

Business Law puerto rico Developments

▶ ANTI-COMPETITIVE effect of mergers and acquisitions

In the past few months there have been several mergers and acquisitions between competing firms. Although most noticeable have been those consolidations in the financial sector due to the economic hardship of that particular market, all business sectors have experienced a substantial increase in merger activity.

A merger or acquisition between two competitors can cause an adverse effect on competition. Therefore, it should not be a surprise that government regulators keep their watchful eye over these transactions. In Puerto Rico, the anti-competitive effect of a merger or acquisition amongst competitors is regulated by the Federal statute – the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the “H.S.R.”) – and by Article 5 of the Puerto Rico Monopolies and Restraint of Trade Act, Act No. 77 of June 25, 1964 (the “P.R. Act”). Under the H.S.R., a filing with the Federal Trade Commission (the “F.T.C.”) of a pre-merger notification notice is required if certain

thresholds are met. The pre-merger notice allows the F.T.C. to examine the transaction during a waiting period of 30 days in order to determine whether it may challenge or stop the same. Most of the

mergers and acquisitions that take place in Puerto Rico do not trigger the threshold for filing the pre-merger notice. The F.T.C. has adopted horizontal merger guidelines (the “Guidelines”) that have been revised several times and that dictate the types of transactions between competitors the F.T.C. may analyze.

The matter is different under Article 5 of the P.R. Act. In essence, in any case where two competitors will merge or consolidate the Puerto Rico Department of Justice has the authority to

either approve the transaction beforehand, through a written opinion, or request that the transaction be annulled, in which case penalties may apply.

Any party to a transaction may request a written opinion under Article 5(c) of the P.R. Act and the Department of Justice, through the Office of Monopolistic Affairs, will issue an opinion approving or disallowing the transaction. Even when approved, the Office can impose certain structure or conduct conditions for the approval.

How do you know if your proposed merger has an anti-competitive effect?

The most significant instrument used by the Office to determine what mergers or acquisitions can have an anti-competitive effect on the market is the H.H.I.

H.H.I. refers to the Herfindahl-Hirschman Index which is a calculation of market concentration. It is named after two economists: Orris C. Herfindahl and Albert O. Hirschman. The H.H.I. is determined by squaring the market share of all the firms which compete in the relevant market and adding them up. The United States Department of Justice issues the following example: “...[for] a market consisting of four firms with shares of 30,





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in this issue

- 1 ▷ Anti-competitive effect of mergers and acquisitions.
- 3 ▷ New regulations for vessel owners.
- 4 ▷ Shareholders' agreements -an essential tool to avoid litigation.
- 5 ▷ The U.S. Department of Labor issues revised regulations for the implementation of the F.M.L.A.
- 6 ▷ E.E.O.C. issues new compliance manual to clarify workplace bias based on religious beliefs.
- 7 ▷ New optional employee medical related benefits.
- 8 ▷ New emergency fiscal laws approved.
- 10 ▷ Staying with your old tax exemption grant may be a good idea after all.
- 11 ▷ Overseas Corporate Prosecutions: complying with the foreign corrupt practices act.
- 12 ▷ Risks of having your lawyer as a member of your board.
- 13 ▷ Banking alert.
- 14 ▷ Proposed bills.
- 15 ▷ The business judgment rule: the life saver of directors is upheld!
- 16 ▷ Lilly Ledbetter Fair Pay Act: signed into law by President Barack Obama.



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30, 20 and 20 percent, the H.H.I. is 2600 (302 + 302 + 202 + 202). If your market has an H.H.I. in excess of 1800, the market is considered highly concentrated.”

If the contemplated merger or acquisition causes an increase of more than 100 points in the H.H.I. in a concentrated market (more than 1800 H.H.I.), then the merger or acquisition is presumed to have an anti-competitive effect.

As it can be inferred, the H.H.I. will vary depending on the definition of the relevant market, which makes this one of the most difficult tasks to determine. Often mergers and acquisition participants are driven by economies and synergy on different market sectors and levels and therefore determining whether a particular firm should be included in the calculation of the H.H.I. may prove to be a troublesome task.

For Puerto Rico, there is no need to file a pre-merger notice with the Department of Justice. For example, a construction company can acquire an insurance company and if the H.S.R. Act threshold is not triggered and, assuming compliance with any other regulatory statutes, there is no pre-merger notice and waiting period nor pre-approval process with the Department of Justice of Puerto Rico. Only if the

transaction causes an anti-competitive effect can the Department challenge the same.

Suggestions when considering a merger or acquisition of a competitor

Therefore, it is recommended that if you are considering the merger or acquisition with a competitor, you should first analyze the effect on competition that such consolidation will provoke. In a highly concentrated market (more than 1800 H.H.I.), you should also consider whether it is advisable to previously obtain the written opinion of the Department of Justice.

The Justice Department may consider several factors other than the H.H.I. and even approve the transaction with conditions on the future conduct of the parties. Such restrictions are usually imposed for three to five years.

In summary, you should consult with knowledgeable professionals in the field if you are a participant in a proposed acquisition or merger, particularly when the parties are in a highly concentrated market. ■

*BY: FRANCISCO J. GARCÍA,
Corporate & Banking Law Department*

NEW REGULATIONS for vessel owners

On December 29, 2008, the U.S. Environmental Protection Agency (E.P.A.) issued the 2008 Vessel General Permit in order to regulate discharges incidental to the normal operation of vessels used as means of transportation. The Permit includes general effluent limits applicable to all types of discharges, general effluent limits that apply to 26 specific discharge streams, narrative water-quality based effluent limits, and inspection, monitoring, recordkeeping and reporting requirements. The Permit also imposes additional requirements for certain types of vessels. Permits were required by *February 6, 2009*.

The Permit regulates 26 vessel discharge streams by establishing effluent

limits and requiring the implementation of Best Management Practices. It requires routine self-inspections, comprehensive annual vessel inspections and monitoring of all areas affected by the Permit. Analytical monitoring may be required for certain vessels. All instances of noncompliance with the Permit requirements must be reported at least once a year to the E.P.A. and those that may endanger health or the environment must be reported to E.P.A. within 24 hours of becoming aware of the situation. The Permit imposes further reporting standards applicable to single or multiple events of noncompliance.

The Permit imposes additional requirements for eight specific types of vessels that have unique characteristics result-

ing in discharges not shared by other types of vessels. These vessel types are:

- ✓ **medium cruise ships**
- ✓ **large ferries**
- ✓ **barges**
- ✓ **rescue boats**
- ✓ **large cruise ships**
- ✓ **research vessels**
- ✓ **oil or petroleum tankers**

Standards to receive permit coverage vary according to vessel size and capacity to hold or discharge more ballast water. ■

*BY: GRETCHEN MÉNDEZ,
Environmental Law Practice Group*

SHAREHOLDERS' AGREEMENTS —an essential tool to avoid litigation

There are advantages to conducting your business by means of an entity separate and distinct from the individual owners, whether it be by operating as a partnership, corporation or a limited liability company. Most people are familiar with the articles of incorporation, or in the case of a limited liability company (L.L.C.) the formation certificate, which when properly completed and filed at the State Department give life to the new entity. They are not, however, aware of the advantages of a well-drafted shareholders' agreement, operating agreement in the case of an L.L.C., or a deed or contract of partnership.

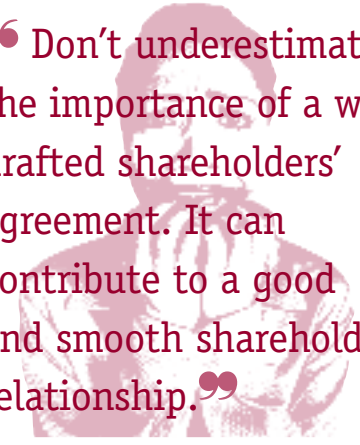
The person starting a new entity is principally focused on getting the formation documents executed and/or filed in order to be able to use the new entity. However, just as important is the preparation and execution of the other complementary governing documents that will establish in writing the basic contractual terms of how things are going to work within the entity and amongst the owners.

This key element of the business structure is often simply ignored because the owners assume everything is going to work out fine or they just put it off until a later date, only to find out that they failed to address major issues before a dispute arose. Shareholder agreements, operating agreements and partnership agreements

serve many important purposes. They allow the owners to know where they stand, what they can or cannot do and what they are entitled to receive. These documents also help to establish beforehand how certain events will be handled, such as the sale or disposition of ownership interests.

- ▷ capital contributions
- ▷ governance and decision making (including extraordinary actions requiring unanimous approval)
- ▷ nature of the business and decisions concerning new businesses
- ▷ distribution of net profits and allocation of net losses
- ▷ additional capital contributions, redemption of shares and borrowing of funds
- ▷ restrictions on transfer or encumbering of ownership interest
- ▷ put or call options
- ▷ death or incapacity of an owner
- ▷ divorce or legal separation of an owner
- ▷ non-disclosure and confidentiality of corporate information
- ▷ non-competition clauses
- ▷ dispute resolution provision
- ▷ sale of assets, liquidation or dissolution of the entity

In conclusion, a substantial number of disagreements or disputes amongst the owners of an entity can be avoided, or at least more readily resolved, if the owners had initially discussed and clarified these issues upon commencing the business. Our experience indicates that making these determinations in a well-drafted agreement at the beginning, when usually everyone gets along and people tend to be more reasonable, will serve to prevent or reduce future litigation. ■



“Don't underestimate the importance of a well-drafted shareholders' agreement. It can contribute to a good and smooth shareholder relationship.”

The following are just a few of the basic issues which are usually addressed in these types of agreements:

THE U.S. DEPARTMENT OF LABOR issues revised regulations for the implementation of the F.M.L.A.

The revised regulations for the implementation of the Family Medical Leave Act (F.M.L.A.) issued by the Department of Labor became effective on January 16, 2009. According to the Department, the revised regulations contain technical changes that reflect interpretations of United States Supreme Court rulings by lower courts and new legislation. They will also help workers and their employers better understand their rights and responsibilities. What follows is a brief primer of the most significant changes.

Military Provisions: Pursuant to the National Defense Authorization Act, the F.M.L.A. now allows families of National Guard and Reserve personnel called to active duty to take F.M.L.A. job-protected leave to manage their affairs for the following “qualifying exigency” events:

- ▷ Short-notice deployment
- ▷ Military events and related activities
- ▷ Childcare and school activities
- ▷ Financial and legal arrangements
- ▷ Counseling
- ▷ Rest and recuperation
- ▷ Post-deployment activities
- ▷ Additional activities where the employer and employee agree to the leave

Further, the F.M.L.A. now provides protection for family members caring for a covered service member with a serious injury or illness which occurred in the line of duty. These family members may take up to 26 workweeks of leave in a 12-month period. The new regulations dictate that, whenever possible, the procedures used when taking military family leave should be the same as those used for other types of F.M.L.A. leave. The new regulations also address specific employee and employer responsibilities for purposes of military family leave.

Technical Change to Reflect Supreme Court Decision: The regulations eliminate the so-called “categorical” penalty and also clarify that if an employee suffers individual harm because the employer did not follow proper notification rules the employer may be liable.

Employee Notice Obligations: Employees are now allowed up to two full business days after the absence to notify their employers of their need for F.M.L.A. leave, even if they could have provided notice sooner.

Medical Certification: Due to privacy concerns under the Health Insurance Portability and Accountability Act



(HIPAA), the regulations add a requirement that limits who may contact the employee’s health provider and specifically bar the employee’s direct supervisor from making such contact.

Waiver of Rights: The Department practice of allowing employees to voluntarily settle their claims without court or Department approval was codified into the regulations. However, the rules continue to prohibit prospective waivers of F.M.L.A. rights.

Employers need to be in full compliance with the new F.M.L.A. regulations. Therefore, employers should revise all existing F.M.L.A. policies in effect and offer training to human resources and other managerial personnel.

For more information, visit www.dol.gov/esa/whd/fmla or contact any of our Labor & Employment Law Department attorneys. ■

*BY: ANGEL X. VIERA,
Labor & Employment Law Department*

E.E.O.C. issues new compliance manual to clarify workplace bias based on religious beliefs

In July of 2008, the United States Equal Employment Opportunity Commission (E.E.O.C.) unanimously voted to adopt and issue a new Compliance Manual that addresses workplace discrimination, harassment and retaliation based on religious beliefs. Although the Manual does not set forth new law or amend or modify previously-existing regulations, it does codify and integrate interpretative civil rights case law into the Commission's position. In addition to providing further clarity on this issue, the Manual also sets forth practical advice for employers, specifically insofar as this revised view of religious freedom may affect or limit the employer's need and capacity to maintain a productive work environment.

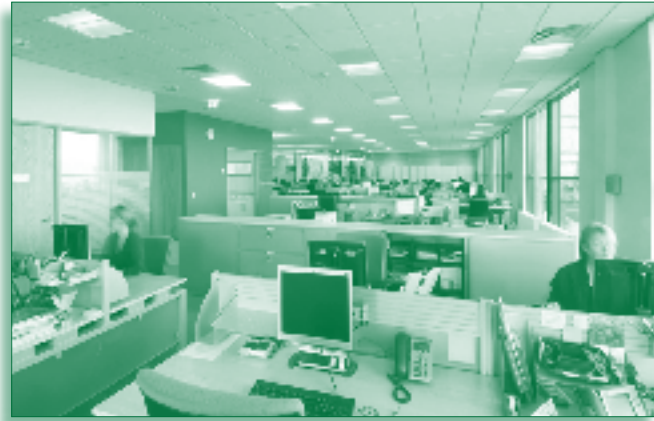
The Manual discusses three specific aspects of the issue of religious belief in the workplace, to wit:

✓ The definition of "religion": In order to be able to request an accommodation under the Civil Rights Act, an employee must be able to assert and prove that he or she is a bona fide believer or practitioner of an actual "religion." Knowing full-well that employers tend to be confused about whether or not an employee's particular belief system constitutes a "religion," the E.E.O.C. has sought to clarify this issue with more specificity.

✓ Harassment on the basis of religion: The Manual also addresses the issue of harassment on the basis of an employee's religious beliefs. The test or analysis would be the same as for a case of harassment on the basis of other categories protected by Title VII, such as race, gender and age. As such, there are two types of harassment contemplated in the Manual: quid pro quo harassment (employee coerced to adopt, change or abandon belief as condition of employment) and hostile work environment harassment (unwelcome statements or conduct based on his/her religion). The Manual discusses both types of harassment thoroughly and provides tips to help avoid harassment claims, such as, for example, the adoption of a publicized and thoroughly-disseminated and well-discussed anti-harassment policy, which should allow religious expression to the same extent that other non-harassing and non-disruptive personal expression is allowed.

✓ Retaliation: The Commission considers a request for religious accommodation to be a protected activity that shields the employee from any retaliation by his or her employer as a result of having made

such request. The Manual provides employers with practical advice for avoiding claims of retaliation by employees who have sought religious accommodation under Title VII. For example, employers are encouraged to document the legitimate non-retaliatory business reasons for the disciplinary action taken against an employee, and then clearly articulate and communicate those reasons to the employee.



Employers should download and study the Manual thoroughly, which may be downloaded at www.eeoc.gov/policy/docs/religion.html, and thereafter contact their legal counsel to clarify any doubt they may have regarding its content or application. More importantly, employers should evaluate and seriously consider any and all requests for religious accommodation, no matter how far-fetched and implausible they might seem at first, given the wide net the Supreme Court has cast in its definition of "religion." It would also be appropriate for employers to analyze their existing anti-discrimination, anti-harassment and anti-retaliation policies to determine whether any modifications are necessary in light of the definitions provided in the Manual. ■

*BY: CARLOS R. PASTRANA,
Labor & Employment Law Department*

NEW OPTIONAL EMPLOYEE medical related benefits

Act No. 156 of August 4, 2008, amended the Puerto Rico Internal Revenue Code of 1994 to introduce the Health Savings Accounts and the Health Reimbursement Arrangements.

Health Savings Accounts

The goal of Health Savings Accounts is to provide a savings vehicle, with a corresponding tax exemption, to enable taxpayers to create a fund to pay for medical and hospital services that are not covered by medical insurance plans. The accounts have various advantages.

- ▶ Annual contributions made by employers to the accounts are not considered income to the employee.
- ▶ All contributions made by the employer are deductible for income tax purposes as ordinary and necessary expenses.
- ▶ The monies deposited in the accounts can be withdrawn tax-free to cover any “qualified medical expenses” that the taxpayer may incur during the taxable year.
- ▶ Any amount remaining at the end of a given year can be transferred to the following year and the interests accumulated in the accounts are exempted from tax when withdrawn from the account.

The term “qualified medical expenses” include the following:

- ▶ Diagnostic, cure, mitigation, treatment or prevention of illnesses.
- ▶ Any medical intervention that affects any body structure or function.
- ▶ Transportation expenses incurred primarily for the abovementioned activities.
- ▶ Mammograms, well-child care and prenatal care, adult and children vaccinations, programs to quit smoking and obesity and weight loss programs.
- ▶ Wellness preventive care.

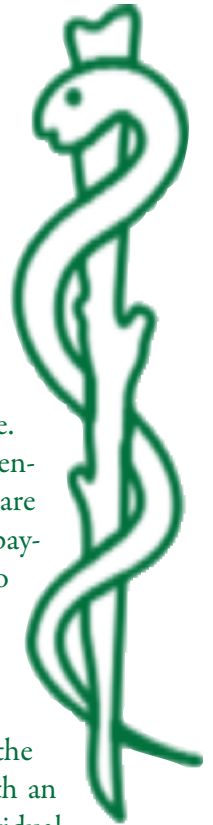
Any withdrawals that are not for qualified medical expenses are subject to a ten percent penalty for taxpayers under 65 years of age. After 65 years of age the ten percent tax penalty is waived. Both types of withdrawals are subject to taxation as ordinary income. Taxpayers can have tax-free access to their funds to pay for medical insurance premiums if they lose their medical insurance as well as for expenses related to long-term care.

Taxpayers can also use the funds to cover the total annual deductible on health plans with an annual deductible of at least \$1,000 for individual coverage (\$2,000 for family coverage) and maximum out-of-pocket expenses (expenses required by the health care providers to be paid by the insured other than premiums) of \$5,500 for individual coverage (\$11,000 for family coverage). Under these plans, the insured covers the annual deductible the traditional medical insurance coverage kicks in. The insured can cover such initial high deductible costs with funds deposited in the Health Savings Account.

The maximum annual contribution to a Health Savings Account will depend on the taxpayer’s status and plan coverage. The monthly contributions are limited to the lower of one-twelfth (1/12) of the annual deductible under such coverage; or \$2,850 for individual coverage and \$5,650 for family coverage.

Health Reimbursement Arrangements

Health Reimbursement Arrangements provide employers with marginal benefit alternatives with tax exemption to the employees. Up to certain limits established in the PR Code, any medical care expenses directly or indirectly paid by an employer not included as part of the employee’s gross income. At the employer’s discretion these arrangements can be extended to employee dependents, retired employ-



ees, and dependents of retired employees (if retired employees are included in the plan).

Under Health Reimbursement Arrangements, contrary to the Health Savings Accounts, the employer has exclusive and complete control of the reimbursement of medical expenses and can decide whether any amounts not used during a year can be transferred to the following year. Furthermore, employees cannot make contributions to Health Reimbursement Arrangements, such amounts do not accrue interests or dividends and the accumulated amounts are not transferable. Reimbursements cannot be used to pay qualified medical expenses but rather can be used to pay the following items:

- ▶ Medical insurance premiums.
- ▶ Prescription medicines.
- ▶ Non-prescription medicines.
- ▶ Federal Medicare insurance premiums.
- ▶ Long term care insurance premiums.
- ▶ Preventive care insurance premiums, including weight-control programs, tobacco-control programs and other similar preventive or maintenance care programs.

Amounts that an employee has accumulated at the time of his retirement can be used to pay for medical expenses after such employee retires if the plan documents so allow. The employer can also choose to contribute at the time of the employees' retirement an amount equal to any accumulated regular vacation and sick time that has not been paid. Such amounts are subject to the same limitations established for regular reimbursements under a Health Reimbursement Arrangement.

To establish a Health Reimbursement Arrangements program the employer must adopt a Health Insurance Plan and a Summary Plan Description and the program must be approved by the Secretary of the Treasury.

The Secretary is required to publish regulations but such regulations have not been published as of the date of this publication. Act No. 156 was effective immediately and applies to taxable years commencing on and after January 1, 2009. ■

*BY: ANGEL MARRERO,
Tax Law Department*



New Emergency Fiscal Laws APPROVED

On January 15, 2009, the Governor of Puerto Rico signed into law four new measures approved by the Puerto Rico Legislature in order to address the current fiscal crisis affecting Puerto Rico. The laws are intended to assist the Government in obtaining loans to cover the budget's structural deficit, which is estimated at \$3.2 billion dollars. All four acts were effective immediately after their approval.

1. IVU

Act No. 1 of January 14, 2009, increases from one percent to two percent the amount of funds collected from the Sales and Use Tax that are assigned to the Dedicated Sales Tax Fund. The Fund was created to refinance the "extra constitutional" debt (financing used by the Government to cover short-term budget deficits) that had accumulated over the years, which was to be repaid over a period of 50 years. Under Act No. 1 COFINA (for its Spanish acro-

nym), the public corporation created to manage the Fund, is now authorized to issue new bonds using the additional one percent of the IVU as the source of repayment. The Government expects to be able to use these new bond proceeds to:

- Recapitalize the Government Development Bank by repaying the amount loaned to the Puerto Rico Treasury Department
- Pay or finance the Government's operational expenses for the 2008-2009, 2009-2010, 2010-2011 and 2011-2012 fiscal years
- Pay all outstanding debts to Government vendors
- Provide funds for the Government's Emergency Fund
- Provide funds for the Government's Economic Stimulus Fund, including:
 - √ Tax relief to taxpayers
 - √ Economic stimulus to businesses and industries
 - √ Training programs
 - √ Assistance to laid-off employees
 - √ Any other purposes established by law

2. GOVERNMENT MAY OBTAIN FINANCING TO BALANCE ITS BUDGET

Act No. 2 of January 14, 2009, amends Act No. 103 of May 25, 2006. Act No. 103, known as the Fiscal Reform Act, prohibits the Government from taking out loans or any other type of financing to balance the Government's budget. In order to prevent any type of interruption of governmental services, the effectiveness of Act No. 103 is now suspended until June 30, 2011. In its place, the Government Development Bank is now required to submit to the Legislative Branch quarterly reports of any type of financing obtained in order to cover operational expenses.

3. GOVERNMENT MAY SELL ITS ASSETS TO PAY ITS DEBTORS

Act No. 3 of January 14, 2009, authorizes the sale of certain assets deposited in the Infrastructure Development Fund's Corpus Account to quickly raise funds for the Government to pay payroll and other operational expenses. The Govern-

ment expects to raise approximately \$650 million, of which approximately \$300 million would be deposited again in the Corpus Account. The remaining \$350 million would be used as follows:

- Two-thirds of the remaining amount (approximately \$233 million) would be used to cover operational expenses for the 2008-2009 fiscal year; and
- One-third of the remaining amount (approximately \$117 million) would be used to recapitalize the Government Development Bank.

4. GOVERNMENT DEVELOPMENT BANK'S LENDING LIMIT INCREASED

Act No. 4 of January 14, 2009, amends Act No. 164 of December 17, 2001, in order to increase the amount that the Government Development Bank can lend to governmental agencies when the repayment is dependent on future legislative allocation. In other words, these types of loans do not have an identifiable repayment source and, as such, would require a legislative allocation from a future budget bill. Before Act No. 4 the Bank could only loan up to \$100 million under these circumstances. Act No. 4 increased this limit to \$200 million, but only until June 30, 2011. After 2011 the limit reverts back to \$100 million. The Bank is also required to submit to the Legislative Branch quarterly reports of any type of financing provided to cover operational expenses. ■

*BY: ANGEL MARRERO,
Tax Law Department*





Staying with your old tax exemption grant MAY BE A GOOD IDEA AFTER ALL

Act No. 73 of May 28, 2008, known as the Economic Incentives for the Development of Puerto Rico Act, allows businesses that possess a tax grant under previous tax incentives acts to convert or renegotiate their grants.

While Act No. 73 provides a lower fixed income tax rate and affords greater percentage of exemptions of property and municipal taxes there are other factors that must be considered before converting or renegotiating your current grant.

Act No. 73 substitutes many of the special deductions under previous tax incentives acts for a new system of tax credits. These tax credits are available to businesses that have tax grants under tax previous acts. In other words, an exempt business under a previous tax incentives act can claim one or more of the new tax credits under Act No. 73 without having to convert or renegotiate its current tax grant.

Act No. 73 establishes a type of “alternate minimum tax” that could limit the amount of tax credits that an entity may be able to claim on its tax returns (one percent for small and medium-sized businesses, three percent for local investment businesses and four percent for all other exempt businesses). Also, Act No. 73 tax grants will have a period of exemption of 15 years regardless of its location, whereas in previous tax incentives acts the period of

duration could run from ten years to up to 25 years.

The following tax credits provided for by Act No. 73 are available to businesses that possess a tax grant under previous tax incentives acts:

- ▷ Credit for the purchase of products manufactured in P.R.: fifty percent of the actual purchases and up to fifty percent of the tax liability of the exempt business.
- ▷ Credit for investment in Research and Development (R&D): fifty percent of the eligible investment made in R&D.
- ▷ Credit for investment in machinery and equipment for generation and efficient use of energy: fifty percent of the eligible investment in the acquisition of machinery and equipment for the generation and efficient use of energy.
- ▷ Tax credit for reducing the cost of electric energy: up to ten percent of the energy cost payments.
- ▷ Credit for investment in strategic projects: up to fifty percent of the eligible investment in strategic projects as defined by the Act No. 73.
- ▷ Industrial investment tax credit:

Act No. 73 provides for a tax credit of up to fifty percent of the cash invested in small and mid-size exempt businesses closing down operations. ■

*By: Roxana Cruz,
Tax Law Department*

We are pleased to announce that Roxana Cruz, partner in our Tax Law Department, will be joining the Puerto Rico Industrial Development Department, effective February 23, 2009.

Ms. Cruz will head PRIDCO's Tax and Legislation Advisers Office.

**Congratulations,
Roxana!**

Overseas Corporate Prosecutions: COMPLYING WITH THE FOREIGN CORRUPT PRACTICES ACT

The Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78dd-1, et seq., is a federal law that imposes record-keeping and reporting obligations on public companies and prohibits offering or promising anything of value “corruptly” to a foreign official for the purpose of “obtaining or retaining business for or with, or directing business to, any person” involved in interstate commerce. Violators risk criminal and civil penalties in actions commenced by the Department of Justice and the Securities and Exchange Commission (SEC).

Anyone considering doing business in a foreign country should have a basic understanding of how the Act works and develop some simple compliance strategies.

The government must prove the following to establish a criminal violation under the Act:

- That the payment of anything of value was made, either directly or through a third party.
- That the payment was made by a

publicly traded company or a U.S. citizen, national, resident, domestic corporation, partnership, trust, association or sole proprietorship.

- That the payment was made to any foreign official, political party or candidate of a foreign government or to anyone acting on their behalf.
- That the payment was made for the corrupt purpose of influencing an official act intended to retain or direct business.
- That the offer or payment was made to an entity involved in interstate commerce.

The Act does not limit itself to the most obvious form of payment: money. The statute expressly includes “giving anything of value.” Some courts have interpreted the term broadly to include, for instance, non-competition or exclusivity agreements, a loan with favorable terms, and even gifts of sports equipment. In terms of considering who qualifies as a “foreign official” the Department and the SEC have considered a broad range of people, including presidents, prime ministers, custom officials, doctors and even public laboratory workers. In short, even low-level employees – regardless of their function – are likely to be deemed foreign officials under the Act.

A company may be held liable even if a bribery attempt does not succeed as the government will likely impute knowledge of the improper payment or offer of payment. Such statutory treatment becomes similar to fraud: “it is the intent – not the success or failure of the scheme – that establishes the crime.” See: *The Foreign Corrupt Practices Act: Pitfalls in Doing Business Overseas*, The Federal Lawyer, Vol. 55, Number 10 (November/December 2008).

There are numerous mechanisms that may be put into place in order to assist corporations with their efforts in complying with the Foreign Corrupt Practice Act. Corporations and shareholders must be vigilant in creating and enforcing a compliance policy that will reduce or minimize their risk of infringing the Act. For example, corporations should:

- Make a general assessment of the business, taking into account the existing and future business relationships outside the U.S.
- Extensively research the laws of those foreign countries where business is conducted.
- Create a compliance program which includes an ethics policy, employee training, assignment of responsibility for compliance, internal reporting mechanism and internal and external audits.
- Hold accountable the corporation’s directors, officers, key employees and shareholders and punish those who fail to comply. ■

*By: Javier G. Vázquez,
Labor & Employment Law Department*

RISKS OF HAVING your lawyer as a member of your board

Historically, corporations have asked their trusted attorneys from outside law firms that provide litigation, corporate and general advice to the corporation, to become members of the client's board of directors. Usually a close relationship develops with the principal lawyer who is constantly in communication with the president and executive management providing legal advice on litigation, employment matters, regulatory issues, workouts and settlements. At some point in time the client understands that it's better if the outside lawyer takes a seat on the board of directors or even at one of its standing committees. Thinking that the client will be even more "attached" with the law firm, the outside counsel seldom declines such offer. However, for some larger corporations, public companies or other businesses in regulated industries, such decision should be seriously pondered.

The issue is even more complex when the public company is a financial institution or a bank in times of economic turmoil, when you may have the SEC, the F.D.I.C. and Congress looking into its past practices. An example of this is the adoption of SEC rules pursuant to Section 307 of the Sarbanes-Oxley Act of 2002 – enacted as a result of the Enron debacle – that require lawyers to report certain internal corporate activities to the SEC.

The actual presence of your counsel or day-to-day legal advisor as a member of the board of directors of your company may compromise the decision-making process of the board and place an immense responsibility on the outside firm. Keep in mind that the lawyer will not actually resign from his legal practice and will likely continue in a dual role with the outside law firm and the corporate client.

The most important disadvantages to having your outside counsel sit on the board of directors are the following:

▶ Attorney-client privilege – The communications between

an external attorney and the client are privileged and protected under the rules of evidence. However, if the client and/or the attorney share these communications with others, the protection is no longer valid. Moreover, if the communication is not legal advice but rather business advice, the privilege does not exist.

▶ Conflicts of Interest – There are several conflicts of interest scenarios. First, as a director the attorney has a duty to the corporation and shareholders different from that of his role as a lawyer and advisor, which is primarily to keep the corporation's acts within lawful boundaries. Secondly, as a member of a law firm with an obligation to its members (including the duty to avoid possible liability), together with the expectancy that legal work from the client is coming his way, the lawyer's decisions as a member of the corporation's board may be compromised.

▶ Increased Liability to the Client – Due to the lawyer's different roles – as a director and as a lawyer – the client may have increased liability and risk. The lawyer in his role as a member of the board will no longer be considered an advisor, and thus his acts will be considered as those of any other director. Courts have traditionally held lawyer-directors to a higher standard than other directors.

▶ Increased Liability to the Law Firm – A lawyer is not supposed to provide business advice. However, that's precisely what's expected from the lawyer-director that sits on the client's board of directors. The law firm's malpractice insurance does not insure against these errors and omissions.

Σ Incapacity to Represent the Client in the Future – In any litigation involving the client, the lawyer-director is a potential witness and his law firm will be unable to represent the client.

WHAT SHOULD THE CORPORATE CLIENT DO?

▶ Examine all applicable laws relating to corporate governance, lawyers' rules of conduct and canons of ethics, specific rules and regulations of your particular industry, for example those of the SEC, the F.D.I.C. and the Insurance Commissioner, which may dictate specific conduct applicable to the regulated corporation or the lawyer-director.

▶ Invite your lawyer to attend the board meetings – instead of sitting as a board member – when you understand it is necessary, particularly when legal advice may be needed. Make sure another attorney from the outside firm is present if there is any doubt that the trusted counsel's advice

could be considered a business one. This could preserve the attorney-client privilege.

- ▶ Verify the insurance coverage on both sides. Generally, the errors and omissions insurance policies that cover the directors and officers of the corporation do not cover malpractice by the lawyer-director and the law firm's malpractice insurance policy does not cover errors, omissions or negligence of the lawyer acting as a director.
- ▶ The lawyer-director and the board should be able to an-

ticipate possible conflicts of interest on matters presented to the board that could involve the past or present use of the lawyer-director's law firm while the lawyer-director is a member or counsel of such firm. Such possibility is common in litigation or commercial transaction matters. In such cases, the lawyer-director should withdraw or abstain from attending the board meeting or the matter should be handled by another firm. ■

*By: Francisco J. García,
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BANKING Alert

I recently attended a very interesting seminar entitled Commercial Real Estate Financing: Strategies for Changing Markets and Uncertain Times. I want to share with you some of the hot topics and trends discussed at the seminar. These are pertinent to the banking industry in the U.S. and are also applicable to Puerto Rico.

It is important to constantly revise loan commitment and loan document forms in order to properly address new issues, particularly those arising more frequently as a result of current market conditions. For instance:

- ✓ A well drafted loan commitment and loan document should include a loan balancing provision addressing the bank's need to insure that there are sufficient funds, including equity and available loan proceeds, in order to properly complete the project. The provision should also give the lender the right to request and receive information necessary to ascertain whether the loan continues to be in balance.
- ✓ The importance and increased use of MAC clauses (material adverse change clauses) in both loan com-

mitments and loan documents to allow the lender to cancel commitments and/or stop advances under certain circumstances.

- ✓ The need for a flexible rate provision in both the loan commitment and loan document that addresses the situation when the lender determines that the stated interest rate will not adequately and fairly reflect the cost to the lender of making or maintaining the loan. This is a phenomenon which has occurred lately due to banks' increased cost in borrowing from other banks.

There are certain actions that should be taken under a default situation or in connection with real estate workouts. These actions are varied but in general terms include the following:

- ✓ Determining the nature and cause of the default so as to be able to understand the situation and devise solutions to the specific problem.
- ✓ Determining the facts, including

review of documentation, physical status of project, survey of assets and numerous other due diligence items.

- ✓ Formulating a plan including buying time, sale of project, creditor takeover, reinstatements, etc.
- ✓ Implementing the plan including proper documentation, collateralization of existing debt and new debt, management and controls.

It is also important to have a detailed and thorough "Defaults Investigation Checklist." You must properly accumulate, organize and review all of the information stated in said Checklist in order to ascertain what information and documents the lender has available, what it is missing and what it needs to obtain in order to properly position itself and protect its rights and interests. ■

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PROPOSED BILLS

The current Legislative Assembly has submitted various bills in the short period it has been in office. A brief summary of some of them follows.

CLOSING LAW

- There are various pending measures relating to the Closing Law. HR 526 seeks to amend business hours on Sundays from the current 11:00 a.m. to 5:00 p.m. to 12:00 n. to 12 midnight. It also proposes to increase the number of employees that a business may have to be exempt from the statute from 15 to 25. On the other hand, HR 531 and Senate Bill 88 would allow commercial and industrial establishments to open on Sundays on the same schedule as they are allowed to open the rest of the week. Bill 88 would also eliminate double compensation for employees in the retail industry who work on Sundays. Finally, HR 792 seems very similar to HR 531.

COMMERCIAL ESTABLISHMENTS

- HR 320 proposes requiring all businesses that are principally engaged in the sale of alcoholic beverages to close operations no later than 2:00 a.m. Violators would be subject to a \$5,000 fine and possibly cancellation of their operational permits.
- HR 355 would permit the installation of Department of Consumer Affairs service centers in shopping centers to receive consumer complaints and provide orientation to the public.
- HR 611 would require all businesses that sell, distribute or dispense vitamins, vitamin supplements, health foods or dietary supplements to prominently display a sign indicating what anabolic steroids are and their secondary effects. This requirement would apply not only to gyms and areas

where any sports are practiced, public or private, but also to any pharmacy, supermarket or other stores where these products are sold.

- HR 764 would grandfather business establishments that have been in operation since 1955 so that they would not be required to obtain a use permit. It would also eliminate the need for a new use permit for businesses that only change their name, as long as they do not change their purpose and do not represent a hazard to the health and security of the general population.

- HR 794 would require the Ports Authority to reserve twenty-five percent of the public space available in its port facilities to allow the local industries with exporting capabilities to showcase their products.

EMPLOYMENT RELATED

- Senate Bill 102 seeks to amend Puerto Rico's general anti-discrimination statute to prohibit the discrimination of employees or applicants because of their past criminal convictions.

- Senate Bill 108 would amend the Working Mothers' Protection Act by extending the maternity leave period for mothers who have children born with a congenital anomaly. The mother would be granted four additional weeks without pay. The bill also proposes a paternity leave period of 20 days for the father whose child has this medical condition.

- HR 120 would amend the Compensation System for Work-Related Accidents Act by ordering the Administrator of the State Insurance Fund Corporation to certify that an employee being discharged is both physically and mentally apt to return to work.

- HR 150 proposes the creation of a paternity leave for the private sector.

- HR 171 would amend the Sex Discrimination in Employment Act by imposing liability for a sum equal to triple the amount of damages if an employer discriminates in any way against an employee because of his or her sex.

- HR 312 would amend the Wrongful Termination Act by establishing reinstatement as one of the remedies available to those employees who have been discharged without just cause. ■

*BY: THELMA RIVERA AND JAVIER G. VÁZQUEZ,
Chief Editors*

The BUSINESS JUDGMENT RULE: the life saver of directors is upheld!

In the midst of an economic tsunami, in a recent ruling the New York Supreme Court strongly endorsed the protection that the business judgment rule offers to the directors of a company and affirmed that directors that act diligently and in good faith when making major corporate control decisions should not be subject to personal liability for their actions. In re Bear Stearns Litigation, N.Y. Sup.Ct., No. 600780/08 of December 4, 2008.

The business judgment rule doctrine emerges from the Delaware General Corporations Law, the basis of the Puerto Rico General Corporations Law of 1995. This doctrine establishes a rebuttable presumption that directors make informed and good faith decisions. The rule applies only if directors comply with their fiduciary duties and responsibilities as required by law, which include acting diligently, in good faith and making informed decisions, among others.

In the mentioned case Judge Herman Cahn of the New York County Supreme Court in Manhattan, dismissed a class action suit brought by a shareholder who – after finding about the Bear Stearns directors’ decision to accept the federally assisted stock-swap deal with JP Morgan in May – alleged that Bear Stearns directors breached their fiduciary duties by selling the company to JP Morgan for far too low a price. Judge Cahn emphasized that the Bear Stearns directors were shielded by the business judgment rule when they accepted what the plaintiffs called a “fire sale” offer of \$10 per share. The business judgment rule gives the decisions of corporate officials the benefit of the doubt as long as there is no evidence of self-dealing or gross negligence. According to the Judge, the board of directors made an “expeditiously” informed decision where they chose the best of the company’s “limited options” and prevented a “potentially cataclysmic” bankruptcy.

Even more importantly, Judge Cahn found that in light of the current magnitude of the financial crisis faced by boards

of directors, even in the absence of the business judgment rule protection the directors would still not be liable. Under the harsher light of the “enhanced scrutiny” rule, a tougher standard that shifts the burden of proof toward the directors who must then show that both their actions and the results were fair to the shareholders, the Court cited experts who said the Bear Stearns Board had only two realistic choices: the federally backed buyout or bankruptcy.

According to the Harvard Law School – Corporate Governance Blog posted on December 13, 2008, recent court judgments may have the following important implications:

- ▷ Courts are aware of the extreme conditions created by the financial crisis and will take into account the overwhelming pressures boards of directors are facing.
- ▷ These cases suggest that courts are aware of the uncertainties created by regulatory and legislative responses to the financial crisis and the courts will not fault boards for failing to accurately predict these governmental responses.
- ▷ Despite the broad deference the courts have given to board decisions made in response to the financial crisis, courts may still be willing to invalidate or enjoin those decisions that courts may believe will prevent boards from fulfilling their fiduciary duties. ■

“It is the first ruling to squarely address unique issues raised by litigation over actions related to the subprime crash and the subsequent \$700 billion federal bailout.”

–Delaware Corporate Litigation Reporter, Volume 23, Issue 11 12/09/08. Copyright 2008, FindLaw, a Thomson Reuters business. ■

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LILLY LEDBETTER FAIR PAY ACT: signed into law by President Barack Obama

On January 29, 2009, President Barack Obama signed into law the Lilly Ledbetter Fair Pay Act, which amends Title VII of the Civil Rights Act of 1964 and the Age Discrimination in Employment Act of 1967, and modifies the Americans with Disabilities Act of 1990 and the Rehabilitation Act of 1973.

The Act clarifies that any payment, compensation or other employment decision or practice that is discriminatory in light of said statutes is understood to have occurred each time compensation is paid pursuant to the discriminatory compensation decision or other practice. The practical importance of this is that, for purposes of filing a charge of discrimination before the Equal Employment Opportunity Commission, each purportedly discriminatory payment of wages would extend the period for filing a charge for an additional 180 days apiece for each payroll event.

The Act was drafted and enacted in response to the United States Supreme Court's decision in the case of *Ledbetter v. Goodyear Tire and Rubber Co.*, 550 U.S. 618 (2007). In this case the Court held that the mere issuance of paychecks as part of a previously-instituted system did not, in and of itself, breathe new life into a claim of discrimination and thus create a new charging period. The Court ultimately agreed

with the employer's defense that Ledbetter's charge of discrimination under Title VII was time-barred.

The Act was signed by the President after having been approved by the United States Senate on January 22, 2009, by a vote count of 61 to 36, and by the House of Representatives on January 27, 2009, by a vote count of 250 to 177. ■

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