GOBIERNO DE PUERTO RICO

DEPARTAMENTO DEL TRABAJO Y RECURSOS HUMANOS

May 20, 2000

Re: Inquiry No. 14755

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 obtain our opinion on whether a client of your law firm may legally implement a plan whereby employees of said client, on a voluntary basis, may purchase common stock from their employer through payroll deductions. The relevant facts, as described in your letter, are as follows:

> [Our client] established the Plan effective January 1, 1996. The purpose of the Plan is to provide employees of the Designated Subsidiaries outside the United States with the opportunity to purchase Common Stock of [the company] through regular and voluntary payroll deductions. [Our client] believes that employee participation in its ownership will be to the mutual benefit of both the employees and [the company], and will allow the employees to benefit from [the company's] success, as measured by the increase in the stock price.
>
> The Plan will be administered by the Board of Directors of [the company] or a committee of members, appointed by [the company's] Board of Directors.

You further indicate that under the proposed plan your client's employees would be able to purchase common stock at a discounted price which "shall be the lower of (i) 85% of fair market value of a share of [the company's] Common Stock on the Enrollment Date; or (ii) 85% of the fair market value of a share of [the company's] common stock on the Exercise Date."

Under the proposed plan, the number of shares purchased by each employee would be

deposited into a Plan Share Account held by an independent brokerage firm authorized to do business in Puerto Rico and supervised by the Puerto Rico Commissioner of Financial Institutions.

The proposed plan further provides that any employee may voluntarily terminate participation in the plan, with payroll deductions discontinued upon receipt of such notice.

Your client's rationale for establishing the plan is summed up as follows:

II.
PROPOSED TRANSACTION

> [Our client] understands that in order to offer participation in the Plan to the employees of the PR-Affiliates, it must obtain authorization from the Puerto Rico Department of Labor and Human Resources ("Labor Department"), under Section 5 (g) of Act No. 17, to deduct from each Eligible Employees paychecks their voluntary contributions to the same. [Our client] believes that its ability to attract and retain the best personnel in its PR-Affiliates, and its ability to market jobs at the PR-Affiliates as appealing and valuable, could be impaired unless it obtains an authorization from the Labor Department under Act No. 17 to allow for the voluntary participation of the employees of the PR-affiliates in the Plan through payroll deductions. It is [our client's] wish to give its employees at the PR-Affiliates the opportunity to elect to purchase [the company's] Common Stock through payroll deductions, just as its employees in the U.S. and several other countries presently have.

CONTENTION IN SUPPORT OF THE
PROPOSED TRANSACTION

> The authorization from the Labor Department under the provisions of Section 5 (g) of Act No. 17 to permit the voluntary participation of Puerto Rico employees of United States companies engaged in trade or business in Puerto Rico in a plan to purchase Common Stock through voluntary payroll deductions: (i) will promote the establishment of employee stock purchase plans for the benefit of employees in Puerto Rico; (ii) will ensure that employees in Puerto Rico are provided with opportunities similar to those of their counterparts in the United States and other foreign jurisdictions; and (iii) will ensure that employees in Puerto Rico receive a benefit from their participation in the growth and the success of the companies they work at.

Following the above, you sum up the constraints that Act No. 17, *supra*, imposes upon employers when making payroll deductions from their employees' wages:

The general rule in Puerto Rico under Section 5 of Act No. 17 is that employers may not deduct or withhold any part of an employee's compensation, even if the employee voluntarily requests for the payroll deduction, unless such deduction is specifically excepted under Act No. 17.

One of these exceptions is found under Section 5 (g) of Act No. 17. Said Section permits employers to execute payroll deductions if such amounts deducted will be used to ". . . pay any plan or group, . . . or any combination of plans", provided certain requirements are met by the employer.

In the instant case, the Plan complies with all, but two, of the requirements mentioned under Section 5 (g) of Act No. 17, as follows:

a. Participants authorize [the company] in writing to make the deductions, and state the percentage of their compensation that may be deducted.

b. The Plan is one expected to be authorized by the Secretary of Labor and Human Resources of Puerto Rico.

c. The Plan is for the sole benefit of the employee or his dependent[s] or beneficiaries.

d. [The brokerage firm], which is authorized to operate in Puerto Rico through an affiliate, and which is under the supervision of the Commissioner of Financial Institutions, is the custodian of the Participants' Plan Share Accounts, established to hold the shares that each Participant purchased pursuant to the Plan until withdrawn, sold or transferred.

e. [The company] will be the custodian of each Participant's Account.

f. Finally, the Plan provides for the voluntary withdrawal by the employee in a manner which is consistent with the continuation and due operation of the Plan.

As you acknowledged above, the plan is represented as complying with all but two of the provisions of Section 5(g), *supra*, which you sum up as follows:

> The Plan, like most employee stock purchase plans, does not provide for employer contributions in an amount equal [to] or greater than the employee's contribution, as required under item (4) of Section 5 (g) of Act No. 17. According to the Plan, [the company] is not required to set apart and directly contribute the aforementioned amounts. Instead, and pursuant to the provisions of the Plan, [the company] provides those Eligible Employees who are Participants of the Plan, with the opportunity to purchase its Common Stock at the lower of the fair market value of a share of [the company's] Common Stock on the Enrollment Date or the fair market value of [the company's] Common Stock on the Exercise Date. [The company] also provides Participants a 15% discount, off the purchase price of the Common Stock during said period. Said difference between the market price and the price at which Plan Participants may purchase the stock is paid for by [the company] or the Designated Subsidiary. [The company] is therefore indirectly contributing to the Plan, an amount equal to 15% discount on behalf of the Participants. The discount constitutes savings for Participants, since he or she would otherwise have to pay it in other circumstances. Under the Plan, every cent of the amounts deducted from the Eligible Employees' compensation goes into purchasing Common Stock of [the company]. Finally, it must be noted that [the company] or the PR-Affiliate already contributes to, and in some cases is fully responsible for, a number of benefit plans provides to its employees, such as:
>
> a. Short and Long-Term Disability Insurance,
>
> b. Life Insurance
>
> c. Accidental Death and Dismemberment insurance,
>
> d. Medical insurance, including dental and prescription drugs.

After the above acknowledgment and enumeration of benefits provided by your client to its employees, you submit the following analysis of the wording of Section 5(g), *supra*:

> A close reading of Act No. 17 reveals no provision that clearly and expressly prohibits the purchase of company stock by employees of said company. In absence of such a prohibition, the restrictions under Act No. 17 should be interpreted to make it possible for employees in Puerto Rico to take advantage of the very excellent benefits and plans, including stock purchase plans, that are presently being offered by many multinational enterprises

such as [our client] to its United States employees, and even employees in foreign countries. The apparent restrictions imposed under Act No. 17 may carry the consequence that stock purchase plans, and other plans of a similar nature, could not be extended to many employees in Puerto Rico, because such benefits are incorporated in plans that do not comply with all of the requirements mentioned under Section 5 (g) of Act No. 17. We thus submit that such restrictions, if true and applicable, are against the best interests of employees in Puerto Rico. Any lack of flexibility in the interpretation of the restrictions under Act No. 17, that would exclude stock purchase plans such as this Plan, would work to the detriment of employees in Puerto Rico, since employers would simply refrain from providing the above mentioned benefits to local employees.

On the other hand, if employees in Puerto Rico are allowed to choose, and designate an amount of their compensation to be deducted and contributed to the Plan for purposes of purchasing company stock, more employers will offer stock purchase plans to their Puerto Rico employees. Employers will have an incentive to establish and/or continue operating such stock purchase plans as part of their compensation package for employees. In this way, they will accomplish their goal of attracting and retaining the best personnel, which should result in an increase in the company's productivity. This, in turn, will promote the public policy of the government of Puerto Rico of encouraging the establishment of employee benefit plans in the island, and will provide a greater number of Puerto Rico employees with the opportunity to accumulate funds for their retirement.

Additionally, the more similar the rules in Puerto Rico and the United States, the simpler it will be for United States corporations doing business in Puerto Rico, such as [our client], to extend participation in their many benefit plans (i.e., stock purchase plans) to their Puerto Rico employees. Furthermore, permitting the establishment of such plans in Puerto Rico, through voluntary payroll deductions, will cause employees in the island to become more similarly situated to their counterparts in the United States and other countries.

RULING REQUEST

Based on the facts, circumstances and reasons expressed above, we respectfully request that an administrative determination be issued under Section 5 (g) of the [sic] Act No. 17 authorizing [our client] to deduct from the compensation paid to its Puerto Rico employees, an amount voluntarily

> elected and stated by such Puerto Rico employee, for its further contribution to the Plan, with the sole purpose of purchasing [the company's] Common Stock according to the provisions of the Plan.

As you are aware, the most recent amendment to Act No. 17, *supra*, was enacted by the Puerto Rico Legislature with the approval of Act No. 74 of June 30, 1995. One of the most significant areas affected by said amendment was Section 5(g), which authorizes payroll deductions for "any plan or group, pension, saving, retirement, allowance, annuity life, life, accident and health and hospital insurance policy, any combination of these plans, or any similar social security plan authorized by the laborer" subject to the provision that the employer contribute "with a sum not less than the sum contributed by the laborer". A new Section 5(l) was added to Act No. 17, *supra*, allowing for payroll deductions "for any plan subject to the provisions of the Employee Retirement Income Security Act of 1974, known as ERISA.", 29 U.S.C. 1001 et seq.

Our reading of the amended act has led us to conclude that the restrictions on payroll deductions now apply in a different manner in the case of plans covered by ERISA. Plans that are not covered by ERISA continue to be subject to the requirement that the employer must contribute "with a sum not less than the sum contributed by the laborer". In the case of plans that are covered by ERISA, however, the new Section 5(l), *supra*, makes no mention of any such restriction.

Prior to the enactment of ERISA, state laws largely governed employee benefit plans Because of the interstate nature of many plans and the scenario of conflicting state laws, it became increasingly evident that there was a need for federal preemption as part of a comprehensive federal regulation of employee benefit plans. The result was the enactment of ERISA in 1974, which as drafted by the Conference Committee of the U.S. Congress preempted any laws "insofar as they may now or hereafter relate to any employee benefit plan covered by ERISA". In the process, the Conference Committee extended preemption well beyond matters regulated by ERISA. In accordance with that legislative intent, ERISA Section 514 of the Act has been held to preempt state laws which neither conflict with or duplicate ERISA provisions.

The legislative history of ERISA plainly indicates the extreme breadth of the preemption provision that was finally adopted. 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. Section 514(c) defines the terms "State law" and "State" very broadly. 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 securities. It is in the nature of a labor-management relations statute. ERISA Section 514(b)(2)(A) provides 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 mentioned, Act No. 17, *supra*, does not fall into any of these 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 the 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 narrowly interpreted to mean something in the nature of "direct regulation", ERISA's scope of preemption will be limited to "mini-ERISA's". On the other hand, if "relate to" is read broadly, which appears consistent with the express legislative intent, 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.

In order to determine whether your client's proposed plan is covered by ERISA, we must refer to Section 1003 of the Act, which states that its provisions "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 Section 1003, *supra*, 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 unfounded.

The term "excess benefit plan" is defined in ERISA Section 1002 (36) as follows:

> 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.

Your letter clearly states that your client is "an employer engaged in commerce" and is thus covered by ERISA. Furthermore, there is no indication in your letter that your client's proposed plan is an excess benefit plan or that it is unfounded. In addition, it does not appear that said plan would qualify as a governmental or church plan, or that it is maintained solely to comply with workmen's compensation or disability insurance laws, or for the benefit of nonresident aliens. We find that an employee "stock ownership 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.

We have also reviewed the legislative history that led to the adoption of the most recent amendments to Act No. 17, *supra*, in which the issue of ERISA preemption was discussed at length. Specifically, the Report of the House of Representatives of Puerto Rico on the bill (P. de la C. 1927) that led to the enactment of the amendments, dated June 22, 1995, recognizes that the application of ERISA regulates the health and pension benefit plans for employees in the private sector. The report further acknowledges that some benefit plans could not be extended to employees in Puerto Rico because said plans did not comply with the provisions of Section 5(g) of Act No. 17. As a result, many employers simply refrained from offering such benefits, while other employers who did provide such benefits in fact did so in violation of the law.

The same view was expressed by the President of the Puerto Rico Chamber of Commerce in a report submitted to the Senate of Puerto Rico on June 1, 1995, in which it was argued that many multinational enterprises have excellent benefit plans (savings, stock purchase, etc.) that could not be made available to employees in Puerto Rico because of the stringent requirements of Act No. 17. The report further states that such requirements are against the best interests of employees of such enterprises. Finally, the report flatly states that the foregoing provisions of Act No. 17 are in conflict with ERISA in an area that is preempted by the federal statute. The Chamber of Commerce conveyed the same opinion to the House of Representatives in a letter dated June 12, 1995.

The Executive Vice President of the Puerto Rico Manufacturers Association also concurred with that opinion in his June 1, 1995 report to the Senate, concluding that the enactment of ERISA nullified all state laws in this field. In his view, Act No. 17 is null and void to the extent that it contravenes ERISA. The Manufacturers Association also expressed the foregoing opinion in a letter to the House of Representatives dated June 13, 1995.

A similar position was assumed by the Director of Puerto Rico's Office of Management and Budget in a letter to the Senate, also dated June 1, 1995. The Director concludes that the provisions of Act No. 17 contravene ERISA, which regulates all aspects of benefit plans, and that to the extent that the provisions of Act No. 17 are in conflict with ERISA, said provisions of the local statute must be repealed.

Also relevant to this discussion is the analysis of the bill to amend Act No. 17 prepared by Puerto Rico's Department of Justice and submitted to the Senate on June 19, 1995. In its analysis, the Department of Justice relied on the U.S. Supreme Court's decision in the case of 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; concluding that preemption may not apply if the state legislation has only a remote, slight or peripheral relation to benefit plans regulated by ERISA. In the Department of Justice's opinion, however, such was not the case with respect to Section 5(g) of Act No. 17.

It should also be noted that In the New York Blue Cross Plans v. Travelers Insurance case, *supra*, the Supreme Court unanimously ruled that the local statutes (i.e., of the states) that have an indirect economic effect on 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, because that particular aspect is deemed to be preempted by ERISA.

In general, the doctrine of preemption provides 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 intent of Congress is clearly manifested. See 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. See Luis Acosta, Inc. v. D.A.C.O., 114 D.P.R. 160, 163 (1983); Hines v. Davidowitz, 312 U.S. 52, 67 (1941). It has also been ruled that 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 New York Blue Cross Plans case, *supra*, the U.S. District Court and the U.S. Court of Appeals ruled that the state law was in conflict with ERISA with respect to the provisions related to employee health plans. The U.S. Supreme Court overruled some aspects of that decision pertaining to some charges that did not fall within the concept of "a statute related to an employee benefit plan". In explaining the scope of the preemption doctrine, however, the Supreme Court said that ERISA Section 514(a) tends to prevent the multiple regulation of such types of benefit plans in the interest of ensuring uniform administration of such laws throughout the nation. Also relevant to this issue is the decision rendered by the U.S. Supreme Court in Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 97 (1983), in which the Court ruled that the state law was related to a benefit plan that was exclusively regulated by the Congress.

In summary, our analysis of the provisions of ERISA, as well as of the provisions of Act No. 17, leads us to conclude that in this particular case ERISA preempts Act No. 17. For the foregoing reasons, it is our opinion that your client's proposed stock purchase plan, as described in your letter, does not contravene Act No. 17, and may therefore be lawfully implemented through voluntary payroll deductions.

We trust the foregoing is responsive to your inquiry.

Cordially,

María C. Marina Durán
Solicitor of Labor