEPPO certifies that the additional burden entailed by new facilities or buildings or improvements has been certified to be efficient under the parameters established by CEPPO through regulations. CEPPO shall adopt regulations as are necessary to enforce these requirements.

During the effective term of this Chapter, with respect to the Entities of the Legislative Branch, the Judicial Branch, and the University of Puerto Rico, whose operating expenses are defrayed totally or partially from the General Fund, the base rate of aqueduct and sewer services in effect on July 1st, 2014, shall not be increased, unless modified by subsequent legislation. The rate provided in Section 8 of Joint Resolution No. 16-2013, whose terms are hereby reasserted and ratified retroactively to the effective date thereof, shall be deemed to be the rate in effect as of July 1st, 2014.

Furthermore, with respect to aqueduct and sewer consumption, the Entities of the Legislative Branch, the Judicial Branch, and the University of Puerto Rico, whose operating expenses are defrayed totally or partially from the General Fund, shall reduce their expenditures in connection with aqueduct and sewer consumption by five percent (5%) annually for the years 2014-15, 2015-16, and 2016-17 to show a total reduction of fifteen percent (15%) in those three (3) years. The reduction percentage shall be computed using as basis the aqueduct and sewer consumption for the year 2012-13. By petition of the Entities of the Legislative Branch, the Judicial Branch, or the University of Puerto Rico, the Aqueduct and Sewer Authority may authorize a variation in the baseline consumption of aqueduct and sewer in light of the additional demand of new facilities and buildings.

CHAPTER IV.- PLANS FOR FINAL AND BINDING JUDGMENTS PENDING PAYMENT

Section 28.- Applicability and Payment Plans.

In view of the negative impact on the fiscal and operational stability of the Commonwealth of Puerto Rico and the municipal governments that the payment of a lump sum would entail, the provisions of this Chapter shall apply to all final and binding judgments, except for those related to eminent domains that, on the date of

approval of this Act, are pending payment and those issued during the effective term of this Act, whereby the agencies, instrumentalities, public corporations, municipalities, or the Commonwealth of Puerto Rico are compelled to make a disbursement of funds chargeable to the General Fund, the fund of the public corporation in question, or chargeable to the municipal budget, as the case may be.

In the event that the agencies, instrumentalities, public corporations, municipalities, or the Commonwealth of Puerto Rico, or officials who have availed themselves of the benefits of this Act, are required to make a disbursement of funds chargeable to the General Fund, the fund of the public corporation in question, or chargeable to the municipal budget, as the case may be, and there is no payment plan previously agreed on in writing and approved by the Court, the provisions of this Section shall apply, regardless of the nature of the judgment or in the case of an administrative, extrajudicial or judicial transaction. The Secretary of Justice shall evaluate the applicable payment plan in accordance with the amount of the judgment, upon which he/she shall request a certification of the availability of funds to the Director of the Office of Management and Budget, the Board of Directors or the governing body of the public corporation in question, or of the Mayor of the corresponding Municipality. Only for purposes of the application of this Section, the term Commonwealth shall include the Commonwealth of Puerto Rico, its agencies and instrumentalities, public corporations, and municipalities. Payment plans shall be established in accordance with the following terms:

(a) If the amount owed by the Commonwealth, a public corporation or municipality is equal to or less than one hundred thousand dollars (\$100,000), it may be paid off through a one (1) to three (3) year payment plan from the time the payment obligation becomes final and binding.

(b) If the amount owed by the Commonwealth, a public corporation, or municipality exceeds one hundred thousand dollars (\$100,000), but does not exceed one million dollars (\$1,000,000), it may be paid off through a three (3) year and one (1) day to four (4) year payment plan from the time the payment obligation becomes final and binding.

(c) If the amount owed by the Commonwealth, a public corporation, or municipality exceeds one million dollars (\$1,000,000), but does not exceed or is equal to seven million dollars (\$7,000,000), it may be paid off through a four (4) year and one (1) day to seven (7) year payment plan from the time the payment obligation becomes final and binding.

(d) If the amount owed by the Commonwealth, a public corporation, or municipality exceeds seven million dollars (\$7,000,000), but does not exceed twenty million dollars (\$20,000,000), it shall be paid off through a seven (7) year and one (1) day to ten (10) year payment plan from the time the payment obligation becomes final and binding.

(e) If the judgment owed by the Commonwealth, a public corporation, or municipality exceeds twenty million dollars (\$20,000,000), the payment plan applicable thereto shall be fixed during the drawing up of the budget following the date on which the payment obligation becomes final and binding, taking into consideration the fiscal situation, and said payment plan shall never exceed an annual sum of three million dollars (\$3,000,000).

(f) In order to determine the applicable payment plan, the judgment shall not be divided by claimant, but rather the total thereof shall be considered as the item value.

(g) If there were no funds available to honor the payment plan during a specific fiscal year, it shall be postponed for the following fiscal year, thus said payment plan shall be automatically extended for the number of unpaid installments.

(h) If the Director of the Office of Management and Budget determines that the budget of the agency may cover the payment plan arising from a judgment issued against it, he/she shall thus notify the agency, which shall make the adjustments and negotiations needed to defray the same from its own budget, without the need for an additional appropriation of funds. In these cases, the filing of a request for additional funds with the Office of Management and Budget shall not be allowed.

(i) The Commonwealth, a public corporation or municipality shall not make any payment whatsoever unless the creditor of the judgment provides an official certification issued by the pertinent agency stating that the creditor has no outstanding debt with the Department of the Treasury, the Municipal Revenues Collection Center, and the Child Support Administration. In the event that the creditor of the judgment has an outstanding debt with any agency, entity or public corporation of the Commonwealth, or with a municipality, the amount of said debt shall be deducted from the total amount to be paid. In the event that the creditor of the judgment has requested an administrative review of the debt, the Government of the Commonwealth of Puerto Rico, the public corporation or the municipality, as the case may be, shall refrain from making any payment whatsoever until the review process has concluded. If the existence of the challenged debt is confirmed, the amount thereof shall be deducted from the total amount to be paid.

These provisions shall apply to the Municipalities, which shall establish through a municipal ordinance the adequate parameters for the implementation thereof, in accordance with the provisions of subsections (a), (b), (c), (d), (e), (f), (g), and (i) of this Section.

The payment plans for judgments issued by virtue of this Section, as well as the provisions thereof, shall remain in effect for the time frame established in the payment plan, and shall not be affected or invalidated by the expiration of the effectiveness of this Act.

Section 29.- Actions against the Commonwealth, Municipalities, and Officials.

No agency or instrumentality of the Commonwealth, or public corporation or municipality, official or employee shall be compelled to make any payment whatsoever with respect to a previously authorized judgment or payment plan, when there are no funds available therefor when the legislative appropriation for such purposes has been exhausted; therefore, the garnishment of funds to enforce a judgment issued against the Commonwealth is hereby prohibited. The determination of lack of funds to make said payment shall be certified by the agency or instrumentality of the Commonwealth, public corporation or municipality in question and, in the event that such funds are appropriated by the Legislative Assembly, including those from the General Fund, it shall be confirmed by the Office of Management and Budget, whose determination with regard thereto shall be final.

The remedy available when there are no funds available for the payment of judgments shall be the payment of interest on the amount owed pursuant to the provisions of the Rules of Civil Procedure and the applicable special laws.

The provisions of this Section shall also apply to Municipalities.

Section 30.- Substantive Rights.

The provisions of this Chapter shall not create substantive rights or any causes for action not existing prior to its approval.

CHAPTER V.- FINAL PROVISIONS**Section 31.- Prohibition on Retroactive Claims upon the Expiration of the Effective Term of this Act.**

Except as provided in Section 11(c) on cash liquidations of vacation and sick leaves accrued in excess, any commitment or obligation that has been temporarily suspended during the effective term of this Act shall not be retroactively claimed, nor shall constitute any credit whatsoever, once the same becomes ineffective.

Section 32.- Implementation and Rulemaking Authority.

In view of the fiscal emergency, and to enable the implementation of the purposes of this Act, the Office of Management and Budget shall have all the powers necessary and convenient to discharge the duties herein entrusted thereto, including but not limited to promulgating regulations; conducting or directing the agencies or departments under its custody to conduct studies as may be needed; requiring from the Entities of the Executive Branch the information needed to carry out its duties; advising the Governor and the Entities of the Executive Branch on all that pertains to spending control and reduction measures, labor and/or fiscal impact measures of the Entities of the Executive Branch; and evaluating, approving, or denying requests for transfers and details, among others.

Except as provided in Section 17, it is hereby provided as the intent of this Legislative Assembly that the powers conferred to the Office of Management and Budget by virtue of this Special Act shall have priority over the respective organic acts of the Entities of the Executive Branch, as defined herein, whether agencies, instrumentalities, or public corporations. For such purposes, inasmuch as it is pertinent and necessary, it shall be construed that during the effectiveness thereof,

this Special Act modifies, adjusts, or conditions any provision of the respective organic acts of the Entities of the Executive Branch in order to comply with the mandates of this Act.

Therefore, the Office of Management and Budget may establish regulations as are necessary geared to the Entities of the Executive Branch, whether agencies, instrumentalities, or public corporations to implement the provisions of this Act. Any regulations implemented by the Office of Management and Budget by virtue of this Act shall be mandatory. The absence or lack of any regulations authorized hereunder shall, in no case, be grounds for invalidating or failing to apply the provisions of this Act.

Section 33.- Immunity from Lawsuits and Forums.

This Act shall not affect the immunity of the Commonwealth of Puerto Rico, and its employees, or officials with respect to lawsuits and forums. None of the provisions herein authorizes actions for damages against the Commonwealth of Puerto Rico, its employees, or officials for acts or omissions of the latter, resulting from compliance with this Act. None of the provisions of this Act shall be construed as to constitute a waiver to the sovereign immunity of the Commonwealth of Puerto Rico.

Section 34.- Separability.

If any clause, paragraph, subparagraph, article, provision, section, subsection, or part of this Act were held to be unconstitutional by a competent court, the holding to such effect shall not affect, impair, nor invalidate the remainder of this Act. The effect of said holding shall be limited to the clause, paragraph, subparagraph, article, provision, section, subsection, or part thereof thus held to be unconstitutional.

Section 35.- Effectiveness.

This Act shall take effect immediately after its approval.

CERTIFICATION

I hereby certify to the Secretary of State that the following **Act No. 66-2014 (H. B. 1922)** of the **7th Regular Session** of the **17th Legislative Assembly of Puerto Rico**:

AN ACT to create the “Government of the Commonwealth of Puerto Rico Special Fiscal and Operational Sustainability Act,” in order to declare a state of fiscal emergency; devise a plan to deal with the consequences of the fiscal and economic crisis of the downgrading of Puerto Rico’s credit rating; establish a structured management to address this situation; provide for the supremacy of this Act and the applicability thereof; etc.

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

In San Juan, Puerto Rico, on this 24th day of October, 2014.

Juan Luis Martínez Martínez
Acting Director