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Third-party funds in joint bank account not subject to garnishment

Only the defendant debtor's share of funds in a joint bank account is subject to garnishment by a creditor; the portion belonging to another person is not. However, that other person has the burden of proof. This was the ruling of the Puerto Rico Supreme Court in *Banco Bilbao Vizcaya v. López*, 2006 T.S.P.R. 135.

Collection suit

Banco Bilbao Vizcaya filed court action in collection of money and mortgage foreclosure against its debtors Ángel López Montes, his wife Carmen Sasso Oliver and other defendants. In order to secure a future judgment in its favor, it served Banco Popular de Puerto Rico with a court order garnishing a savings deposit account that existed to the joint names of co-defendant Sasso and her mother, Concepción Oliver Aneiro.



“depository” bank and a “depositor” is a debtor-creditor relationship pursuant to which the bank owes money to its customer. The customer possesses a credit claim against the bank—the likes of an account receivable; and that right

Continued on page 2

Oliver intervened in the case to claim that her portion of the money could not be garnished by the plaintiff bank. One of her major obstacles was the joint nature of the account and the fact that the account documentation provided that the money belonged to both.

Nature of a bank account

The Puerto Rico Supreme Court first repeated the long-established doctrine that bank deposits are not deposits at all, but loans. Citing its 1953 opinion in the case of *Portilla v. Banco Popular*, 75 D.P.R. 100, the Court ratified that what actually exists between a

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PUERTO RICO

BUSINESS LAW
DEVELOPMENTS

Box 70364
San Juan PR 00936-8364
Telephone (787) 759-8000
Fax (787) 767-9333
jorge.souss@gaclaw.com
http://www.gaclaw.com

Editor: Jorge Souss

Contributors:

Luis Antonetti
Alexis Hernández
Raúl Reichard

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to receive payment is subject to garnishment by a creditor of the customer.

How much?

The Supreme Court continued to explain that case law in the United States points to the norm that such garnishment is limited to the interest of the defendant in the account balance. Therefore, if the defendant has an interest of only 25% in a \$1,000 account, the garnishing creditor can only attach \$250. However, in joint accounts there is presumption that the total amount is subject to garnishment, unless the non-defendant party claiming an interest proves otherwise. The Court quoted as follows from *Delta Fertilizer, Inc. v. Morgan*, 547 So. 2d 800 (1989):

“In the majority of jurisdictions, the entire account is vulnerable [to garnishment], but evidence is permitted to show the respective ownership of each depositor.”

Puerto Rico adopted this stateside rule, adding that the burden of proof lies on the third-party claiming partial ownership, because the joint depositors are in a much better position to prove ownership than either the bank or the garnishing creditor.

Account documentation

As to the provision in the account documents to the effect that joint depositors are co-owners, the Court answered that this too is a presumption that may be rebutted by the interested party. ■



Federal Deposit Insurance Corporation

Authentication in an Internet banking environment

The Federal Deposit Insurance Corporation issued its *Financial Institution Letter FIL-77-2006* that clarifies a number of points on what the federal agencies that supervise financial institutions expect in connection with authentication of Internet banking transactions.

- By the end of the current year financial institutions are expected to have completed a risk assessment of its authentication procedures.
- Also by the end of 2006 they are expected to have implemented such risk mitigation measures as may prove necessary from the result of the assessment.
- A financial institution may rely on an external provider (e.g., an outside entity that provides Internet banking services to the institution) to perform the risk assessment. However, the financial institution remains ultimately responsible for managing the risk. As such, it should perform adequate due diligence in selecting the service provider.
- The risk assessment exercise should specifically consider the risks of “phishing,” “pharming” and “malware,” as well as reputation risk, harm to the customer and transaction risk.



According to the *Wikipedia* online encyclopedia (www.wikipedia.org):

“Phishing” is attempting to acquire sensitive information, such as passwords and credit card details, by masquerading as a trustworthy person or business in an electronic communication.

“Pharming” is a hacker’s attack aiming to redirect a website’s traffic to another (bogus) website.

“Malware” is software designed to infiltrate or damage a computer system without the owner’s informed consent.

- The financial institution remains ultimately responsible for the adequate authentication of transactions that involve access to customer information or movement of funds. Again, if it employs an external provider, it must ensure that the authentication techniques chosen by the provider are appropriate for the services offered by the institution. ■

Federal Reserve Board

Regulation E to cover payroll card accounts

The Board of Governors of the Federal Reserve System has amended its *Regulation E* (which regulates electronic fund transfers) to extend coverage to payroll card accounts established through an employer, and to which transfers of salaries, wages, or other compensation are made on a recurring basis.

The amendment will become effective on July 1, 2007.

Background

The 1978 *Electronic fund Transfer Act*, 15 U.S.C. 1693, establishes the rights, liabilities and responsibilities of those that participate in the electronic transfer of funds, such as:

- automated teller machines,
- point-of-sale terminals,
- automated clearinghouses,
- telephone bill payment systems and
- Internet banking services.

Most provisions of the law and its implementing *Regulation E* deal with disclosures that must be given to users, but they also delve into substantive rules such as maximum customer liability for unauthorized transfers, procedures for error resolution, issuance of unsolicited ATM cards and the like.

Payroll cards

The payroll card product involves an employer who arranges with a bank to make available to its employees a plastic card that allows access to individual accounts. The employer transfers the employees' wages and other compensation to these accounts, instead of paying the employees in cash or by check, or making direct deposits to their checking or savings accounts. Employees can use the payroll card as a debit card: to make purchases and withdraw funds from ATMs, for example. Payroll cards particularly benefits "unbanked" employees that do not have traditional bank accounts.

Regulation E Amendment

Although payroll cards will become covered by *Regulation E* come next July, they will be subject to some special rules. For example, banks need not provide periodic statements in connection to payroll card accounts (as they must do for other electronic transactions), if:

- balance information is made available through the telephone,
- transaction history is made available through the Internet or other electronic media, and
- the history is provided in written form upon request. ■

A consumer's maximum liability for unauthorized electronic fund transfers:

If the consumer notifies the bank within two business days after learning of the loss or theft of the card: the lesser of \$50 or the amount of unauthorized transfers that occur before the notice.

If the consumer fails to notify: the lesser of \$500 or the sum of:

(i) \$50 or the amount of unauthorized transfers that occur within the two business days, whichever is less; and

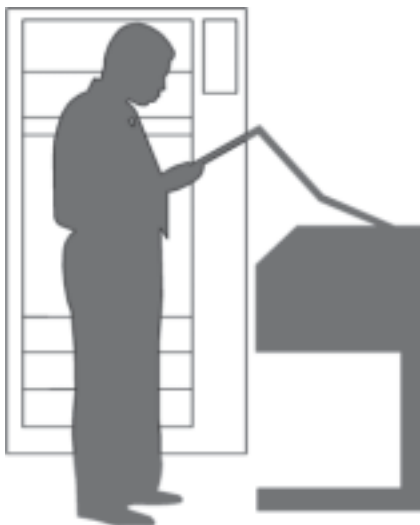
(ii) The amount of unauthorized transfers that occur after the close of two business days and before the notice, provided the bank establishes that the transfers would not have occurred had timely notice been given.

New DACO regulation on information security

Infringement of information security is the subject of a new regulation promulgated by the Puerto Rico Department of Consumer Affairs (DACO)—Regulation Number 7207.

Data banks

It provides that entities that maintain data banks with information that include the names of persons and at least one of the other items listed below, must deliver certain notices whenever it discovers a security breach. The list of other items is the following:



- * Social Security number,
- * number of driver's license, electoral card or other official identification,
- * bank account number (whether or not protected by an access code),

- * user name and access code,
- * medical information protected by HIPAA,
- * tax information, or
- * work performance evaluation.

Exceptions

The regulation does not apply if the information in question is limited to mailing or residential addresses, or other data available to the general public. Also exempted are data banks protected by cryptographic code, as well as those not kept for commercial purposes.

Notices

If a breach in security happens, the entity keeping the information must notify the persons affected as soon as possible. It must also give notice to the entity from which it acquired the data, or who provides it access to the data.

The notice must be in writing and must contain certain information listed in the regulation.

Alternate notification

The regulation permits alternate means of notification, such as advertising in the press, if the cost of individual notifications exceeds \$100,000, or if individual notifications are otherwise too onerous, given the number of persons involved, difficulty in locating them or the entity's economic condition.

Notice to DACO

In addition, the breach must be notified to DACO within ten days of its discovery. DACO, in turn, must make a public announcement, if notice to all persons affected was not possible. ■





from our archives: 1989

P.E.G. endorsement enforced

In the case of *Autoridad de Energía Eléctrica v. Las Américas Trust*, 123 D.P.R. 834 (1989), the Supreme Court of Puerto Rico considered the legal consequences of the "P.E.G." ("Prior Endorsements Guaranteed") initials that financial institutions stamp on the reverse of checks. The Court found them to constitute an express guaranty that a check is genuine and has not been altered.

The reason behind P.E.G.

The *Uniform Negotiable Instruments Law*, which used to regulate check negotiations in Puerto Rico prior to the adoption of the *Uniform Commercial Code*, did not cover the subject of inter-bank collections. That omission resulted in a somewhat confusing state of the law regarding the point of endorsement guaranties: did endorsements in inter-bank check collections warrant the validity of prior transfers? Some courts in the United States had ruled that at that stage of the collection process the check was not being "negotiated," and as a result no guaranty was offered. Others, to the contrary, had found the endorsing bank to be liable, based on a number of different legal theories. To set aside doubts and assure the reliability of the clearing process, banks started explicitly to guaranty the validity of previous endorsements by so stating on the checks themselves. Thus was born the banking practice that has survived to this day.

Extent of the guaranty

But even after the adoption of the P.E.G. practice, some doubts concerning the extent of the guaranty remained. An area particularly plagued was that of alterations other than forged endorsements. The enactment

of the U.C.C. set the record straight. The U.C.C., however, had not been adopted by the Puerto Rico legislature when *Las Américas Trust* was resolved.

Alteration

A check drawn by the Electric Power Authority in favor of John Grazel, Inc. was altered by deleting Grazel's name and in its place inserting that of Héctor Rivera Rivera. Rivera endorsed the instrument and deposited it to his account at Las Américas Trust Company. Las Américas in turn endorsed it to Royal Bank de Puerto Rico and added the P.E.G. initials. Royal presented the item to Citibank, the drawee, who

honored it. The Power Authority sued both Las Américas and Citibank; Citibank then brought Royal into the case.

Liability chain

The Supreme Court adopted the legal doctrine proposed by Royal Bank. Citibank, the Court found, was liable to the Power Authority for honoring the altered check. Royal, in turn, had to answer to Citibank, and Las Américas to Royal, on account of the respective P.E.G. stamps. Thus, the first bank to receive the item and stamp it "Prior Endorsements Guaranteed" was made ultimately responsible. ■

"The P.E.G. stamp employed by banks stands for 'Prior endorsements guaranteed.' While the Uniform Commercial Code, as will be seen, frequently fails to provide clear answers to questions in the area of negotiable instruments, it is unequivocal in its insistence that that indorsement is to be spelled with the letter 'i.' Bankers, who claim to know much of such weighty matters, may insist on beginning with 'e,' but this practice could be attributed to the bankers' understandable reluctance to stamp 'Pay any Bank PIG' on the backs of the checks they handle."

—*Perini Corp. v. First Nat. Bank of Habersham County*, 553 F.2d 398, 401 (5th Cir. 1977).



from our archives: 1991

Junior lien cancelled without notice

Junior liens not recorded in the Registry of Property at the time that a mortgage foreclosure complaint is filed may be cancelled without notice of the public auction, the United States District Court for the District of Puerto Rico ruled in *United States v. Vélez Vélez*, 772 F. Supp. 56, (1991).

The facts

The Small Business Administration commenced foreclosure proceedings against Carmelo Vélez Vélez and Nereida Huertas Fress. Although another mortgage had been executed over the same property, this one in favor of Eulogio Colón Díaz, the same was presented for recordation after the filing of the S.B.A. foreclosure complaint. After judgment, the court ordered the public auction of the property, which S.B.A. did not notify to Colón, although his mortgage was already in the Registry. Colón opposed S.B.A.'s motion that his mortgage be cancelled as a junior lien, based on the lack of notice.

The ruling

The court was not impressed by Colón's claims, and ordered the cancellation. That Colón did not receive notice was due to his failure to file the mortgage at an earlier date, the court said. "As the various provisions of the previous and current Mortgage Act clearly establish . . . , a foreclosure need only notify the holders of

subsequent credits appearing in the Registry when it begins the judicial action."

✓ Note:

Article 149 of the Mortgage Act (30 P.R. Laws Ann. § 2473) reads as follows:

"In cases of mortgage foreclosures, those who have recorded or noted their rights after the mortgage and prior to the notation of a lawsuit, must be notified of the auction in accordance with the procedural law in force in the defendant's case, without which the court cannot order the cancellation of these entries."

The published opinion does not clarify if S.B.A. noted in the Registry the filing of its lawsuit and if Colón's mortgage was presented for recordation subsequent thereto. In *Retirement System v. El Registrador de la Propiedad*, 104 D.P.R. 791 (1976), the Supreme Court of Puerto Rico said that a junior lien may be cancelled without notice if recorded subsequent to the Registry noting of the filing of the foreclosure suit. ■

FDIC enhancing protection of exam data

The FDIC has issued a reminder on how to handle examination data. *FIL-78-2006*.

- o All information stored in computer media must be encrypted.
- o E-mail messages that contain confidential information must be encrypted.
- o Computer passwords must be kept secure, i.e., not near or on the computer.
- o Unattended computers must be locked in an office or drawer, in a car trunk when traveling, or secured by a cable lock system.
- o Hard copies of examination work papers must be stored in locked filing areas.
- o Copying documents containing confidential bank customer information is discouraged. ■

CORPORATIONS

Corporate directors should register as “merchants”

Although there is diversity of opinion as to how to interpret the Puerto Rico Treasury Department’s regulation, the safe way to go for a member of a board of directors is to register as a “merchant” rendering services to the corporation.

Internal Revenue Code

Section 2801 of the Puerto Rico Internal Revenue Code provides that any person engaged in business on the island “as a merchant” must register with Treasury for purposes of implementation of the new sale and use tax. Implementing Regulation 7230’s § 2801(a)-1(a) ups the ante by referring to persons who engage for gain in any type of business. “Merchant” is any person who sells taxable items or services.

Directors

Members of a corporate board of directors normally receive some sort of taxable compensation for their services. If this is viewed as “selling taxable services,” then they may be considered to fall within the code’s definition of “merchant,” and their actions as board members as a “business.” Although the code and the regulation exempt occasional and sporadic sales from coverage, the fact that board meetings usually occur at regular intervals seems to prevent access to this exception.

Tax

The fact that a director registers does not entail that he or she must also collect a sales and use tax from the corporation, however. This is so if the corporation is deemed to be a “merchant” too. Services rendered by one merchant to another are exempt from said tax. Regulation 7230 requires, though, that the corporation issue to its directors a so-called “Exempt Sales Certificate.”

Failure to register

Failure to register carries a fine of \$10,000. Moreover, an unregistered director would have to collect the tax from the corporation and remit it to Treasury. Failure to do so would make the director personally liable for its payment. ■



Registration via Internet:
<http://www.hacienda.gobierno.pr>

Puerto Rico Supreme Court

Lowest contract bid rejected for being too low

Government contracts need not necessarily be awarded to the lowest bidder. In fact, in *Empresas Toledo, Inc. v. Junta de Revisión y Apelación de Subastas, 2006 T.S.P.R. 138*, the Supreme Court blessed the decision of the Public Buildings Authority to reject a bid because it was too low, and, thus, not viable.

Although *Empresas Toledo* was the lowest bidder, at \$467,718, the Authority awarded a demolition contract to Gatec, Inc., who bid \$749,900. The reason given was that Toledo's bid was much under the estimates that had been presented by the project's designer and the Authority itself. This cast doubts as to the feasibility of the Toledo bid, which the Authority deemed to be improbable.

Too good to be true!

The Authority's Board of Appeals agreed, concluding that the huge difference in pricing demonstrated that Toledo's bid was indeed unreal, as the work could not conceivably be performed properly for such a small sum.

Courts

The Circuit Court of Appeals disagreed, pointing out that a bid cannot be discarded simply because it is too low; that consideration of additional factors was necessary. It referred to *Empresas Toledo's* vast experience in demolishing structures, its financial capacity, equipment availability, adequate materials, and trained and competent employees.

On appeal, the Supreme Court sided with the Authority. There is no legal requirement that government contracts be awarded to the lowest bidder, it said. The Authority is fully empowered to reject a lower bid—absent evidence of fraud or unreasonableness—if it believes that the bid does not adequately protect its interests. No such evidence of fraud or favoritism was offered by Toledo, added the Supreme Court. ■



FRANCHISES

Change in ownership did not terminate franchise agreement

A franchise to operate a hotel under the *Howard Johnson* brand did not terminate by the fact that the property changed owner. *Hotel Associates, Incorporated v. Howard Johnson*, 2006 U.S. App. LEXIS 19355 (1st Cir.).

The U.S. Court of Appeals faced three related legal issues in considering this appeal from the U.S. District Court for the District of Puerto Rico:

- 1- Did a change in ownership actually take place? This question the court answered affirmatively.
- 2- Did failure to notify the change in owner automatically terminate the franchise agreement? The court answered in the negative.
- 3- Did by granting another franchise in the same area the franchisor breach the franchise agreement? Again the court answered “no.”

Change in ownership

Howard Johnson Franchise Systems, Inc. had licensed Hotel Associates, Incorporated to operate a hotel in Isla Verde (the *Carib Inn*) under the *Howard Johnson* flag. As a result of a mortgage foreclosure suit filed by a creditor, Hotel Associates lost title to the property to the highest bidder at public auction: a corporation by the name “R.R. Isla Verde Hotel Corp.” This normally would be a clear case of change in ownership, except that the sole shareholder of both Hotel Associates and R.R. Isla Verde was the same person: Benito R. Fernández. This fact led to the claim that no change in ownership had really taken place.

The court did not agree, pointing out that the licensee was the corporation and not its shareholder, citing the New York case of *Hotel Esplanade, Inc. v. Herman*, 197 N.Y.2d 579 (N.Y. Sup. Ct. 1960), which had rejected the converse argument that ownership of a hotel changed where the identity of the stockholders changed, despite continuity of corporate ownership.

Termination of franchise

The contract required the licensee to notify the licensor in writing at least 30 days in advance of the occurrence of any change in the ownership of the hotel. Failure to notify gave Howard Johnson the right to terminate the franchise agreement. Neither notice of change in ownership nor notice of termination were given. However, termination did not occur automatically. To reach this conclusion the court examined a number of contract clauses.

It pointed to the text of the ownership provision—“Howard Johnson may, in its sole discretion, immediately terminate this Agreement . . .”—and contrasted it to that used for other reasons for termination—the “Agreement shall automatically and immediately terminate . . .” “Based on those language differences . . . Howard Johnson may exercise its discretion to terminate the contract, but the contract does not terminate *ex proprio vigore* (‘by its own force’).”

Another franchise

Even though the franchise was found to have survived the transfer of title, Howard Johnson had rightfully licensed another entity to operate a *Howard Johnson* hotel in the same geographic area. The Court of Appeals so held because the agreement defined the term of the first license to commence “upon the integration of the [hotel] into the Howard Johnson Reservation System,” which never took place. “Because the Carib Inn property was never integrated into the Howard Johnson Reservation System, under the unambiguous language of the Agreement, the territorial protection provision . . . was not in effect at the time of the alleged breach.” ■

“Ricas” crackers infringe trademark of “Rica” crackers

In its opinion in the case of *Borinquen Biscuit Corp. v. M.V. Trading Corp.*, 443 F.3d 112 (1st Cir. 2006), the U.S. Court of Appeals for the First Circuit discussed the factors used to determine the likelihood of confusion between two brands.

Sweet vs. salty

The *Rica* trademark for crackers, cookies and biscuits has been registered with the U.S. Patent and Trademark Office since 1969, initially by the Sunland Biscuit Company, and since 1976 by plaintiff Borinquen biscuit Corp., who purchased it. The product in question, a round, yellowish, semi-sweet cracker, has been sold in Puerto Rico since 1962. Borinquen uses a logo that consists of a red circle encompassing white letters. *Rica* is the only cookie, cracker or biscuit registered under that name.

In April of 2003 “the tectonic plates shifted,” as the court stated, when defendant M.V. Trading Corp. began selling a round, yellowish, salty cracker under the name *Nestle Ricas*. This product’s logo consisted of a white oval with red letters.

Borinquen sued, and the District Court granted a preliminary injunction prohibiting M.V. from selling its product. M.V. promptly appealed, but the Circuit Court affirmed the injunction.

Confusion

First the Court of Appeals concluded that *Rica* was eligible for trademark protection, and then went on to explore if the District Court had correctly concluded that *Rica* and *Ricas* were similar enough as to make it likely for consumers to be confused. The court listed eight factors to be considered:

- 1- the similarity of the marks,
- 2- the similarity of the goods,
- 3- the relationship between the parties’ channels of trade,

- 4- the relationship between the parties’ advertising,
- 5- the classes of prospective purchasers,
- 6- evidence of actual confusion,
- 7- the defendant’s intent in adopting its mark, and
- 8- the strength of the plaintiff’s mark.

“A proper analysis takes cognizance of all eight factors but assigns no single factor dispositive weight.”

District Court

After applying the eight factors, the District Court had concluded that M.V.’s use of its mark was likely to result in consumer confusion. On one hand, the goods were dissimilar, no actual confusion had been shown, and no evidence existed that M.V. intended to mislead consumers. On the other, the remaining factors tended to favor a likelihood of confusion.

Court of Appeals

The Circuit Court started out by clarifying that the burden of a holder of a trademark is to show likelihood of confusion, not actual confusion. “Historically, we have attached substantial weight to a trademark holder’s failure to prove actual confusion only in instances in which the relevant products have coexisted on the market for a long period of time.” It added that such was not the case here, as M.V.’s product had been introduced to the Puerto Rico market in 2003.

As to the mark “strength” element, the court stated that the District Court had found that the *Rica* mark had been registered for more than three decades, that Borinquen’s *Rica* was the only cookie, cracker or biscuit trademarked under that name in the United States, and that Borinquen’s efforts in promoting and protecting its mark were in conformance with industry standards. ■

LABOR UPDATE

Employer's vicarious liability for sexual harassment

In *Hernández v. Televisión*, 2006 T.S.P.R. 142, the Puerto Rico Supreme Court addressed the question of an employer's potential vicarious liability for omission of disciplinary actions to prevent subsequent sexually harassing conduct.

The script

Let's assume that you manage a television station and one of your cameramen makes harassing sexual advances (including indecently exposing himself) to an employee of an independent contractor that you retain to produce one of your shows. Let's also assume that there was a prior incident where the same cameraman had made a lewd pass at a makeup lady, who later qualified the incident as a misunderstanding. After a quick investigation of the incident, your director of human resources and you decide to send a letter informing the cameraman of your harassment-free workplace policy.

Could or should you have foreseen, by virtue of the sexually charged incident later taken as a misunderstanding, the very serious acts perpetrated by your employee against the employee of the independent contractor? Are you, as the cameraman's employer, to be held responsible for his lewd and indecent acts?

The law

Puerto Rico Civil Code article 1803 provides that owners or directors of an establishment or enterprise are liable for any damages caused by their employees in the course of employment. This responsibility for someone else's acts is what is called "vicarious liability."

The ruling

The Supreme Court ruled in *Televisión* that a series of elements must be present in order for vicarious liability to exist, as required by article 1803. These include that the conduct or acts be carried out with the purpose of serving and protecting the employer's interests and objectives. The Court held that even in the hypothetical case that you would have carried out disciplinary procedures for the prior incident, the cameraman's actions under scrutiny were in no way foreseeable. That, coupled with the fact that the employee had never been singled out as a person likely to commit acts of this nature, lead it to conclude that the defendant did not incur in an omission that brings about vicarious liability.

The dissenting opinion

The dissenting judges in this case opined that *Televisión* was liable by omission, for failing, in spite of its anti-harassment policy, to act in a reasonable way in order to prevent the damages caused by the cameraman to the plaintiff. Faced with a violation of the company's norms, the dissenting opinion expresses that the employer merely communicated to the offender that he could not again incur in such conduct. It is the duty of every employer not only to anticipate damages, but also to prevent that these occur, when it is reasonably foreseeable. Therefore, as a result of said omission, it was reasonably predictable, the two dissenting judges continued, that such regrettable events would eventually take place. In view of this, the employer should have been held accountable for its omissions and the damages resulting from them. ■



New Puerto Rico law

Protocol required to manage domestic violence in the workplace

Law No. 217 of September 29, 2006 requires both public and private sector employers to develop and implement a Protocol to manage domestic violence situations in the workplace.

Zero tolerance

The legislation was motivated by the need to promote the public policy of zero tolerance of domestic violence. The implementation of the protocol intends to provide uniformity with respect to measures and procedures to be followed when an employee, male or female, has been a victim of domestic violence.

The law states that taking effective preventive and security measures will enable the adequate handling of cases that may carry over into the workplace.

Minimum requirements

It is the responsibility of each and every employer in Puerto Rico to comply with the requirement of

establishing the protocol, which should include the following minimum requirements:

- a declaration of public policy,
- a legal basis,
- personal duties, and
- uniform procedures to be followed in the handling of such cases.

Technical counsel

The Office of the Solicitor for Women will offer the technical counsel necessary for the elaboration and implementation of these Protocols; and the Department of Labor and Human Resources will shoulder the responsibility of enforcing them. ■

Seven reasons why employers should address domestic violence

1. Domestic violence affects many employees.
2. Domestic violence is a security and liability concern.
3. Domestic violence is a performance and productivity concern.
4. Domestic violence is a health care concern.
5. Domestic violence is a management issue.
6. Taking action in response to domestic violence works.
7. Employers can make a difference.

Source: www.endabuse.org

Pension Protection Act of 2006

The Pension Protection Act of 2006 is one of the most comprehensive pension reform legislations by the United States Congress since ERISA was enacted in 1974.

It strengthens plan reporting and participant disclosure rules, requires stricter funding rules for single-employer and multiemployer defined benefit pension plans, resolves legal uncertainty surrounding cash balance and other hybrid defined benefit plans, allows plan fiduciaries to give investment advice to participants, and makes permanent significant tax retirement savings incentives enacted under prior law.

Effective date

The act will be phased in over the next few years. Some of the disclosure requirements and diversification rules will go into effect after December 31, 2006; while most of the other rules will not be effective until 2008. Other rules, such as those involving cash balance or hybrid plans, will be effective retroactively or upon enactment.

The act will cause changes in the way pension plans are designed and administered, amend plan documents, increase plan funding, and make additional plan disclosures in regulatory filings and to plan participants.

Reporting and disclosures

- ◆ In the case of multiemployer defined benefit plans, § 202 requires actuarial certification as to whether the plan is in endangered or in critical status.
- ◆ Section 503 requires additional information to be provided in the Form 5500 annual report, for certain defined benefit pension plans.
- ◆ Section 504 requires plan Form 5500 annual reports to be made available electronically on the Department of Labor's website and on the sponsor's website.
- ◆ Section 1103 directs the Secretary of the Treasury and the Secretary of Labor to simplify Form 5500 annual return reporting requirements for certain plans with fewer than 25 participants, and the filing requirements for one-participant plans.

Notices

- ◆ Section 501 requires single-employer defined benefit pension plans to provide an annual funding notice, similar to the current rules for multiemployer plans, and eliminates the summary annual report requirement for single-employer defined benefit pension plans.
- ◆ Section 507 requires a notice when participants are eligible to exercise their right to divest employer securities.



- ◆ Section 508 requires quarterly benefits statements for participant-directed defined contribution plans, annual statements for other defined contribution plans, and statements every three years for defined benefit pension plans.
- ◆ Section 506 requires notices to workers and retirees for plan terminations, and § 509 for blackout periods.

Pension funding

- ◆ Section 101 § 102 replace the existing funding rules and establish new minimum funding standards for single-employer defined benefit pension plans.
- ◆ Section 201 establishes new minimum funding rules for multiemployer defined benefit pension plans and extends interest rate rules for the funding standard account for multiemployer defined benefit plans that require the use of a rate based on long-term investment grade.
- ◆ Section 405 allows small plans that are fully-funded to pay variable-rate premiums to PBCC and establishes special PBCC premiums for small plans.

The act also accelerates contribution requirements for at-risk plans; amends the interest rate calculation for lump sum distributions; limits benefit increases and accruals for under-funded plans; requires that shutdown benefits be funded through corporate assets; and promotes increased funding for retiree medical costs and long-term care costs, by allowing transfer of excess pension assets to fund the estimated retiree medical costs.

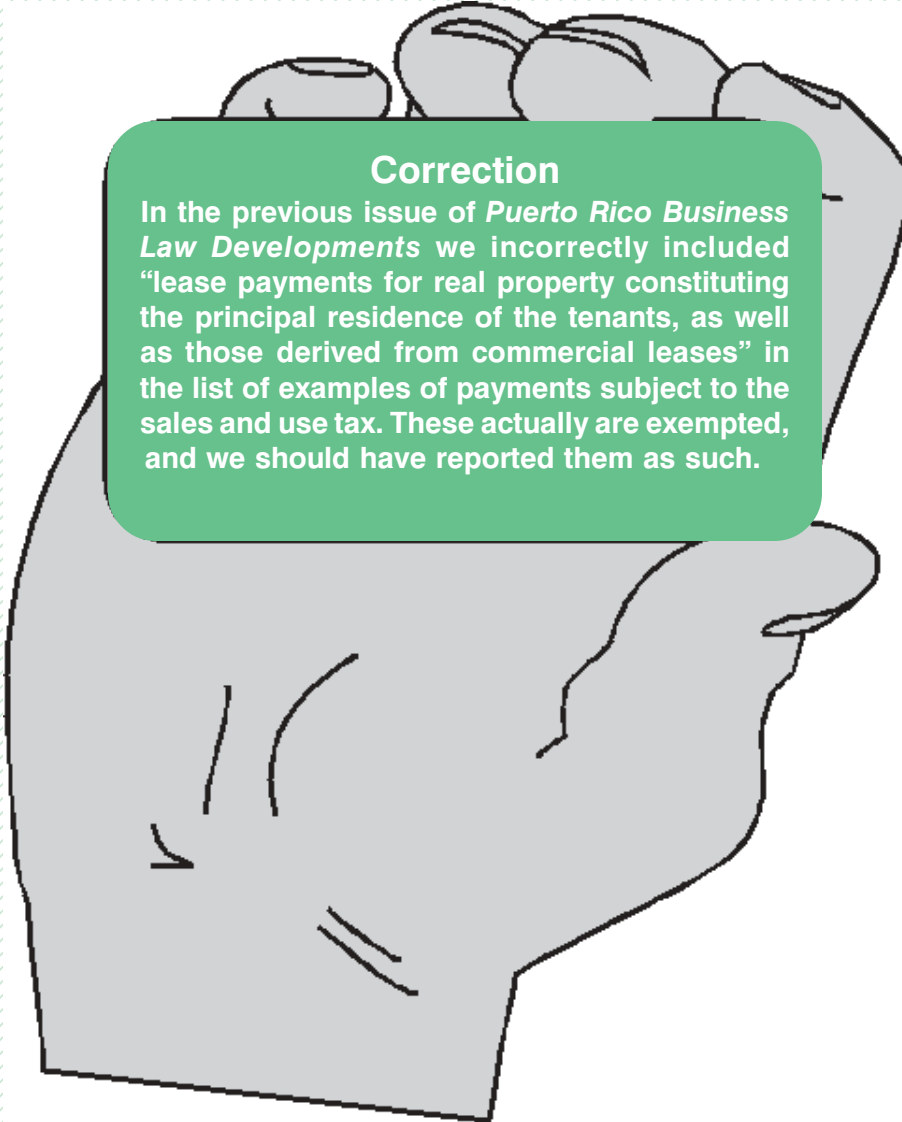
401(k) plans

- ◆ Section 903 provides rules for an “eligible combined plan,” allowing small employers (with up to 500 employees) to establish combined defined benefit and automatic enrollment 401 (k) plans using a single plan document and trust fund, beginning in 2010.
- ◆ Section 611 creates a prohibited transaction exemption for advice provided by a “fiduciary adviser” under an “eligible investment advice arrangement.” Fiduciary advisers of a plan are allowed to give investment advice to 401(k) participants or beneficiaries if requirements are met.

Miscellaneous

- ◆ Section 701 establishes new rules for testing defined benefit plans, including cash balance and other hybrid plans, for age discrimination under the Internal Revenue Code, ERISA, and the Age Discrimination in Employment Act (ADEA).
- ◆ Title XII of the act also includes miscellaneous provisions related to exempt organizations and charitable contributions, including public disclosure of Forms 990T by 501 (c)(3) organizations.
- ◆ Finally, the act establishes a new independent audit requirement for certain defined contribution plans; creates a safe harbor to encourage employers to offer automatic enrollment in their defined contribution plans; allows direct rollovers from retirement plans to Roth IRAs; and requires defined contribution plans to permit employees to diversify out of investments in employer securities if the securities are publicly traded. ■





Correction

In the previous issue of *Puerto Rico Business Law Developments* we incorrectly included “lease payments for real property constituting the principal residence of the tenants, as well as those derived from commercial leases” in the list of examples of payments subject to the sales and use tax. These actually are exempted, and we should have reported them as such.

GOLDMAN ANTONETTI & CÓRDOVA, P.S.C.
PO BOX 70364, SAN JUAN PR 00936-8364

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