Commonwealth of Puerto Rico
DEPARTMENT OF LABOR AND HUMAN RESOURCES

May 24, 1999

Re: Inquiry No. 14631

This is in reply to your inquiry pertaining to payroll deductions under Section 5(g) of Act No. 17 of April 17, 1931, as amended. The purpose of your inquiry is to ascertain whether the provisions of the Act permit the voluntary participation of employees of your client in a plan to purchase common stock 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 made 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. The entire payroll deductions will be used to buy the Company's common stock at the purchase price equal to the lesser of (1) 85% of the Fair Market Value of the Common Stock on the first day of trading of the Opion Period, or (2) 85% of the Fair Market Value on the last trading day of the Option Period.
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> Any employee who has elected to purchase shares may cancel his election in its entirety or may partially cancel his election by reducing the amount which he has authorized the Company to withhold from each of his payroll period[s].
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> In addition to the benefits granted under the Plan, the Company provides its employees the benefits of a Savings Plan as well as the benefits of a medical plan, and life insurance plan. Pursuant to the terms of the savings and medical plans, employer contributions are made on behalf of the employees participating in the plans.

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Enclosed with your letter you submitted a copy of the plan and a draft of the election to buy shares that would authorize the company to make the payroll deductions. In addition, you provide the following discussion:

> 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, from here on "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.
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> The applicable exception in this particular case is Section 5(g) of Act 17, which provides that any employer may execute payroll deductions if the amounts deducted will be used to pay any plan or group, pension, saving, retirement, allowance, annuity life, accident and health and hospital insurance policy, any combination of these plans, or any similar welfare benefit plan provided:
>
> (1) The employee authorizes his employer in writing to make the deduction stating the amounts that may be deducted,
> (2) The Secretary of Labor and Human Resources of Puerto Rico authorizes the plan,
> (3) The plan is for the sole benefit of the employee or his dependents or beneficiaries,
> (4) The employer contributes an amount not less [than] the amount contributed by the employee,
> (6) The payment is made to an insurance company or a trust bank acceptable to the Secretary of Labor and authorized to operate in Puerto Rico under the supervision of the Commissioner of Insurance or the Commissioner of Financial Institutions, as the case may provide,
> (7) The employer does not receive, take or withhold any part of the amount deducted for its own use or benefit,
> (8) The plan provides for the voluntary withdrawal by the employee in a manner consistent with the continuation and due operation of the plan.
>
> In this particular case, the proposed plan is not specifically enumerated in Section 5(g), but its adoption and implementation is certainly addressed to benefit those eligible employees electing to participate. Specifically, the proposed plan complies with Section 5(g) as it is designed for the sole benefit of the employee or his dependents or beneficiaries, the Company is authorized by the employee to make the corresponding deductions, and the Company does not receive, take or withhold any

part of the amount deducted for its own use or benefit.
Although not specifically provided under the Plan, the Company is willing to enter into a trust agreement with a local bank, in which the bank will act as a collection agent, if the payroll deductions are finally approved by the Labor Department in accordance with the provisions under the Plan.

Based on the above mentioned, we hereby request that the deductions to be made under the Plan be authorized pursuant to Section 5(g) of Act 17.

As you are aware, the main obstacle to employee participation in such plans under Act No. 17, *supra*, was the requirement that the employer contribute an amount not less than that contributed by the employee. Accordingly, in the past this Department had invariably rejected any plan that did not meet this requirement. The situation changed with the enactment of Act No. 74 of June 30, 1995, which added a new subsection (l) to Section 5 of Act No. 17, *supra*, a key amendment that provides an exception to the above rule for any plan which is covered by the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 USC 1001 et seq.

In light of this amendment, the Department has reexamined its previous interpretation and has concluded, on the basis of the doctrine of preemption, that the answer to your inquiry no longer depends on Act No. 17 alone. Briefly, the requirement that the employer contribute an amount not less than that contributed by the employee now applies only to plans that are not covered by ERISA. On the other hand, the new Section 5(l), *supra*, does not require any contribution from the employer in the case of any plan covered by ERISA. We construe the words "any plan" as being broad enough in meaning to encompass a plan to purchase company stock by employees of that company.

A close reading of Act No. 17, *supra*, reveals no provision that clearly and expressly prohibits the purchase of company stock by employees of said company. Opinions issued by the Department in the past have relied on the broad principle that if something is not included in a statute, then it is understood to be excluded. Accordingly, the absence of a specific provision authorizing the purchase of company stock was interpreted as prohibiting such purchase.

It appears, however, that most of the provisions of Act No. 17, *supra*, are in the nature of a criminal statute. Violations of certain provisions of the Act are confinement in jail and/or penalties. For example, see paragraphs (j)(2), (3), and (5) of the Act. If something is not prohibited, then it is permitted, in accordance with 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 company stock by an employee is not prohibited, then it should be permitted based upon the aforementioned principle, if such statute is viewed in the nature of a criminal statute. The latter principle, of course, is at odds with the principle that applies to a civil statute, which states that what is not included is excluded.

In any event, it is our position that the purchase of stock by employees of a company qualifies as

employee contributions to "any plan" covered by ERISA, and that the words "any plan" are broad enough to include a combination of health plan, retirement or pension plan, purchase of stock, 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 the provisions of Act No. 17, *supra*, pose no problem. It is clear that ERISA broadly preempts any and all state laws insofar as they relate to plans covered by ERISA.

Before the enactment of ERISA, state laws largely governed employee benefit plans. Given the interstate nature of many plans and the potential conflict between state laws, a need for federal preemption was perceived to be a necessary part of comprehensive federal regulation of employee benefit plans. In enacting ERISA, the Conference Committee of the U.S. Congress worded the statute in such a way as to preempt <u>any laws</u> insofar as they may now or hereafter relate to any employee benefit plan covered by ERISA. The Committee thus extended preemption well beyond matters regulated by ERISA. As a result of that extension, Section 514 of ERISA has been held to preempt state laws which neither are in conflict with or duplicate ERISA provisions.

Pursuant to Section 514(a) (29 USC 1144), 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. It should also be noted that Section 514(c) defines the term "State law" and "State" very broadly. For example, judicial decisions constitute a "State law", and the term "State" includes Puerto Rico (29 USC 1002[10]).

Puerto Rico Act No. 17, *supra*, does not "regulate" insurance, banking, or security, being 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 previously noted, Act No. 17, *supra*, does not fall into any of the foregoing categories. 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-ERISA's". 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, Section 1003 provides that the Act "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 or unemployment compensation or disability 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.

ERISA Section 1002 (36) 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 extent 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 find no indication that your client's plan is an excess benefit plan or that it is unfunded. Similarly, your client's plan does not appear to qualify as a governmental or church plan or that it is maintained solely to comply with workmen's or unemployment compensation or disability insurance laws, or for the benefit of nonresident aliens. The documents submitted for our review indicate that your client's company is in interstate commerce or that it affects interstate commerce. With respect to an employee "stock ownership plan", we find 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, pages 10-34, Section 10.02 (12), published by National Lawyers Guild.

It should also be noted that at the time of enacting the most recent amendments to Act No. 17, *supra*,

Puerto Rico's House of Representatives recognized the applicability of ERISA to the regulation of health and pensions plans in the private sector. See page 7 of the House Report dated June 22, 1995 on P. de la C. 1927, the bill that became Act No. 74, *supra*, amending Act No. 17, *supra*. According to the report, at present there are some benefits that cannot be extended to many employees in Puerto Rico because such benefits are incorporated in plans that do not comply with the requirements of Section 5(g) of Act No. 17, *supra*. Therefore, employers simply refrain from providing such benefits. In other cases, employers violate local law, perhaps unwittingly.

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 U.S. Supreme Court in a unanimous decision ruled 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). The aforementioned section provides that state law related to any employee benefit plan will be preempted, since that particular aspect is by definition preempted by ERISA.

Also relevant is the report submitted on June 1, 1995 to Puerto Rico's Senate by Mr. Frank Unanue, then President of the Chamber of Commerce of Puerto Rico. In that report, the Chamber of Commerce noted that at present there are many multinational enterprises that have excellent savings plans, stock purchase plans, and others of a similar nature that cannot be extended to employees in Puerto Rico because of the restrictions imposed by Act No. 17, *supra*. The Chamber of Commerce argued that such restrictions are against the best interests of employees of such enterprises. In addition, it was noted that those provisions of Act No. 17, *supra*, are in conflict with ERISA in a field that is clearly preempted by the federal statute.

A similar position was assumed by Mr. Héctor Jiménez Juarbe, then Executive Vice President of the Puerto Rico Manufacturers Association in his report to the Senate dated June 1, 1995. On page 3 of that report, it is stated that the bill to amend Act No. 17, *supra*, would harmonize said statute with ERISA, since all state legislation in that field was preempted with the enactment of ERISA. In other words, those provisions of Act No. 17, *supra*, that contravene ERISA are preempted by the federal statute.

Also in agreement with that position is Puerto Rico's Office of Management and Budget, as expressed by CPA Jorge E. Aponte, then Director of that office, in his letter to the Senate of June 1, 1995. Mr. Aponte states that the provisions of Act No. 17, *supra*, contravene the provisions of ERISA that regulate everything related to benefit plans, and concludes that such provisions of the local law must be overruled or repealed. In the opinion of the Office of Management and Budget, such changes are required to attune our laws to modern banking systems and current circumstances.

Also supporting the foregoing interpretations was the Department of Commerce and Economic Development, represented by its Secretary, the Hon. Luis G. Fortuño, in a letter to the Puerto Rico Senate dated June 2, 1995. As stated by Mr. Fortuño, the intent of Senate Bill 1145 was to amend Act No. 17, *supra*, to authorize payroll deductions for the payment of health plans, pension plans, savings plans, stock purchase plans and others, without complying with "the onerous requirements"

of the local statute that are in conflict with ERISA. See page 2 of Mr. Fortuño's letter.
The case New York Blue Cross Plans v. Travelers Insurance, *supra*, reflects that ERISA preempts state law when benefit plans affect interstate commerce. It controls the administration of benefit plans (29 USCA Sec. 1001(b)) as by imposing reporting and disclosure mandates (29 USCA Secs. 1051-1061); funding standards (29 USCA Secs. 1101-1114). It envisions administrative oversight, imposes criminal sanctions, and establishes a comprehensive civil enforcement scheme (29 USCA Secs. 1131-1145). It also preempts some state laws (29 USCA Sec. 1144).

The above case was discussed in detail at the Puerto Rico Legislature before the amendment to Act No. 17, *supra*, was enacted. It was also understood throughout the discussion that led to the amendment that the legislative intent was to conform and harmonize the local statute to ERISA.

Puerto Rico's Chamber of Commerce reiterated its position in Mr. Frank Unanue's letter of June 12, 1995 to the Hon. Julio Lebrón Lamboy, Chairman of the House Labor and Veterans' Affairs Committee. Referring to purchase of stock and other employee benefit plans, Mr. Unanue states that the overly restrictive provisions of Act No. 17, *supra*, make it impossible for employees in Puerto Rico to take advantage of many of those plans. Mr. Unanue also argues that those provisions are in conflict with ERISA. As Mr. Unanue points out, the provisions of ERISA at present allow employees to purchase stock from their employer's company, among other benefits, whereas Act No. 17, *supra*, does not permit payroll deductions for that purpose. Thus, Mr. Unanue argued that the lack of flexibility in legislation pertaining to employee benefits works to the detriment of the employees' best interests.

Also supporting the proposed amendment was Puerto Rico's then Secretary of Justice, the Hon. Pedro R. Pierluisi, in his letter of June 13, 1995 to the Hon. Julio Lebrón Lamboy, Chairman of the House Labor and Veterans' Affairs Committee. On page 5 of his letter, Mr. Pierluisi states that through the amendment to Act No. 17, *supra*, any possible deduction from the employees' wages is permitted to comply with the provisions of ERISA.

On behalf of the Puerto Rico Manufacturers Association, Mr. Héctor Jiménez Juarbe also addressed the House of Representatives in regard to this issue in his letter of June 13, 1995. Mr. Jiménez states that the amendment to Act No. 17, *supra*, if approved, would have the effect of conforming the local statute to ERISA.

Puerto Rico's lawmakers had all the foregoing positions before them at the time the amendment to Act No. 17, *supra*, was enacted. They were also aware of the extent of the application of ERISA in Puerto Rico and of the doctrine of preemption.

With regard to the doctrine of preemption, it is well-settled that a state law may be preempted by an express 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 Commission, 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, U.S. Supreme Court, No. 96-79 of June 2, 1997, 65 Law Week 4418.

In the case of New York Blue Cross Plans v. Travelers Insurance, *supra*, the U.S. District Court and the U.S. Court of Appeals ruled that the state law was in conflict with ERISA as to the provisions regarding employee health plans. 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". The Supreme Court went on to explain ERISA and its preemption aspect. According to the Supreme Court, Section 514(a) of ERISA tends to prevent the multiple regulations of such type of benefit plans in order to obtain a uniform administration of those plans on a nationwide basis.

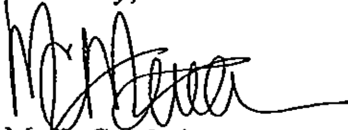
In the case of Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 97 (1983), the Supreme Court concluded that the state law was related to a benefit plan that was exclusively regulated by the Congress.

In the analysis prepared by the Department of Justice, dated June 19, 1995 and addressed to the Puerto Rico Senate, with respect to the bill to amend Act No. 17, *supra*, it was concluded that preemption may not apply if the state legislation has a remote, light, or peripheral relation to benefit plans regulated by ERISA. New York Blue Cross Plans v. Travelers Insurance, *supra*. The Department of Justice concluded that such is not the case with respect to Section 5(g) of Act No. 17, *supra*.

On the basis of our analysis of the provisions of ERISA, as well as the provisions of Act No. 17, *supra*, as amended, it is our conclusion that ERISA preempts Act No. 17 in this particular instance. Accordingly, on the basis of your representation of the proposed stock purchase plan, it is our opinion that payroll deductions for the employee benefit plans would be legal. Your client may thus proceed to make the payroll deductions subject to the specified conditions.

We trust the foregoing is responsive to your inquiry.

Cordially,



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