Commonwealth of Puerto Rico

DEPARTMENT OF LABOR AND HUMAN RESOURCES

November 25, 1998

Re: Inquiry No. 14583

This is in reference to your inquiry pertaining to payroll deductions under Section 5(g) of Act No. 17 of April 17, 1931, as amended. Specifically, you request our opinion on whether employees, on a voluntary basis, may legally participate in a plan to purchase common stock from their employer through payroll deductions. You describe the relevant facts as follows:

> Pursuant to the provisions of the Plan, all eligible employees may contribute a designated amount of their regular weekly, bi-weekly, semimonthly or monthly pay for each payroll period. Participation in the Plan is voluntary and contributions are to be made through payroll deductions. All employee contributions will be after-tax.
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> Pursuant to the terms of the Plan, the contributions will be credited to an employee account under the Plan. All the payroll deductions will be used to buy [the company's] common stock at a purchase price equal to 85% of the closing market price reported by the New York Stock Exchange, either on Friday, October 23, 1998 or on Friday, October 22, 1999, whichever is lower. All the stocks acquired will be deposited in an individual broker account that will be open[ed] on behalf of each employee.

> An eligible employee who has elected to purchase shares may cancel his selection in its entirety or may partially cancel his election by reducing the amount which he has authorized [the company] to withhold from his [wages] for each payroll period.

Also included with your letter is a copy of the plan and a draft of the election to buy shares through which the employee would authorize the company to make the payroll deductions. You also state the following:

> In addition to the benefits granted under the Plan, [the company] offers its Puerto Rico employees the benefits of a savings plan intended to meet the requirements of Section 1165(e) of the Puerto Rico Internal Revenue Code of 1994, as amended (the "Code"). Under this savings plan, participating employees may contribute, through payroll deduction[,] an amount not in excess of the maximum amount allowed by the Code to be taken as a deduction. [The company] also make[s] contributions to the plan based on participant's contributions. The contributions are transferred to a trust.
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> Finally, [the company] also provides to its Puerto Rico employees a medical plan that includes Basic Life, Accidental Death and Dismemberment. The premiums for the plan are paid by [the company].

After summing up the terms of the proposed plan, you explain, among other things, the following:

> The general rule in Puerto Rico is that employers may not deduct or withhold any part of an employee's salary unless the deduction falls into one of the exceptions authorized by Section 5 of Act No. 17 of April 17, 1931, as amended ("Act 17") even if the employee requests the payroll deduction. If an employer does not comply with Act 17, it would be liable for a penalty of twice the amount illegally deducted.

We, also, quote from your letter:

> In the particular case of the Plan, although not a plan specifically enumerated in Section 5(g), its adoption and implementation is certainly addressed to benefit those eligible employees electing to participate. Specifically, the Plan is for the sole benefit of the employees or his dependents or beneficiaries, the employee authorizes [the company] to make the deduction, and [the company] does not receive, take or withhold any part of the amount deducted for its own use or benefit.

In summary, you have requested the Department's approval of the proposed payroll deductions pursuant to the provisions of Section 5(g) of Act No. 17, *supra*. In fact, the Office of the Solicitor of Labor has issued, few years ago, at least two opinions in response to similar inquiries under Act 17. The first was issued on January 20, 1976 in response to Inquiry No. 9971 and dealt with a cancer insurance plan that was intended to supplement the employer's regular health insurance. Although that opinion was issued long before the most recent amendment to Act No. 17, the analysis contained therein is still relevant to understand the questions you pose and the answers before the amendment of 1995. Specifically, the relevant portion of that opinion states the following:

> Payroll deductions in Puerto Rico are regulated by Act No. 17 [....]. With respect to deductions for medical plans, subsection (g) of the aforementioned law provides that the employer must contribute an amount not less than that contributed by the employee for the payment of health insurance premiums, hospitalization and other plans or combination of these. This statement of law means that in the event that there is only one plan, the employer must contribute at least fifty percent of the cost of the premium, but should there be a combination of plans, the employer's obligation is limited to contributing only fifty percent of the aggregate cost of of the premiums for the payment of the combined plans; that is, the employer does not have to make any particular contribution for each individual plan as long as he contributes at least half the cost of the combined plans.
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> In the case you describe in your letter, the employer may deduct from his employees[' wages] for the Cancer Insurance [policy], even if he makes no contribution whatsoever to said policy as long as he contributes not less than half the cost of the combined premiums for which the employees make some contribution.
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> You should be advised that our opinion is based on general principles of law without reference to the employment contract between the parties. Should the proposed deductions be in conflict with the existing job conditions, the employment contract must be renegotiated. Furthermore, it is our assumption that the affected employees are not covered by a collective bargaining agreement. If the employees are not covered by a CBA, the insurance plans must be approved by the Secretary of Labor [and Human Resources]. [our translation]

The principle on which this response is based was reiterated on September 22, 1976 in response to Inquiry No. 10114, which involved a medical plan that was wholly funded by the employer and that covered the firm's employees, but not the employees' dependents. The employees, who were covered by a CBA, were willing to pay the additional premiums in order to extend the plan to cover their dependents. Our response was as follows:

> The insurance company is willing to admit family members of the bargaining unit employees into the plan, but the employees would have to pay the corresponding premium. The problem that now comes up is to determine whether the employer may legally make payroll deductions from bargaining unit employees['s wages] that are earmarked for the payment of medical insurance premiums for their family members.
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> The general principle is that the employer may not make any payroll deduction from an employee['s wages] other than those specifically authorized by law. Subsection 5(g) of Act No. 17 [....], which regulates the employment contract, authorizes payroll deductions when the employee has authorized his employer in writing to withhold from his salary a sum stipulated in a CBA for payment of any health and hospitalization plan or policy or any combination of such plans, among others, but for the sole benefit of the employee and/or his dependents or beneficiaries and provided the employer contributes an amount not less than that contributed by the employee. The other requirements set forth in the statute must also be complied with.
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> On the basis of the legal provisions examined, the employer may legally deduct from [the wages of] the bargaining unit employees for the payment of the medical premiums corresponding to the dependents of said employees, provided the total amount withheld from the employees for such plans, including the amount contributed for the benefit of their dependents, does not exceed the total amount contributed by the employer for said plans. [our translation]

Those were interpretations of Act No. 17 before the amendment of 1995. The amendment of such statute now clearly allows for the application of the federal statue Employee Retirement Income Security Act of 1974, "ERISA" (29 USC 1001 et seq.) based on the doctrine of "preemption". It appears that Act No. 17 did not have enough flexibility to allow for the purchase of stocks by employees. Now the situation is different and the applicable law does not depend only on Act 17.

With respect to deductions from wages to pay health plans, pension plans, savings plans and others, which are covered by ERISA, the employers in Puerto Rico are authorized, by the amendment to Act No. 17 (supra), to effectuate such deductions in a different manner to employees that are not covered by ERISA. For employees that are not covered by ERISA the employer shall contribute with an amount which is more or at least equal to the amount paid by the employee. Such requirement is not applicable with respect to those plans convered by ERISA. Reference is made to the book, in the Spanish language, "Apuntes Para El Estudio De La Legislación Protectora Del Trabajo En El Derecho Laboral Puertorriqueño", Edition of 1998, Page 198, whose Author is the Exsecretary of Labor and Human Resources, Attorney Ruy N. Delgado Zayas.

With respect to those deductions which are allowed or permitted by Act No. 17, as amended, in 1995, by Act No. 74 of June 30, 1995, Article 3 of the same added a subparagraph to Section 5 which states that outside of those situations enumerated in the Section no employer shall deduct, or retain, for any motive, a portion of the salary paid to the employees except when it is a contribution of the employee to any plan which is covered by the provisions of ERISA.

The local statue (Act No. 17) , as amended, recognizes the application of the doctrine of preemption, and allows for such application, when any plan is covered by ERISA. The words "any plan" are very broad in their meaning and in their application, Deductions are permitted when ERISA applies, which deductions may not be permitted under Act 17.

An analysis related to Act No. 17 (supra) reflects that there is absolute silence with respect to a clear and express prohibition as to the purchase of stocks of an enterprise by employees of the company. The opinions of the Department of Labor in the past have been based on a broad principle which states that if something is not included in a statute then it is understood to be excluded; therefore, employees were prohibited from purchasing stocks from their own company. That was the interpretation of the past.

But a closer look at the provisions of Act No. 17, as amended in 1995, reflects that nothing is contained with respect to a prohibition of purchase of stocks by the employees of a company.

In addition we have detected that most of the provisions of Act No. 17 are in the nature of a criminal statute. The results of violations of some provisions of such statute are confinement in jail and/or penalties (See Paragraph (j)(2), (3) and (5) of Act No. 17 as an example). If something is not prohibited, then it is permitted, based upon the principle applicable to criminal statutes that behavior must first be forbidden and the corresponding range of criminal sanctions predetermined before an act or omission can be used as the basis for criminal liability and accountability. Clark and Marshall, Law of Crimes, Pages 29, 30, Wingersky Revision. If the purchase of stocks by employees is not prohibited then it should be permitted based upon the principle above-stated, if such statute is viewed in the nature of a criminal statute. We wonder how such principle interacts with the first principle mentioned above that what is not included is excluded which is applied when the statute is viewed in the nature of a civil statute.

In any event, it is our position that the purchase of stocks by employees of a company qualifies as contributions of employees to "any plan" covered by ERISA; and the words "any plan" are broad enough to include a combination of health plan, retirement or pension plan, purchase of stocks and others. It is, also, our position that the doctrine of preemption by ERISA, in this matter, is applicable.

If preemption applies, in your particular case, then there is no problem related to the provisions of Act No. 17 (supra). The federal statute mentioned above, referred to as ERISA; broadly preempts any and all state laws insofar as they relate to plans covered by the Act.

Prior to ERISA, state laws largely governed employee benefit plans. Because of the interstate nature of many plans and given the potential inconsistency between state laws, a need for federal preemption was perceived to be a necessary part of comprehensive federal regulation of employee benefit plans. The Conference Committee of the U. S. Congress produced a version of the statute (ERISA) which preempted any laws insofar as they may now or hereafter relate to any employee benefit plan covered by ERISA. Such Committee extended preemption well beyond matters regulated by ERISA. As a result of such extension, then Section 514 has been held to preempt state laws which neither are in conflict with nor duplicate ERISA provisions.

The legislative statements related to ERISA stress the extreme breadth of the preemption provision finally adopted.

Section 514(a) (29 USC 1144) provides that the provisions of Title I and Title IV of ERISA "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan" covered by the Act. Section 514(c) defines the terms "State law" and "State" very broadly. Judicial decisions constitute a "state law". The term "State" includes Puerto Rico (29 USC 1002[10]).

Act No. 17 (supra) of Puerto Rico does not "regulate" insurance, banking or security. It is in the nature of a labor-management relations statute. ERISA provides in Section 514(b)(2)(A) that nothing in it shall be construed to exempt or relieve any person from any law of any State which "regulates" insurance, banking or securities. As stated above Act No. 17 (supra) does not fall with such categories of a statute.

A plan covered by ERISA shall not be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate such companies.

The scope of preemption, under ERISA, depends on an interpretation of the words "relate to" in Section 514's clause preempting state laws which relate to plans covered by the Act. If "relate to" is interpreted to mean something akin to "direct regulation" the scope of preemption by ERISA will be limited to "mini-ERISAs". On the other hand, if "relate to "is read broadly, it is likely that preemption will be found to exist even as to matters which ERISA in no way purports to regulate, such as community property laws.

With respect to the application of ERISA, it is provided in Section 1003 that the same "shall apply to any employee benefit plan if it is established or maintained:

(1) by an employer engaged in commerce or in any industry or activity affecting commerce; or
(2) by any employee organization or organizations representing employees engaged in commerce or in any industry or activity affecting commerce; or
(3) by both."

Subparagraph (b) of the same Section 1003 provides as follows:

"The provisions of this subchapter shall not apply to any employee benefit plan if

(1) such plan is a governmental plan (as defined in section 1002 (32) of this title);

(2) such plan is a church plan (as defined in section 1002 (33) of this title) with respect to which no election has been made under section 410(d) of title 26;

(3) such plan is maintained solely for the purpose of complying with applicable workmen's compensation laws of unemployment compensation or disability I insurance laws,

(4) such plan is maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens; or

(5) such plan is an excess benefit plan (as defined in section 1002(36) of this title and is unfunded."

Section 1002 (36) of ERISA provides the following: "The term 'excess benefit plan' means a plan maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations on contributions and benefits imposed by section 415 of Title 26 on plans to which that section applies without regard to whether the plan is funded. To the extend that a separable part of a plan (as determined by the Secretary of Labor) maintained by an employer is maintained for such purpose, that part shall be treated as a separate plan which is an excess benefit plan". We do not see any indications that the plan of The Home Depot, Inc., is an excess benefit plan and that is is unfunded. In addition, we have not detected that such plan may qualify as governmental, church plan, solely to comply with workmen's or unemployment compensation, or disability insurance law, or for the benefit of nonresident aliens. The documents submitted for our study indicate that The Home Depot, Inc. is a company that is in the interstate commerce, or that it is affecting the interstate commerce. With respect to an employee "stock ownership plan", we found that such plan is the only type of qualified plan that is exempt from the general prohibited-transaction rules under Section 406 of ERISA. See: Employee And Union Member Guide To Labor Laws, Page 10-34, Section 10.02 (12), Published by National Lawyers Guild.

In the Report of the House of Representatives of Puerto Rico (P de la C 1927) of June 22, 1995, we found, at Page 7, that the project recognizes the application of ERISA which regulates the health and pension plans for employees in the private sector. At present time, says the report, there are some benefits that cannot be made extensive to many employees in Puerto Rico because those plans do not comply with the requirements of Section 5 (g) of Act 17. Therefore, the employers simply do not provide for such benefits. Some employers violate the local law.

In the case of New York Blue Cross Plans v. Travelers Insurance, 1995 U. S. Lexis 3038 of April 26, 1995, (115 S. Ct. 1671; 131 L.Ed.2d.695; 63 U.S.L.W. 4372) the Supreme Court of the United States, in a unanimous decision, explained that the local statutes (of the states) that have an indirect economic effect over ERISA will be preempted under Section 514 (a), 29 USCA Sec. 1144(a), which provides that state law related to any employee benefit plan, will be preempted, due to the fact that such particular aspect will be considered as preempted by ERISA.

In the report submitted by the President of the Chamber of Commerce of Puerto Rico, Mr. Frank Unanue, to the Senate of Puerto Rico, dated June 1, 1995, the Chamber of Commerce expressed that at the present time there are many multinational enterprises that have excellent saving plans, purchase of stock plans and others of a similar nature, and they cannot be made extensive to Puerto Rico due to the requirements of Act No. 17, which makes the application of such plans impossible. Such situation is against the best interest of the employees of such enterprises he stated. In addition, such provisions of Act No. 17 are in conflict with ERISA in a field that is clearly preempted by the Federal Statute.

The report of the Manufacturers Association, by Mr. Héctor Jiménez Juarbe to the Senate, dated June 1, 1995, expressed, at Page 3, that the project with respect to Act No. 17, will armonize said statute with ERISA, due to the fact that all state legislation was left without effect, within the same field, with the approval of ERISA. Therefore, Act No. 17, will be left without any effect, at all, when it contravenes ERISA.

The position submitted by CPA Jorge E. Aponte, by means of a letter dated June 1, 1995 to the Senate of Puerto Rico, in representation of the Bureau of Budget (Oficina de Presupuesto y Gerencia) explains that the provisions of Act No. 17 contravene the provisions of ERISA which regulate everything related to benefit plans; and he concludes that such provisions of Act No. 17, that are in conflict with ERISA, must be overruled or eliminated from the local statute. Such action is necessary due to the changes and modernization in the banking systems and actual circumstances.

The position of the Department of Commerce and Economic Development, then represented by Attorney Luis G. Fortuño, in a letter to the Senate of Puerto Rico, dated June 2, 1995, explains that Project 1145, of the Senate, to amend Act No. 17, will allow or permit payroll deductions for the payment of health plans, pension plans, saving plans, stocks-purchase plans and others, without complying with the onerous requirements of the local statute that is in conflict with ERISA. (Page 2 of the above-referred letter).

The provision, which is an amendment to Act No. 17, as to benefit plans, recognizes the application of ERISA in Puerto Rico, which regulates, in an exclusive manner, the benefit plans of employees. (Page 7 of the letter referred-to-above). It is Mr. Fortuño's position that Section 514 (a) of ERISA leaves without any effect, or invalidates, all local legislation, (including Puerto Rico Statutes) that regulate any benefit plan of employees. All the provisions of Act No. 17, related to benefit plans of employees, are contrary to the provisions of ERISA (which regulates everything related to such plans). Reference is made to Page 8 of Mr. Fortuño's letter.

The case New York Blue Cross Plans v. Travelers Insurance, 1995 U.S. Lexis 3038; S. Ct. 1671; 131 L.Ed.2d.695; 63 U.S.L.W. 4372; reflects that ERISA preempts state law when benefit plans affect interstate commerce. It controls the administration of benefit plans (29 U.S.C.A. Sec. 1001 (b)) as by imposing reporting and disclosure mandates (29 U.S.C.A. Secs. 1051-1061); funding standards (29 U.S.C.A. Secs. 1101-1114). It envisions administrative oversight, imposes criminal sanctions and establishes a comprehensive civil enforcement scheme (29 U.S.C.A. Secs. 1131-1145). It also preempts some state law (29 U.S.C.A. Sec. 1144).

The case referred-to-above was discussed in detail at the Legislature of Puerto Rico before the amendment to Act No. 17 was approved. It was also understood during the whole discussion of the amendment to Act No. 17 that the intention was to conform and armonize the local statute to ERISA. The local statute (Act No. 17) was finally amended.

The position of the Chamber of Commerce of Puerto Rico at the House of Representative is expressed by means of a letter dated June 12, 1995, from Mr. Frank Unanue to Hon. Julio Lebrón Lamboy. Such letter refers to purchase of stocks and other plans with respect to benefits of employees. Mr. Unanue explains that many plans, including purchase of stocks, cannot be put into effect in Puerto Rico due to the provisions of Act No. 17, which are too restrictive. In addition, he states, such provisions are in conflict with ERISA. In the actual circumstances, under ERISA, employees may benefit from the purchase of company-stocks, among other benefits. Such deductions are not permitted under Act 17, said Mr. Unanue. Flexibility in this aspect, related to benefit plans, is essential.

The position of the Secretary of Justice of Puerto Rico, addressed in a letter dated June 13, 1995 to the House of Representative (Hon. Julio Lebrón Lamboy) with respect to the proposed amendment to Act No. 17 (P. de la C. 1927) is expressed at Page 5, in which

Hon. Pedro R. Pierluisi, then Secretary of Justice, explains that by means of the amendment to Act No. 17, any possible deduction, from the employees' wages, is permitted, to comply with the provisions of ERISA.

Mr. Héctor Jiménez Juarbe addressed a letter to the House of Representative, in representation of the Puerto Rico Manufacturers Association, dated June 13, 1995, in which he states that the local statute (Act No. 17) will be armonized with ERISA if the Project (P. de la C. 1927) is approved.

The legislators of Puerto Rico had all those positions before them at the time of the approval of the amended version of Act No. 17. They know about the extent of the application of ERISA in Puerto Rico and about the doctrine of preemption.

With respect to the doctrine of preemption it is established that a state law may be preempted by an expressed provision of a federal statute, or if there is a conflict between the state and the federal statute. See: Pacific Gas & Electric Co. v. State Energy Resources Conservation And Development Comm'n, 461 U.S. 190, 203-204 (1983). It has been established that preemption does not operate unless the purpose of Congress is clearly manifested Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 724, 740 (1985): Even indirect state action bearing on private pensions may encroach upon the area of exclusive federal concern. See: Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504, 525 (1981). The local statute should not frustrate the Congressional purpose. Luis Acosta, Inc. v. D.A.C.O., 114 D.P.R. 160, 163 (1983); Hines v. Davidowitz, 312 U.S. 52, 67 (1941). ERISA preempts a state law allowing a nonparticipant spouse to transfer by testamentary instrument an interest in undistributed pension plan benefits. See: Boggs v. Boggs, US Supreme Court, No. 96-79 of June 2, 1997, 65 Law Week 4418.

In the case New York Blue Cross Plans v. Travelers Insurance, supra, the U. S. District Court and the U. S. Court of Appeals decided that the state law was in conflict with ERISA as to the provisions related to health plans of employees. The Supreme Court overruled those decisions as to some charges that did not fall within the concept of a "statute related to an employee benefit plan". Anyway, the Supreme Court explained ERISA and the preemption aspect of the same. Section 514 (a) of ERISA, said the Supreme Court, tends to prevent the multiple regulations of such type of benefit plans in order to obtain a uniform administration of them through the Nation.

In the case Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 97 (1983) the Supreme Court concluded that the state law was related to a benefit plan that was exclusively regulated by the Congress.

In the analysis prepared by the Department of Justice, dated June 19, 1995, addressed to the Senate of Puerto Rico, with respect to P. del S. 1145, to amend Act No. 17, it was concluded that preemption may not apply if the state legislation has a remote, light or

peripherical, relation with benefit plans regulated by ERISA. (Case New York Blue Cross Plans v. Traveleres Insurance, supra). The Department of Justice concluded that such is not the case with respect to Section 5(g) of Act No. 17 (supra).

Based upon our analysis of the provisions of ERISA, as well as the provisions of Act No. 17, as amended, it is our conclusion that ERISA preempts Act No. 17, in this particular instance.

In accordance with the above, and on the basis of your representation, it is our opinion that the deductions for the employees benefit plan(s) would be legal. .
may proceed with the payroll deductions.

We trust the foregoing is responsive to your inquiry.

Cordially yours,

Edwin A. Hernández Rodríguez
Acting Solicitor of Labor