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The Editorial Board would like to thank all the authors whose works compose the first number of this fourth volume of the *University of Puerto Rico Business Law Journal*. This number includes our first term analysis, focused on labor law jurisprudence from the United States Supreme Court, The First Circuit and the District Court for the District of Puerto Rico; a discussion of the various applicable methods to interpret the relevant statutes in order to determine the "location" of national banks for purposes of establishing diversity of citizenship; an analysis of the changes in Puerto Rico's flow-through taxation and the importance of choice of entity strategies as well as its consequences; a historical analysis on the feudal origins of public utilities in the European Union; and, finally, a discussion about the legal nature of bank loans in Puerto Rico's civil law system that defends its mercantile nature.

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With the utmost gratitude,

Paola Medina Prieto, CPA
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2011-2012 TERM ANALYSIS OF FIRST CIRCUIT COURT OF APPEALS, U.S. DISTRICT COURT FOR THE DISTRICT OF PUERTO RICO, AND U.S. SUPREME COURT LABOR AND EMPLOYMENT LAW JURISPRUDENCE

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I. INTRODUCTION

During the 2011-2012 term, the First Circuit Court of Appeals, the U.S. District Court for the District of Puerto Rico ("the USDC-PR"), and the U.S. Supreme Court decided multiple labor and employment cases. From those, a selection of over 30 cases was made in order to summarize the most important holdings made by those courts concerning Labor and Employment Law. The cases are organized according to their respective subject matters.

II. DISABILITY

A. The Americans with Disabilities Act "Association Provision" and the Family and Medical Leave Act

In *Mena Valdéz v. E.M. T-Shirt Distributors, Inc.*,[1] the plaintiff claimed that he was discriminated against and forced to resign from his job based of the stress he suffered and leaves of absences he had to take because of his daughter's medical condition. As a result, he filed claims pursuant to sections 12122(a) and 12112(b)(4) ("the association provision") of the Americans with Disabilities Act ("ADA"),[2] and also the Family and Medical Leave Act ("FMLA").[3] The defendant filed a motion for summary judgment and the Court granted it with respect to the ADA claims but denied it with respect to the FMLA claim.

To establish an unlawful discrimination claim under section 12112(a) of the ADA, a plaintiff must prove by a preponderance of the evidence that: (1) he was disabled within the meaning of the Act; (2) with or without reasonable accommodation he was qualified to perform the essential functions of the job; and (3) the employer discharged him because of his disability. The Court held that the plaintiff failed to prove the first element. In reaching that conclusion, the Court applied the following sub-analysis which is used by the First Circuit.[4] In order to demonstrate a disability: (1) the employee must prove that he suffers from a physical or mental impairment; (2) the Court must evaluate the life activities affected by the impairment to determine whether they constitute "major" life activities; and (3) the Court

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[1] Mena Valdéz v. E.M. T-Shirt Distributors, Inc., 869 F. Supp. 2d 252 (D.P.R. 2012).
[2] Americans with Disabilities Act, 42 U.S.C. §§ 12112(a)-12112(b)(4) (1990).
[3] Family Medical Leave Act, 29 U.S.C. §§ 2601-2654 (1993).
[4] *See e.g.*, Carroll v. Xerox Corp., 294 F.3d 231, 238 (1st Cir. 2002).

must ask whether the impairment substantially limits the major life activity. In this case, the Court held that the employee failed to satisfy the first prong as he failed to provide evidence of any "medical care" he received in light of his daughter's condition or a psychiatric evaluation diagnosing his alleged mental impairment. Thus, the Court granted summary judgment against the plaintiff with respect to the section 12112(a) claim.

Concerning section the "association provision" of ADA, which protects employees from discrimination for knowing or having a relationship with a disabled person, the Court held that the it does not require an employer to make any reasonable accommodation to an employee caring for a disabled relative. Rather, section 12112(b)(4) only guarantees that an employee with a disabled relative be treated no differently than any other employee; it does not provide extra benefits or allowances to an employee simply because of his association with a disabled person.[5] Thus, the Court also granted summary judgment against the plaintiff on his ADA association provision claim.

However, the Court refused to grant summary judgment on the FMLA claim. The FMLA contains two distinct types of provisions: those establishing substantive rights for employees and those providing protection for those rights.[6] The first, codified at 29 U.S.C. § 2612(a)(1)(C), "awards eligible employees 'a total of 12 workweeks of leave during any 12–month period,' which may be taken intermittently in order to care for a child with a 'serious health condition.'"[7] "The second type of provision prohibits employers from interfering with the substantive rights conferred by the FMLA."[8] Section 2619(a) sets forth a notice provision requiring an employer to prominently display notices containing excerpts or summaries of pertinent FMLA employee information. Moreover, under 29 U.S.C. § 2615(a), an employer may not restrain or deny an employee from exercising his right to take an FMLA leave. If such a situation arises, an employee may bring a civil action seeking compensatory damages, including wages, salary, and benefits. In this case, the employer failed to provide notice to its employees about their FMLA rights to 12 unpaid weeks leave to take care of a disabled child.[9] Additionally, there were genuine issues of material fact as to that regard.

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[5] Torres-Alman v. Verizon Wireless Puerto Rico, Inc., 522 F. Supp. 2d 367, 382 (D.P.R. 2007);
[6] Mena-Valdez, 869 F. Supp. 2d at 262 (citing Colburn v. Parker Hannifin Corp., 429 F.3d 325, 330 (1st Cir. 2005)).
[7] *Id.* at 252 (citing 29 U.S.C. § 2612(a)(1)(C)).
[8] *Id.* (citing 29 U.S.C. § 2615).
[9] *Id.* at 263.

In our opinion, the logical statute to bring this claim was under the FMLA. Although the plaintiff's argument with respect to the association provision of the ADA was creative, it was destined to fail and seems to have been a long shot argument by the plaintiff.

B. Exhaustion of Administrative Remedies

In four cases during the 2011-2012 term, the Courts analyzed the need to exhaust administrative remedies before filing a claim under the ADA or Title VII of the Civil Rights Act of 1964 ("Title VII").[10] First, in *Cintrón-García v. Supermercados Econo, Inc.*,[11] the USDC-PR had to decide whether a party is barred from filing a lawsuit in federal court after receiving a second right-to-sue letter from the U.S. Equal Employment Opportunity Commission ("EEOC"), if that party failed to file a lawsuit within the ninety day period provided by a first right-to-sue letter. It is a notable case because the issue at hand has not been covered by the First Circuit and therefore Judge Gelpí had to cite to cases from other circuits (notably the Fifth, Sixth, and Eight circuits).

In *Cintrón-García*, the plaintiff filed an ADA discrimination claim with the Anti–Discrimination Unit of the Commonwealth of Puerto Rico Department of Labor and Human Resources ("ADU")[12] on May 2, 2007. After being subsequently terminated on July 16, 2007, he amended his charge to include retaliation. On May 21, 2008, the plaintiff received a right-to-sue letter ("the First Letter") from the EEOC. Almost a year later, on April 13, 2010, he inexplicably received a second right-to-sue letter from the EEOC ("the Second Letter"). The plaintiff then filed suit in the USDC-PR pursuant to Title VII[13] and ADA[14] alleging disability discrimination, retaliation, and wrongful termination. The defendant filed a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6)[15] on grounds of failure to exhaust administrative remedies, arguing that the complaint was time-barred because it was not filed within ninety days of the receipt of the First Letter. The plaintiff countered by arguing that the complaint was not time-barred since it was filed within ninety days of the Second Letter.

Title VII and the ADA require, as a predicate to a civil action, that the complainant first file an administrative charge with the EEOC within a

[10] Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000e-2000e17.
[11] Cintrón-García v. Supermercados Econo, Inc., 818 F. Supp. 2d 500 (2011).
[12] The filing of an administrative charge with the ADU is considered a filing with the EEOC. *See id.* at 507.
[13] Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000e-2000e17.
[14] Americans with Disabilities Act, 42 U.S.C. §§ 12112(a).
[15] Fed. R. Civ. P. 12(b)(6).

specified time period, usually 180 or 300 days,[16] after the discrimination complained of, and that the lawsuit be brought within a period of 90 days after notice that the administrative charge was dismissed or after the agency instead issues a right-to-sue letter.[17] If the suit is not filed within the 90 days, the complainant forfeits his right to bring a private civil action.[18] In lieu of an on point First Circuit case, Judge Gelpí relied primarily on a Sixth Circuit case: *Brown v. Mead,*[19] which presented almost identical circumstances to the instant case.[20] In *Brown*, the Sixth Circuit held that "a plaintiff in a Title VII action, who received two successive, facially valid right-to-sue notices from the EEOC, but who did not commence a suit in a district court within ninety days of receipt of the first notice, is precluded from proceeding under the second notice."[21] The Sixth Circuit reached such conclusion even though the first-issued right-to-sue letter later turned out to be in error and was followed by the second letter with an admission by the EEOC to that effect. Under some circumstances, the EEOC may issue a second right-to-sue notice upon completion of a discretionary reconsideration of a prior determination provided it has given notice to both parties of its decision to reconsider within the ninety-day period provided by the initial notice of the right-to-sue. A party may challenge the validity of that reconsideration and second notice only by showing that the sole purpose of reconsideration was to extend the initial notice period.[22]

In the instant case, the two right-to-sue letters issued were based on the same charge and the plaintiff admitted that he did not file a new charge or a reconsideration with the ADU or the EEOC. Thus, the Court applied *Brown* and held that the plaintiff's Title VII and ADA claims were time barred

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[16] *See* Cintrón-García, 818 F. Supp. 2d at 507 n. 5 ("In Puerto Rico, an aggrieved employee has 300 days from the occurrence of the employment action complained of to file an administrative charge in instances where the local Department of Labor is empowered to provide relief, i.e., in instances of 'deferral' jurisdiction.") (citing Lebrón–Ríos v. U.S. Marshals Service, 341 F.3d 7, 11 n. 5 (1st Cir. 2003)). The Court further held that "[o[therwise, the applicable period is 180 days." *Id.* (citing 42 U.S.C. § 2000e–5(e)(1)).

[17] *Id.* at 507 (citing 42 U.S.C. § 2000e–5(f)(1); Clockedile v. New Hampshire Dept. of Corrections, 245 F.3d 1 (1st Cir. 2001)).

[18] *Id.* at 507 (citing 42 U.S.C. § 2000e–5(f)(1)).

[19] Brown v. Mead, 646 F.2d 1163, 1164 (6th Cir. 1981).

[20] Judge Gelpí also relied, to a lesser extent, on Spears v. Mo. Dep't of Corr. & Human Res., 210 F.3d 850, 853 n. 2 (8th Cir. 2000) (refusing to consider an adverse employment action stemming from an earlier EEOC complaint where complainant did not file suit within ninety days of the prior EEOC decision).

[21] Brown, 646 F.2d at 1164.

[22] González v. Firestone Tire & Rubber Co. Et al., 610 F.2d 241, 246 (5th Cir. 1980).

due to not being filed within 90 days of having exhausted administrative remedies unless the plaintiff could demonstrate that an equitable tolling exception applied.[23]

The Court also held that "equitable tolling is not appropriate unless a claimant misses a filing deadline because of circumstances effectively beyond his control (such as when his employer actively misleads him, and he relies on that misconduct to his detriment)."[24] Cases in which the equitable tolling doctrine is invoked are most often characterized by some affirmative misconduct by the party against whom it is employed, such as an employer or an administrative agency.[25] Courts generally weigh five factors in assessing claims for equitable tolling: "(1) lack of actual notice of the filing requirement; (2) lack of constructive knowledge of the filing requirement; (3) diligence in pursuing one's rights; (4) absence of prejudice to the defendant; and (5) a plaintiff's reasonableness in remaining ignorant of the notice requirement."[26] Assessing those factors, the Court in *Cintrón-García* found that equitable tolling was not justified and thus held that the plaintiff's ADA and Title VII claims were time barred and dismissed them.

The second case in this term related to the exhaustion of administrative remedies was *Vázquez-Rivera v. U.S.*,[27] which dealt with a federal U.S. Army employee who filed claims under the ADA[28] and the Age Discrimination in Employment Act ("ADEA").[29] With respect to the ADEA claim, "whereas most employees must first exhaust administrative remedies before instituting an ADEA action, a federal employee has the option of bypassing administrative remedies entirely and suing directly in federal district court."[30] For federal employees that opt to file suit directly, § 633a(d) provides that the employee must give the EEOC not less than thirty days' notice of an intent to file suit and must file said notice within one hundred and eighty days after the alleged unlawful practice occurred.[31] In the instant case, the plaintiff did not exhaust administrative remedies. Moreover, he did not meet the requisites under § 633a(d) because he did not give thirty days' notice to the EEOC. Thus, the USDC-PR dismissed the ADEA claim.

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[23] Cintrón-García, 818 F. Supp. 2d at 509.
[24] *Id.* (citing Bonilla v. Muebles J.J. Álvarez, Inc., 194 F.3d 275, 278 (1st Cir. 1999)).
[25] *Id.*
[26] *Id.* (citing Kelley v. N.L.R.B, 79 F.3d 1238, 1248 (1st Cir. 1996); Neves v. Holder, 613 F.3d 30, 36 n.5 (1st Cir. 2010)).
[27] Vázquez-Rivera v. United States, Civil No. 11–1346, 2012 WL 2423285 (D.P.R. Jun. 26, 2012) ("Vázquez-Rivera I") (amended in Vázquez-Rivera v. United States, Civil No. 11–1346, 2012 WL 4863728 (D.P.R., Oct. 12, 2012) ("Vázquez-Rivera II")).
[28] Americans with Disabilities Act, 42 U.S.C. §§ 12101–12203.
[29] Age Discrimination in Employment Act, 29 U.S.C. §§ 621–634.
[30] Vázquez-Rivera I, 2012 WL 2423285 at *4 (citing Jorge v. Rumsfeld, 404 F.3d 556, 566 (1st Cir. 2005); 29 U.S.C. § 633a(c)).
[31] Vázquez-Rivera I, 2012 WL 2423285 at *4 (citing 29 U.S.C. § 633a(d)).

With respect, to the ADA claim, Judge Fusté of the USDC-PR noted that federal employees are not covered by the ADA, but are instead "covered under the Rehabilitation Act."[32] Therefore, the plaintiff's claim was actually under the Rehabilitation Act rather than the ADA. In this case, it was undisputed that the plaintiff did not exhaust administrative remedies. The Court initially erroneously held that under the Rehabilitation Act, the exhaustion of administrative remedies was never required and consequently did not dismiss the plaintiff's Rehabilitation Act claim.[33] However, the Court reversed itself 4 months later and granted a motion to alter its judgment filed by the defendant.[34] The Court explained that in sections 794a(a)(1) and (a)(2) of the Rehabilitation Act, a distinction is made between the remedies and procedures for employees of the federal government versus those for employees of federal fund recipients.[35] In summary, under the Rehabilitation Act, the remedies available to employees of the federal government are outlined in section 794a(a)(1) which specifies that the procedural rules for such remedies are to be derived from Title VII of the Civil Rights Act,[36] which in turn requires the exhaustion administrative remedies. However, the remedies available to employees of mere recipients of federal funds are governed by the procedural rules of Title VII of the Civil Rights Act,[37] which do *not* require an exhaustion of administrative remedies.[38] Since the plaintiff was a U.S. Army employee, he was obliged to exhaust administrative remedies. Since he did not do so, the Court altered is previous judgment and also dismissed the Rehabilitation Act claim.[39]

Third, in *Flores-Silva v. McClintock-Hernández*,[40] Judge Fusté faced a similar situation to the one presented in *Vázquez-Rivera* albeit with a Puerto Rico Department of State employee as the plaintiff. In this case, the plaintiff

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[32] *Id.* at *3 (citing Enica v. Principi, 544 F.3d 328, 338 n.11 (1st Cir. 2008) (Federal Employees are not covered by the ADA); *see also* Rehabilitation Act, 29 U.S.C. §§ 791-794f.
[33] Vázquez-Rivera I, 2012 WL 2423285.
[34] Vázquez-Rivera II, 2012 WL 4863728.
[35] *Id.* at *1.
[36] *See* Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e–16.
[37] *Id.* § 2000d–1.
[38] *Id.* at *1-2 (citing 29 U.S.C. § 794a; Prescott v. Higgins, 538 F.3d 32, 44 (1st Cir. 2008); Roman–Martinez v. Runyon, 100 F.3d 213, 216 (1st Cir. 1996)); *see also* Brennan v. King, 139 F.3d 258, 268 n.12 (1st Cir. 1998) (citing Cook v. Rhode Island Dept. of Mental Health, Retardation, and Hospitals, 783 F. Supp. 1569, 1572 (D.R.I. 1992), *aff'd*, 10 F.3d 17 (1st Cir. 1993)).
[39] Vázquez-Rivera II, 2012 WL 4863728.
[40] Flores-Silva v. McClintock-Hernández, 827 F. Supp. 2d 64 (2011).

had presented a discrimination claim under section 12101 of the ADA,[41] a retaliation claim under section 12203 of the ADA,[42] and a Rehabilitation Act[43] claim. However, the plaintiff never filed a claim with the EEOC prior to filing suit. Consequently, the defendant presented a motion to dismiss all the federal claims due to a failure to exhaust administrative remedies.

The Court reiterated the well-established principle that administrative remedies must be exhausted before filing a claim under section 12101 of the ADA, such as that filed by the plaintiff, and dismissed said claim.[44] With respect to the retaliation claim under section 12203 of the ADA, the Court noted the remedies and procedures that apply to such claims depend on which Title is the source for the plaintiff's underlying claim. Since the section 12203 claim's underlying claim was under section 12101, which requires exhaustion of administrative remedies, the plaintiff's retaliation claim also required an exhaustion of administrative remedies, something which the plaintiff failed to do.[45] Thus, that claim was also dismissed.

With respect to the plaintiff's Rehabilitation Act claim, Judge Fusté contradicted his own opinion published only 15 days before[46] in *Vázquez-Rivera v. U.S.*.[47] In a concise section, the Court justified its dismissal of the plaintiff's Rehabilitation Act claim by stating that "[t]he First Circuit has held that the Rehabilitation Act requires plaintiffs to exhaust administrative remedies before filing suit in federal court."[48] It does not go more in depth into its justification. However, as the same Judge noted in *Vázquez-Rivera*, the Rehabilitation Act does not always require an exhaustion of administrative remedies.[49] Since the plaintiff in this case worked for a state agency which was the recipient of federal funds, the applicable Rehabilitation Act provision was § 794a(a)(2), which in turn states that the remedies are governed by the procedural rules of Title VI of the Civil Rights Act, which do *not* require the exhaustion of administrative remedies.[50]

Therefore, dismissing the plaintiff's Rehabilitation Act claim on the sole basis of a failure to exhaust administrative remedies, as the Court did, is

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[41] Americans with Disabilities Act, 42 U.S.C. § 12101.
[42] *Id.* § 12203.
[43] Rehabilitation Act, 29 U.S.C. § 791.
[44] Flores-Silva, 827 F. Supp. 2d at 74.
[45] *Id.* at 75.
[46] Flores-Silva was published on October 27, 2012.
[47] Initially Vázquez-Rivera v. United States, Civil No. 11–1346, 2012 WL 2423285 (D.P.R. Jun. 26. 2012) ("Vázquez Rivera I"). Judgment amended in Vázquez-Rivera v. United States, Civil No. 11–1346, 2012 WL 4863728 (D.P.R., Oct. 12, 2012) ("Vázquez-Rivera II").
[48] Flores-Silva, 827 F. Supp. 2d at 75.
[49] *See* Vázquez-Rivera II, 2012 WL 4863728, at *1 n.2.
[50] *See id.*; *see also* Brennan v. King, 139 F.3d 258, 268 n.12 (1st Cir. 1998) (citing Cook v. Rhode Island Dept. of Mental Health, Retardation, and Hospitals, 783 F. Supp. 1569, 1572 (D.R.I. 1992), *aff'd,* 10 F.3d 17 (1st Cir. 1993)).

erroneous because the plaintiff was not a federal employee. The fact that this error was made despite the same judge having published an opinion only 15 days before which corrected a similar error and explained in detail the distinction between how the Rehabilitation Act applies to federal and non-federal employees is puzzling.

Fourth and finally, in *Villalongo Gordillo v. Centennial de Puerto Rico/ AT&T Mobility, Inc.,*[51] the USDC-PR had to analyze the applicability of an exception to the exhaustion of administrative remedies requirement in ADA cases —the so-called reasonably related retaliatory claims test, commonly known as the *Clockedile* exception in the First Circuit.[52] This exception states that claims based on retaliation for filing an EEOC charge are "preserved so long as the retaliation is reasonably related to and grows out of the discrimination complained of to the agency. That is, the retaliation must be for filing the complaint with the EEOC."[53] Thus, the failure to file an EEOC charge for retaliatory activities does not preclude district courts from considering a plaintiff's retaliation claim if the plaintiff previously filed the claim for which it claims to have been retaliated against with the EEOC.

In this case, the plaintiff first filed a claim with the EEOC and the ADU alleging Title VII sexual harassment. However, the plaintiff subsequently amended her claim to add a retaliation claim related to the previously reported Title VII sex discrimination claim. She alleged that the retaliation had negatively affected her emotional and mental state, and caused her to suffer from severe major depression for which she was denied reasonable accommodations and short term benefits. After receiving a right-to-sue letter from the EEOC, the plaintiff proceeded to file a suit in district court alleging a Title VII sex discrimination claim, a retaliation claim for filing her EEOC charge in regard to sex discrimination, and an ADA retaliation claim. The plaintiff clearly exhausted the proper administrative remedies with respect to her Title VII and retaliation claims on the basis of sex. Rather, the issue at hand was whether she had exhausted administrative remedies with respect to the ADA claim.

In response to the defendants' motion to dismiss the ADA claim, the plaintiff conceded that she did not exhaust the administrative remedies for her ADA claim, but argued that her ADA claim was proper under the *Clockedile* exception because it was reasonably related to, and grew out of,

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[51] Villalongo Gordillo v. Centennial de Puerto Rico/ AT&T Mobility Inc., No. 11-1115 (DRD), 2012 WL 589576 (D. P.R. Feb. 21, 2012).
[52] *See* Clockedile v. New Hampshire Dept. of Corrections, 245 F.3d 1 (1st Cir. 2001).
[53] *Id.* at 6.

the conduct which gave rise to her Title VII claim. However, in this case, the retaliation charge she added to her EEOC complaint was based on sexual discrimination rather than disability discrimination. The disability was a result of the retaliation rather than the cause. Therefore, *Clockedile* did not apply. In order for the district court to properly entertain her ADA claim, the plaintiff was required to first exhaust the proper administrative remedies by filing a claim with the EEOC or ADU alleging disability discrimination. Thus, the plaintiff should have filed a second EEOC charge for her disability claim. Therefore, the Court dismissed the plaintiff's ADA retaliation claim.

C. Individual Liability in ADA Claims

In *Román-Oliveras v. Puerto Rico Electric Power Authority ("PREPA")*,[54] the First Circuit resolved an issue of first impression for the Circuit: whether an individual can be liable for a claim brought under section 12101 of the ADA ("Title I of the ADA")[55]. In this case, the plaintiff sued PREPA and his supervisors, in their individual capacities, pursuant to both 42 U.S.C. § 1983 ("section 1983") and Title I of the ADA. On a motion to dismiss, the USDC-PR dismissed the claims in their entirety and the plaintiff appealed. After affirming the USDC's dismissal of the section 1983 claims as to all defendants, the First Circuit overturned the USDC's dismissal of the ADA claim because the defendant did state a claim upon which relief could be granted under the "regarded as" provision of Title I of the ADA. However, the individual supervisors argued that the USDC's dismissal as to them was valid even though the plaintiff stated a claim upon which relief could be granted because there was no individual liability under the ADA.

The Court acknowledged that neither it (the First Circuit) or the U.S. Supreme Court had explicitly rejected individual liability under the ADA, but that a number of other circuits have.[56] The First Circuit, in *Fantini v. Salem State College*, had already rejected individual liability in Title VII cases.[57] The Court noted the similarity between the ADA and Title VII in that "[t]he statutory scheme and language [of both statutes] are identical in many respects" such as directing their prohibitions to employers, and identically

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[54] Román-Oliveras v. Puerto Rico Electric Power Authority (PREPA), 655 F.3d 43 (1st Cir. 2011).

[55] Americans with Disabilities Act, 42 U.S.C. § 12101.

[56] Román-Oliveras, 655 F.3d at 50 (citing Fantini v. Salem State College, 557 F.3d 22, 31 (1st Cir. 2009). *See also e.g.,* Albra v. Advan, Inc., 490 F.3d 826, 830 (11th Cir. 2007); Walsh v. Nev. Dep't of Human Res., 471 F.3d 1033, 1037-38 (9th Cir. 2006); Fasano v. Fed. Reserve Bank of N.Y., 457 F.3d 274, 289 (3d Cir. 2006); Corr v. MTA Long Island Bus, 199 F.3d 1321, 1999 WL 980960, at *2 (2d Cir. 1999); Butler v. City of Prairie Vill., 172 F.3d 736, 744 (10th Cir. 1999); EEOC v. AIC Sec. Investigations, Ltd., 55 F.3d 1276, 1282 (7th Cir. 1995).

[57] Fantini, 557 F.3d at 31.

defining "employer."[58] Under both statutes, an employer is "a person engaged in an industry affecting commerce who has fifteen or more employees . . . and any agent of such . . . person."[59]

Extending the logic it used in *Fantini*, the First Circuit held that, just like Title VII, Title I of the ADA's exemption for small employers with less than 15 employees signified an intention not "to burden small entities with the costs associated with litigating discrimination claims."[60] "If Congress decided to protect small entities with limited resources from liability, it is inconceivable that Congress intended to allow civil liability to run against individual employees."[61] Furthermore, with respect to the statutory mention of "any such agents" in the ADA's definition of "employer," the First Circuit again deferred to *Fantini* in holding that said mention does not connote individual liability, but " 'simply . . . establish[es] a limit on an employer's liability for its employees' actions.'"[62] Thus, the First Circuit affirmed the USDC-PR's dismissal of the Title I ADA claims against the plaintiff's supervisors in their individual capacities and only limited its reversal to the claim against PREPA, therefore rejecting individual liability in claims under the ADA.

D. Failure to Accommodate

In *Pagán-Torres v. House of Representatives of the Commonwealth of P.R.*,[63] the USDC-PR analyzed an employer's motion for summary judgment against an employee's ADA failure to accommodate claim. The Court held that it was to be analyzed using the *McDonnell Douglas* burden shifting framework[64] albeit with a different set of requirements or elements from those that would have been used to establish an ADA disability

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[58] Román-Oliveras, 655 F.3d at 50 (citing Walsh, 471 F.3d at 1038).
[59] *Id.*; *see* Americans with Disabilities Act, 42 U.S.C. § 12111(5)(A); *see also* Title VII of the Civil Rights Act of 1964, 42 U.S.C § 2000e(b).
[60] Román-Oliveras, 655 F.3d at 50 (citing Fantini, 557 F.3d at 29).
[61] *Id.* (citing Fantini, 557 F.3d at 29; Miller v. Maxwell's Int'l Inc., 991 F.2d 583, 587 (9th Cir. 1993)).
[62] *Id.* (citing Fantini, 557 F.3d at 30); *see also* Mason v. Stallings, 82 F.3d 1007, 1009 (11th Cir. 1996) (noting that "the 'agent' language was included to ensure *respondeat superior* liability of the employer for the acts of its agents").
[63] Pagán Torres v. House of Representatives of the Commonwealth of P.R., 858 F. Supp. 2d 172 (D. P.R. 2012).
[64] *See* McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973).

discrimination case.[65] Accordingly, the first step was for the plaintiff to establish a *prima facie* case for a "failure to accommodate," for which he must: (a) furnish sufficient admissible evidence she is a qualified individual with a disability within the meaning of ADA; (b) establish that he/she worked for an employer covered by ADA; (c) demonstrate that the employer, despite its knowledge of the employee's limitations, did not accommodate those limitations; and, (d) show that the employer's failure to accommodate the known limitations affected the terms, conditions or privileges of the plaintiff's employment.[66] The burden then shifts to the employer to establish a legitimate, non-discriminatory reason for its actions.[67] If the employer offers a non-discriminatory reason, the burden then shifts back to the plaintiff to show that the employer's justification is a mere pretext used to cloak the discriminatory animus.[68] In this case, the Court applied the test and held that the plaintiff had proved a *prima facie* case for his failure to accommodate claim and that there were genuine issues of material fact as to the employer's justification's legitimacy. Thus, it denied the employer's motion for summary judgment.

E. "Major Life Activity"

In *Pérez v. Saint John's School,*[69] the USDC-PR found that considering an employee not suitable to perform one task within the rest of her responsibilities is not evidence of her having been regarded as disabled because it does not imply belief that she was substantially limited in the major life activity of working. Rather, it implied doubt over her ability to perform a single task, in this case that of completing mailings.

In *Ramos–Echevarría v. Pichis, Inc.,*[70] the Court found that the plaintiff's disability did not impair him from performing his duties since no evidence was introduced about his inability to work, other than that he stopped working temporarily when he had an epileptic episode and continued working after it finished. The Court held that the plaintiff failed to introduce evidence that his impairment affected a major life activity outside of the workplace. He also accepted during a deposition that he was capable of working. Other aspects taken into consideration by the Court were that the employer knew about the plaintiff's health condition since the beginning of

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[65] Pagán Torres, 858 F. Supp. 2d at 186 (citing Orta–Castro v. Merck, Sharp & Dohme Química P.R. Inc., 447 F.3d. 105, 112 (1st Cir. 2006)).
[66] *Id.*
[67] *Id.*
[68] *Id.*
[69] Pérez v. Saint John's School, 814 F. Supp. 2d 102, (D.P.R. 2011).
[70] Ramos–Echevarría v. Pichis, Inc., 659 F.3d 182 (1st Cir. 2011).

his employment and did not consider it an impairment and that he had a second job in another restaurant.

III. LABOR LAW

During this term the U.S. Supreme Court had the opportunity in *Knox v. Service Employees International Union, Local 1000*,[71] to decide whether the First Amendment allows a public-sector union to require objecting nonmembers to pay a special fee for the purpose of financing the union's political and ideological activities. Under California law, public-sector employees in a bargaining unit may decide by majority vote to create an "agency shop" arrangement under which all the employees are represented by a union selected by the majority. While employees in the unit are not required to join the union, they must nevertheless pay the union an annual fee to cover the cost of union services related to collective bargaining (so-called chargeable expenses). In the seminal case of *Teachers v. Hudson*,[72] the Supreme Court identified procedural requirements that a union must meet in order to collect fees from nonmembers without violating their rights. One of these requirements is the so-called *Hudson* notice which is a yearly notice sent to non-members explaining the basis for the annual fee assessment.

In this case, a union of a California "agency shop" properly issued its annual *Hudson* notice, charging non-union members 56.35% of the member fees since that was the percentage of union expenditures related to collective bargaining. However, it subsequently issued a temporary mid-year fee increase for expenses not related to the union's representation costs but rather to sponsor political activities to oppose "anti-union" initiatives. The union did not issue a second *Hudson* notice. Instead, it gave non-members the choice to, within a 30 day period, opt out of paying 56.35% of the emergency fee despite all of the payments going to political activities. The non-members then sued the union for violating their First, Fifth, and Fourteenth Amendment rights. The district court granted summary judgment in favor of the non-members, the Ninth Circuit reversed, and the Supreme Court granted certiorari.

The Supreme Court held for the non-members. It ruled that the First Amendment requires unions to provide non-members with a fresh *Hudson* notice regarding its special assessment and the affirmative consent of non-members to charge them the fee. Although it is a "tolerable" practice to

[71] Knox v. Service Employees International Union, 132 S. Ct. 2277 (2012).
[72] Teachers v. Hudson, 475 U.S. 292 (1986).

provide non-members with a single opportunity per year to make a decision regarding the use of funds by the union, in this case they were not provided with "a fair opportunity" to make an informed decision since the special assessment was not disclosed at the time the original *Hudson* notice was made. Moreover, the same unexpected circumstances that led to the establishment of the special fee may have also changed the non-members' choice, justifying that they be provided with a new opportunity to make a decision.

The Court also stated that an offer of a full refund to the non-members did not justify or remedy the infringement of their First Amendment rights. In order to comply with the First Amendment, the union should have sent a new Hudson notice for non-members to be able to opt in, rather than to opt out of the special fee since non-members "should not be required to fund a union's political and ideological projects unless they choose to do so."[73] Although an opt-out requirement is allowable for the annual process, there is no justification for additional opt-out requirements whenever the union chooses to collect special fees.

Another important labor law case in this term was decided by the First Circuit. In *Balser v. International Union*,[74] an employee filed a claim under section 301 of the Labor Relations Management Act ("LRMA")[75] against both her employer and her union. She alleged that:

> [T]he company violated the collective bargaining agreement between itself and the Union when it reclassified a position for which she was hired, resulting in her subsequent removal from that position; and that the Union violated its duty of fair representation in colluding with the employer to reclassify her position and in refusing to take her filed grievance to arbitration.[76]

The Court held that such a claim under the LRMA against both an employer and a union was a "hybrid claim" and that in order to prevail in such a claim, the plaintiff needs to prove a breach of duty of fair representation by *both* the union and the employer.[77] The court proceeded to analyze the plaintiff's allegations against the employer and found that she did not prove the requisite breach of duty. Under the labor agreement, the company had the right to assess staffing needs for positions at the facility at any time. Having this right, the company did not violate the collective bargaining agreement with the union. Therefore, the Court found it

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[73] Knox, 132 S. Ct. at 2291 (citing Hudson, 475 U.S. at 303).
[74] Balser v. International Union, 661 F.3d 109 (2011).
[75] Labor Relations Management Act, 29 U.S.C. § 185.
[76] Balser, 661 F.3d at 110.
[77] *Id.* at 118 (citing Fant v. New Eng. Power Serv., 239 F.3d 8, 14 (1st Cir. 2001)).

unnecessary to consider whether the union breached its duty of fair representation. The case was therefore dismissed.

In the third case during this term dealing with labor law, *NLRB v. USPS*,[78] the First Circuit had the opportunity to consider an issue involving the disclosure of employees' private information to labor unions. In this case, the Court was presented with a balancing-of-interests case between two federal acts: the National Labor Relations Act (NLRA)[79] and the Privacy Act.[80] The union requested the dossiers of 22 new hires after an unfair employment practice concern regarding seniority based on an aptitude test was communicated to the union by some of the new hires. The USPS refused to release the register information because under the Privacy Act "any information contained within a federal agency's 'system of records' may not be disclosed by any means of communication, to any person or entity except upon 'prior written consent of the individual to whom the record pertains,' or unless the disclosure falls within one of several enumerated exceptions."[81] One of these exceptions requires that agencies define and disclose specific "routine uses" for which the agency may reveal employee information. In the USPS's case, such a routine use included disclosure to unions "[a]s required by applicable law . . . when needed by that organization to perform its duties as the collective bargaining representative . . . ."[82] The USPS did offer to disclose the information of employees' for which the union had previous consent but the union was not satisfied.

The case was brought to the National Labor Relations Board (NLRB), which confirmed the Administrative judge's ruling in favor of the union, ordering the USPS to disclose the new hires' information. The NLRB found that the information was relevant for collective bargaining purposes and that the USPS committed an unfair labor practice by not providing the employee information to the union without the employees' consent. The NLRB decision rested on the idea that there are no conflicting interests to bar the employer from releasing the information while the USPS argued that employees' privacy would be compromised if the information were to be revealed. The NLRB filed suit seeking enforcement of its order.

The First Circuit held that the NLRA does not oblige the employer to disclose "all the information in the manner requested" nor that it trumps all

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[78] NLRB v. USPS, 660 F.3d 65 (2011).
[79] National Labor Relations Act, 29 U.S.C. § 158(a)(5).
[80] Privacy Act, 5 U.S.C. § 552a(b).
[81] USPS, 660 F.3d at 67 (citing 5 U.S.C. § 552a(b)).
[82] *Id.* at 68.

other interests.[83] The Supreme Court, in *Detroit Edison Co. v. NLRB*, established that the NLRA does not impose an unconditional obligation to disclose.[84] Similarly, other circuits have stated that the routine use exception "*permits* disclosure of relevant information, but does not *mandate* such disclosure unconditionally where there is a strong competing interest in privacy."[85] The aptitude tests which the union sought included notices to the applicants regarding the privacy of their information and the limited reasons of disclosure. This provided them with a legitimate expectation of privacy and therefore required that the First Circuit apply a balancing test. A balancing of interests is required based on three factors: "the interest of the employees in confidentiality, the burden placed upon the union by conditional disclosure, and whether there was evidence that the company was using employee privacy as a pretext to avoid its statutory obligations to bargain collectively."[86] The Court applied the test and held that the notices did not eliminate all expectation of privacy, that the requirement of consent was a "minimal burden," and that the USPS was acting on a serious concern for their employees' privacy and not with intent to frustrate the bargaining process. Therefore, the USPS did not violate its obligations under the NLRA by resisting the un-consented disclosure of the information. Moreover, the USPS complied with its statutory obligations under the NLRA by offering the edited register. The Court vacated the NLRA's decision, holding that the employees had a legitimate privacy interest that was ignored in the original analysis, and remanded the case for further proceedings.

IV. WORKERS' COMPENSATION

In *Martínez v. Eagle Global Logistics (CEVA)*,[87] the USDC-PR had to decide how the date of accrual for claims under Puerto Rico's Workers' Compensation Act ("Law 45")[88] is calculated and whether presenting such a claim before Puerto Rico's ADU tolled the statute of limitations. In this case, the plaintiff, who had been on leave authorized by the Puerto Rico State Insurance Fund, sought to go back to work on December 13, 2006. She was reinstated the next day, albeit at a different position and with a different schedule than she had prior to her leave. Consequently, on January 25, 2007, she filed a disability and age discrimination complaint with the ADU. Almost

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[83] *Id.* at 69 (citing Detroit Edison Co. v. NLRB, 440 U.S. 301 (1979)).
[84] *Id.* at 71 (citing Detroit Edison, 440 U.S. at 301).
[85] *Id.*
[86] *Id.* at 69.
[87] Martínez v. Eagle Global Logistics (CEVA), No. 09-2265, 2011 WL 5025904 (D. P.R. Oct. 21, 2011).
[88] Puerto Rico Worker's Compensation Act, Act No. 45 of Apr. 18, 1935, PR LAWS ANN. tit. 11, §§ 1-42 . (1935).

two years later she filed a claim in the USDC-PR under Article 5-A of Law 45[89] against her employer. The defendant requested the dismissal of the claim, arguing that it was time-barred because the plaintiff requested reinstatement more than three years prior to filing that complaint and the claim she presented in the ADU did not toll the statute of limitations. With respect to the claim's accrual date, the Court held that the 3 year statute of limitations of article 5-A claims begins to run on the day the employee seeks reinstatement and his employer refuses to do so.[90] The plaintiff had argued that on December 14, 2006 she did "not know for certain" that she would not be reinstated and was "in a sort of limbo." The Court cited to a Puerto Rico Supreme Court case in holding that the plaintiff's "subjective mental state as to her belief that she might be reinstated later is irrelevant, since as early as December 14, 2006, she had notice that she would not be reinstated to her former position."[91]

With respect to the plaintiff's argument that filling a claim with the ADU constituted an extrajudicial claim for purposes of Law 45 and therefore tolled the statute, the Court rejected it. According to Article 3 of the General Regulation of the ADU, this administrative agency does not have jurisdiction over Article 5-A claims. That is, "the ADU is not empowered to hear, investigate or solve claims under Law 45–such unit's jurisdiction is limited to claims arising under the enumerated state statutes."[92] Therefore, the court held that filing the claim with the ADU did not toll the statute of limitations.

In another case related to worker's compensation rights, the U.S. Supreme Court in *Pacific Operators v. Valladolid*,[93] held that the widows of workers that are compensated under the Outer Continental Shelf Lands Act[94] (OCSLA) are beneficiaries entitled to benefits under the Longshore and Harbor Workers' Compensation Act[95] (LHWCA), even if the employee's accident occurred while not working on the Outer Continental Shelf (OCS).[96] That is, benefits under the LHWCA are not limited to injuries or deaths that

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[89] *Id.*

[90] Martínez, 2011 WL 5025904, at *3 (citing Vélez Rodríguez v. Pueblo International, Inc., 135 DPR 500 (1994)).

[91] *Id.* (citing Vélez Rodríguez, 135 DPR at 500).

[92] *Id.* at *4.

[93] Pacific Operators v. Valladolid, 132 S. Ct. 680 (2012).

[94] Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. §§ 1331A-1356 (1953).

[95] Longshore and Harbor Workers' Compensation Act (LHWCA), 33 U.S.C. §§ 901A-950 (1927).

[96] Valladolid worked 98% of his time on the offshore platform and the remainder on the onshore facilities.

occur on the Outer Continental Shelf. However, the Court also held that the plaintiff must establish a substantial causal link between the injury that he suffered and his employer's extractive operations on the OCS.

V. DISCRIMINATION AND RETALIATION

It is well settled that to establish a *prima facie* retaliation claim under the ADA or Title VII, a plaintiff must show that: (1) she was engaged in protected conduct; (2) suffered an adverse employment action; and (3) there was a causal connection between the protected conduct and the adverse action.[97] The employer then has a burden of persuasion to offer a "legitimate, nondiscriminatory justification for the adverse employment decision" that is the basis of the plaintiff's complaint.[98] If the employer satisfies that requirement, the plaintiff then "retains the ultimate burden of showing that the employer's stated reason ... was in fact a pretext for retaliation."[99]

The cases analyzed under this section are organized according to the retaliation element or analysis phase on which they focus.

A. Protected Conduct

In *Colón v. Infortech Aerospace Serv., Inc.*,[100] the USDC-PR held that sending confidential company information without authorization and in violation of company policy was not a protected activity. Moreover, the Court noted that establishing that the employee engaged in protected conduct is necessary before considering the "particularly close temporal proximity" element between protected conduct and an adverse employment action. Although such a connection can be "strongly suggestive of retaliation," it is only one of three requirements for establishing a prima facie case of retaliation.[101] Since in this case there was no protected conduct, it was unnecessary to delve into the causal connection element.

B. Adverse Employment Action and Causal Connection

In *Colón–Fontánez v. Municipality Of San Juan*,[102] the First Circuit reiterated the well settled legal standard to determine whether a certain action or conduct is an adverse retaliatory employment action. Firstly, an

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[97] *See, e.g.,* Colón-Fontánez v. Municipality of San Juan, 660 F.3d 17 (1st Cir. 2011) (ADA); González Santos v. Torres Maldonado, 814 F. Supp. 2d 73, (D.P.R. 2011) (Title VII).
[98] Colón v. Infotech Aerospace Serv., Inc., 869 F. Supp. 2d 220, 226 (D.P.R. 2011) (citing Mesnick v. General Elec. Co., 950 F.2d 816, 823 (1st Cir. 1991)).
[99] *Id.*
[100] *Id.*
[101] *Id.* at 228.
[102] Colón-Fontánez v. Municipality of San Juan, 660 F.3d 17 (1st Cir. 2011).

"adverse employment action must be 'materially adverse' which means that it well might have dissuaded a reasonable worker from making or supporting a charge of discrimination."[103] Moreover, for the action to be material, it must produce "a significant, not trivial, harm."[104] Actions like "petty slights, minor annoyances, and simple lack of good manners will not [normally] create such deterrence."[105] However, "demotions, disadvantageous transfers or assignments, refusals to promote, unwarranted negative job evaluations, and toleration of harassment by other employees" may constitute adverse employment action, subject to the facts of a particular case.[106]

With respect to causality, it is mainly a question of intent. The plaintiff must show a nexus between the protected conduct and the alleged retaliatory act.[107] That is, the plaintiff must show that the defendant took the adverse employment action because of, in whole or in part, the protected conduct he or she engaged in. An important but not determinative element to consider is the close temporal proximity between the employer's knowledge of the protected conduct and the adverse employment action.[108]

In *Colón-Fontánez*, an employee had requested reasonable accommodation for her alleged disability in the form of a reserved parking space. The Court held that this constituted a protected conduct and proceeded to analyze whether a series of actions alleged by the plaintiff were in effect adverse and held a causal connection with the protected conduct. The employee specifically alleged five adverse employment actions which she claimed were retaliatory. First, she alleged that a temporary removal of "essential working tools," specifically her phone and computer, were adverse. However, the Court held that the evidence proved that such removal was temporary and a result of the municipality's maintenance practices. Moreover, the plaintiff did not prove retaliatory intent as to the removal.[109] Second, the employee alleged that several of her paychecks were withheld as retaliation. The Court held that the defendant presented evidence that "that any withheld, docked, or delayed paychecks were paid and/or justifiably attributable to days owed or insufficient remaining sick or annual leave" and therefore held that there was no causal connection.[110] Furthermore, in

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[103] *Id.* at 36 (citing Burlington N. & Santa Fe Ry. Co. v. White, 548 U.S. 53, 68 (2006)).
[104] *Id.*
[105] *Id.* at 36-37 (citing Burlington, 548 U.S. at 68).
[106] *Id.* at 37.
[107] *See id.*
[108] *See id.*
[109] *Id*. at 38.
[110] *Id.*

support of its conclusion, the Court analyzed the temporal proximity between the protected conduct and the alleged retaliatory acts. In this case, the Municipality customarily docked the employee's pay, or sent letters indicating a reduction in a subsequent paycheck, well before the protected action took place. Also, the contested withheld payments took place well over seven months after the protected request; an amount of time the Court deemed too distant to establish causality.[111]

Third, the employee alleged that she sent a request to her supervisor to make a change in her work schedule so that she could attend medical appointments but never received an answer and thus lost sick/vacation days to attend her appointment. However, she made the request by means of a single email and did not follow up on it. The Court held that the fact that the supervisor "simply never responded to what likely was one of numerous emails received over the course of a month in her supervisory position is not sufficient for purposes of establishing a causal connection" to the protected conduct.[112] Fourth, the employee alleged that a delay in approving her participation in a computer training session was retaliatory. The Court also rejected this argument, noting that the delay was not "intentional, material, or causally connected" to the protected conduct.[113]

Fifth and finally, the employee alleged the removal of her assistant, effectively eliminated her supervisory duties and therefore constituted an adverse retaliatory action. However, the Court held that the removal was not a material adverse action. Although a change in an employee's responsibilities may be sufficient to establish an adverse employment action, the evidence cast doubt on whether the employee was a "supervisor" in the first place because she was not responsible for evaluating her assistant's performance.[114] Moreover, the evidence showed that the employee received the assistant "on account of her unpredictable yet recurring absences, not because of any promotion in employee status, raise in salary, or change in job title."[115] Finally, upon the alleged elimination of supervisory duties, the employee suffered no demotion, salary reduction, position reclassification, or loss of rank or prominence in her department.[116] Thus, the removal of the assistant was not an adverse action. On account of all the above, the Court affirmed the USDC's granting of summary judgment in the defendants' favor.

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[111] *Id.* at 39 (citing Calero–Cerezo v. U.S. Dept. of Justice, 355 F.3d 6, 25 (1st Cir. 2004) (noting that "[t]hree and four month periods have been held insufficient to establish a causal connection based on temporal proximity")).
[112] *Id.* at 40.
[113] *Id.* at 41.
[114] *Id.* at 42.
[115] *Id.*
[116] *Id.*

In another case, *Ayala Sepúlveda v Municipality of San Germán*,[117] a sexual orientation discrimination case, the First Circuit held that the plaintiff did not prove that a transfer to another department constituted an adverse employment action. In that case, the employee was transferred but suffered no change in pay, rank, or duties. Thus, the Court held that the transfer was not an adverse action.[118]

During this term, the First Circuit decided in *Muñoz v. Soc. Española de Auxilio Mutuo*,[119] yet another case related to temporal proximity as a factor to take into consideration in determining the causal connection between a protected conduct and an adverse employment action. In that case, a doctor/employee sued his employer for age discrimination in 1998. Then, in 2004, one day after the employee was deposed in connection with that lawsuit, the hospital terminated his employment. The plaintiff then sued in federal court, alleging that he was terminated in retaliation for his pending lawsuit and related 2004 deposition testimony. After a jury trial, a verdict was reached in favor of the plaintiff and the employer appealed.

The First Circuit held that 5 years was too distant a causal proximity between the alleged protected act (filing a lawsuit against the employer) and the adverse employment action (termination of the employee) so as to by itself establish causality.[120] However, the 1998 lawsuit was only one of several pieces of evidence that the employee had presented at trial. In this particular case, the Court held that when all of the pieces of evidence were viewed together and in the plaintiff's favor, they formed "a mosaic that is enough to support the jury's finding of retaliation."[121] Thus, the First Circuit again reiterated that causal proximity or the lack thereof between a protected act and an adverse employment action is an important but not determinative factor in establishing a causal connection in federal retaliation claims.

In *Gómez Pérez v. John E. Potter*,[122] the First Circuit analyzed whether three alleged retaliatory acts against the plaintiff constituted adverse employment actions. The first act evaluated was the denial of a requested transfer. The Court held that the denial was not an adverse action because the employee requested it after the post had already been filled and before

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[117] Ayala Sepúlveda v. Municipality of San Germán, 671 F.3d 24 (1st Cir. 2012).
[118] *Id.* at 32.
[119] Muñoz v. Soc. Española de Auxilio Mutuo, 671 F.3d 49 (1st Cir. 2012).
[120] *Id.* at 56.
[121] *Id.*
[122] Gómez Pérez v. John E. Potter, 452 F. App'x 3 (1st Cir. 2011).

her protected action took place.[123] The second act was a pre-disciplinary meeting between the plaintiff, her supervisor, and two other employees (included as witnesses) in which the filing of eight sexual harassment complaints against the plaintiff by other employees was discussed. The Court held that this meeting constituted a reprimand without tangible consequences and was therefore not a material adverse action.[124]

The third alleged adverse action was taunting and threats by other employees which the employee claimed amounted to a hostile workplace. Indeed, "toleration of harassment by other employees" can possibly constitute an adverse employment action.[125] However, the plaintiff's supervisor immediately addressed the situation by informing the staff that this behavior would not be tolerated. Thus, that action was also held to not be materially adverse. Finally, the plaintiff alleged that her hours were reduced in retaliation. However, the Court also held that the plaintiff failed to present enough evidence that her scheduled hours were more or less than other employees'.[126] Thus, the plaintiff failed to establish a *prima facie* case of retaliation and the case was dismissed.

C. Legitimate or Pre-textual Employer Reasons for the Adverse Action?

Once a plaintiff meets the burden of establishing a *prima facie* retaliation case, the burden shifts to the defendants, who must presented evidence that they had legitimate, non-discriminatory, and non-retaliatory reasons to take the adverse employment action.[127] If the defendants meet this burden of proof then the burden shifts back to the plaintiff, who needs to prove that the employer's motives were pre-textual in order for her case to survive.[128]

In *García v. Sprint PCS Caribe*,[129] the plaintiff proved a *prima* facie retaliation case. However, the employer managed to give a legitimate explanation for terminating the plaintiff's job: they had received numerous complaints from the plaintiff's subordinates and customers due to her repeated attitude problems and lack of tact. The burden of proof was then shifted back to the plaintiff who based her argument on the close temporal proximity between the adverse action and her protected act. However, the Court reiterated that "temporal proximity alone is not probative of

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[123] *Id.* at 8.
[124] *Id.*
[125] *Id.*
[126] *Id.*
[127] *See* Rivera García v. Sprint PCS Caribe, 841 F. Supp. 2d 538, 560 (D.P.R. 2012) (citing Fantini v. Salem State College, 557 F.3d 22, 32 (1st Cir. 2009)).
[128] *Id.* (citing Medina-Muñoz v. R.J. Reynolds Tobacco Co., 896 F.2d 5, 9 (1st Cir. 1990)).
[129] *Id.*

retaliation"[130] and that the plaintiff failed to prove that the employer's motives were pre-textual.[131] The retaliation claim was therefore dismissed.

In *Oliveras Zapata v. Univision Puerto Rico, Inc.*,[132] an age and sex discrimination retaliation case, the USDC-PR was faced with a motion for summary judgment by the employer. The employee managed to establish a *prima facie* retaliation case and, in response, the employer argued that it terminated the employee due to poor job performance. Thus, the burden shifted back to the employee to argue that the reason was pre-textual.

The Court stated that in cases where the parties' focus is on whether the employer's grounds for its actions are pre-textual or legitimate, "a court may often dispense with strict attention to the burden-shifting framework, focusing instead on whether the evidence as a whole is sufficient to make out a jury question as to pretext and discriminatory animus."[133] Such evidence can include "weakness, implausibility, inconsistency, incoherencies, or contradictions in the employer's proffered legitimate reasons for its action that a reasonable fact finder could rationally find them unworthy of credence and hence infer that the employer did not act for the act" because of the proffered non-discriminatory reasons.[134] That is, a plaintiff must present enough evidence to enable a jury to find that the reason given for the adverse action is "not only a sham, but a sham intended to cover up the employer's real motive: discrimination."[135]

The Court then proceeded to examine the evidence offered by the employee, which focused on two allegations. The first was that the investigation of the employee's discrimination complaint (the "protected activity" in this case) deviated from company policy. The Court acknowledged that pretext may be demonstrated by showing an employer has deviated inexplicably from a regular business practice.[136] However, it noted that "where an employer's approach to personnel matters is flexible or discretionary, there is by definition no standard practice from which to deviate."[137] Thus, it rejected this argument.

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[130] *Id.* at 562.
[131] *Id.*
[132] Oliveras Zapata v. Univision Puerto Rico, Inc., No. 09–1987(BJM), 2011 WL 4625951, at *8 (D.P.R. 2011).
[133] *Id.* at 19.
[134] *Id.*
[135] *Id.*
[136] *Id.* at 19 (citing Kouvchinov v. Parametric Technology Corp., 537 F.3d 62, 68 (1st Cir. 2006)).
[137] *Id.*

The second allegation proposed by the plaintiff was an email by the employee's supervisor which, the Court held, could permit the inference that he considered the employee's pursuit of his claim to be in direct tension with whether he could perform his job well.[138] Thus, the Court held that the employee met his burden and provided, with the email, enough evidence to permit a rational inference that poor performance was used a pretext for retaliation.

VI. CONSTRUCTIVE TERMINATION

During this term, there were two cases that analyzed an employee's constructive termination. In *Cabrera Ruiz v. Rocket Learning, Inc.*,[139] the plaintiffs alleged that they were forced to resign from their jobs, i.e. were constructively terminated, due to a hostile environment created against then because of their age,. They sued under the Age Discrimination Employment Act[140] (ADEA).

Under a normal ADEA case, to establish a *prima-facie* case of employment discrimination, a plaintiff must establish (1) that he is within the age protected category; (2) was qualified for the position and met the employer's legitimate expectations; (3) was subjected to an adverse employment action, and (4) was substituted by a person with substantially less age. Once the plaintiff has established his prima-facie case,[141] the burden of proof shifts to the employer to come forward with a legitimate, nondiscriminatory reason for the decision. If the employer meets this burden, "the focus shifts back to the plaintiff, who must then show, by a preponderance of the evidence, that the employer's articulated reason for the adverse employment action is pre-textual and that the true reason for the adverse action is discriminatory."[142]

However, in order to establish a *prima facie* ADEA hostile workplace harassment claim with a constructive termination being alleged as the adverse employment action, the plaintiff must establish an additional element: that the employee's working conditions were so "onerous, abusive, or unpleasant that a reasonable person in the employee's position would have felt compelled to resign."[143] In this case, neither of the two plaintiffs

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[138] *Id.* at 20.
[139] Cabrera Ruiz v. Rocket Learning, Inc., 852 F. Supp. 2d 154 (D.P.R. 2012).
[140] Age Discrimination Employment Act (ADEA), 29 U.S.C. § 621-634.
[141] The First Circuit has described "this prima facie showing as 'modest,' . . . and a 'low standard.'"
[142] Lockridge v. Univ. of Me. Sys., 597 F.3d 464, 470 (1st Cir. 2010) (citing Smith v. Stratus Computer, 40 F.3d 11, 16 (1st Cir. 1994)).
[143] Cabrera Ruiz, 852 F. Supp. 2d at 169 (citing Suarez v. Pueblo Int'l, Inc., 229 F.3d 49, 54 (1st Cir. 2000).

demonstrated that additional element and summary judgment was thus granted for the defendants.

In *Mena Valdez v. E.M. T-Shirt Distributors, Inc.*,[144] the court also discussed constructive termination; this time, under Puerto Rico's Act Number 80.[145] The Court noted that under Law 80, plaintiffs have a similar burden of proof as in an ADEA claim such as that of *Cabrera*: they must demonstrate that the working conditions were "so difficult or unpleasant that a reasonable person . . . would have felt compelled to resign." The standard "cannot be triggered solely by an employee's subjective beliefs, no matter how sincerely held."[146] In this case, just like *Cabrera*, the plaintiffs failed to meet their burden and the Court granted summary judgment for the defendants.

VII. SUCCESSOR EMPLOYER DOCTRINE UNDER LAW # 80 (PUERTO RICO'S TERMINATION LAW)

In *Acosta-Ramírez v. Banco Popular de Puerto Rico (BPPR)*,[147] the court decided that Banco Popular was not accountable for several ex-employees' claims under Puerto Rico Act 80[148] since BPPR did not continue with Westernbank's business operations. The court stated that BPPR's acquisition of some of Westernbank's assets and deposits by means of the transaction executed with the Federal Insurance Deposit Corporation as Receiver (FDIC–R), did not turn BPPR into the successor of Westernbank. The court emphasized the fact that Westernbank was closed by the OCFI due to its insolvency and therefore BPPR did not ". . . continu[e], without interruption or substantial change, the predecessor's business operations."[149] This is, as the Court stated, the determining factor when analyzing if a business has become the successor of another. The District Court also considered the fact that Westernbank's employees were terminated as a result of the bank's insolvency and much before any agreement was consummated between the FDIC and BPPR. Therefore, all but one employee were hired under a contract that specifically stated "that their employment relationship with BPPR was

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[144] Mena Valdéz v. E.M. T-Shirt Distributors, Inc., 869 F. Supp. 2d 252 (D.P.R. 2012).
[145] *See* Wrongful Discharge Act, Act No. 80 of May 30, 1986, P.R. LAWS ANN. tit. 29, § 185a-185m.
[146] Suárez, 229 F.3d at 54.
[147] Acosta-Ramírez v. Banco Popular de Puerto Rico, No. 10-2131, 2012 WL 1123602, at *1 (D.P.R. 2012).
[148] Wrongful Discharge Act, Act No. 80 of May 30, 1986, P.R. LAWS ANN. tit. 29, § 185a-185m.
[149] Acosta-Ramírez, 2012 WL 1123602, at *9 (D.P.R. 2012).

new, and did not constitute a continuation of their prior relationship with Westernbank . . ."[150] Consequently, BPPR was not found to be the plaintiffs' successor employer and was not liable for such claim.

With this decision the court opened the door to the erosion of the successor employer doctrine. It is yet to be seen whether an acquisition could be structured to look like a liquidation followed by acquiring most but not all of the assets and deposits would have the effect of evading the successor employer doctrine. Moreover, in such an acquisition, would re-hiring the employees in temporary capacities have the effect of bypassing the successor employer doctrine? Or, on the other hand, can the USDC's rationale be explained by considering the nature of the transaction between BPPR and the FDIC as the predominant element?

After *Acosta-Ramírez*, the District Court reaffirmed its decision in the case of *Alvarado-Rivera v. Oriental Bank and Trust*.[151] In *Alvarado-Rivera*, the court also decided that the bank, in this case Oriental Bank, was not responsible for its ex-employees' claims under Puerto Rico's Act 80 because the bank could not be considered a successor employer of Eurobank. The court applied the same reasoning used in *Acosta-Ramírez*, establishing that "[t]he mere fact that Eurobank was closed on insolvency grounds and that the FDIC dismissed all Plaintiffs prior to being hired by Oriental, confirms that Oriental was not a successor employer of Eurobank."[152] Therefore, the Court seemed to imply that it is not enough for the bank to have been closed, what was in large part determinative was that it was closed on grounds of insolvency. Thus, Oriental Bank, as was BPPR in *Acosta-Ramírez*, was not considered responsible for any "severance benefits accrued during the [employee's] employment with Eurobank."[153]

It is worth mentioning that in this same case, a motion to dismiss filed by the FDIC prior to the matter discussed above, was not upheld because the court considered that the successor employer issue would be better addressed ". . . at the summary judgment juncture."[154] This is why the defendants in Alvarado-Rivera later filed the motion for summary judgment, which was upheld.

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[150] *Id*. at *9.
[151] Alvarado-Rivera v. Oriental Bank and Trust, No. 11-1458, 2012 WL 6213305 (D.P.R. 2012).
[152] *Id*. at *4.
[153] *Id*.
[154] *Id.* at *5.

VIII. SEXUAL HARASSMENT

In *González Santos v. Torres Maldonado*,[155] two plaintiffs sued their former employer and supervisors alleging, among other things, Title VII discrimination under hostile work environment and *quid pro quo* sexual harassment. With respect to this work, we shall discuss what the District Court considered a plaintiff needs to present in order to establish a prima facie case of *quid pro quo* sexual harassment and hostile work environment and, therefore, survive a motion to dismiss under Fed. R. Civ. P. 12(b)(6). For *quid pro quo* claims, a plaintiff needs to show that (1) he or she was subject to unwelcome sexual advances by a supervisor and (2) that his or her reaction to these advances affected tangible aspects of his or her compensation, terms, conditions, or privileges of employment or educational training.[156] A tangible employment action constitutes a significant change in employment status, such as hiring, firing, failing to promote, reassignment with significantly different responsibilities, or a decision causing a significant change in benefits.[157] The First Circuit Court of Appeals has held that "[i]f the plaintiff is threatened, and if the plaintiff is rewarded or punished, then there is quid pro quo harassment."[158]

The First Circuit has repeatedly held that in order to state a *prima facie* case of hostile work environment under Title VII, a plaintiff must prove that: "(1) she (or he) is a member of a protected class; (2) she was subjected to unwelcome sexual harassment; (3) the harassment was based upon sex; (4) the harassment was sufficiently severe or pervasive so as to alter the conditions of plaintiff's employment and create an abusive work environment; (5) the sexually objectionable conduct was both objectively and subjectively offensive, such that a reasonable person would find it hostile or abusive and the victim in fact did perceive it to be so; and (6) some basis for employer liability has been established."[159]

In hostile work enviroment cases, an employer is subject to vicarious liability if the hostile work environment was caused by a direct or indirect supervisor.[160] The employer may raise an affirmative defense to the vicarious liability. Under the *Faragher/Ellerth* defense, an employer must prove, by a

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[155] González Santos v. Torres Maldonado, 814 F. Supp. 2d 73 (D.P.R. 2011).
[156] *See* Lipsett v. U.P.R., 864 F.2d 881 (1st Cir. 1988); *see also* 42 U.S.C. §§ 2000e1-e17.
[157] *See* Burlington Industries, Inc. v. Ellerth, 524 U.S. 724, 761 (1998).
[158] Lipsett, 864 F.2d at 913-914.
[159] O'Rourke v. City of Providence, 235 F.3d 713, 728 (1st Cir. 2001); *see also* Pérez-Cordero v. Wal-Mart Puerto Rico, Inc., 656 F.3d 19 (1st Cir. 2011).
[160] *See* Burlington, 524 U.S. at 765.

preponderance of the evidence, that: "(1) the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior, and (2) the plaintiff employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise."[161] The affirmative defense is only available "when no tangible employment action is taken . . . ."[162] In this case the court found that the record did not indicate that a tangible employment action took place.

IX. FAIR LABOR STANDARDS ACT (FLSA)

In *Cristopher v Smithkline Beecham Corporation*,[163] the U.S. Supreme Court evaluated if pharmaceutical sales representatives (PSR's) are "outside salesmen" as defined in the Fair Labor Standard Act[164] (FLSA). A PSR's primary duty is "promote their products to physicians through a process called "detailing," whereby . . . [they] try to persuade physicians to write prescriptions for the products in appropriate cases."[165] According to the FLSA, an outside salesman "is any employee whose primary duty is making sales and who is customarily and regularly engaged away from the employer's place of business in performing such primary duty"[166] Their duties also includes "exchange, contracts to sell, consignment for sale, shipment for sale, or other disposition".[167] Outside salesmen, as defined previously, are exempt from FLSA overtime provisions.[168] The Court, led by Justice Alito, affirmed a summary judgment, holding that PSR's "qualify as outside salesmen under the most reasonable interpretation of the DOL's regulations."[169] The Court noted that "the provision that establishes the overtime salesman exemption does not furnish a clear answer to the question."[170] The Court therefore relied upon a textual analysis of applicable law.[171]

A similar claim was brought before the First Circuit in *Hines v. State Room, Inc.* In this case a group of sales managers sued their former employer for overtime back-pay.[172] However, the employers filed a motion for summary judgment, arguing that the sales managers were administrative

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[161] *Id.*
[162] *Id.* at 761.
[163] Cristopher v Smithkline Beecham Corporation, 132 S. Ct. 2156 (2012).
[164] Fair Labor Standard Act (FLSA), 29 U.S.C. §§ 201-219 (1938).
[165] Cristopher, 132 S. Ct. at 2163.
[166] 29 C.F.R. § 541.500 (2011).
[167] *Id.*
[168] 29 U.S.C. § 213(a)(1).
[169] Cristopher, 132 S. Ct. at 2174.
[170] *Id.* at 2170.
[171] *See id.* at 2170-75.
[172] Hines v. State Room Inc., 665 F.3d 235 (1st Cir. 2011).

employees as defined by the FLSA and were therefore exempt from the overtime provisions pursuant to 29 U.S.C. § 213(a)(1). The Court began its analysis by noting that the Department of Labor regulations in effect at the time of the plaintiffs' employment provided the following three-prong test for determining whether an employee qualifies for the administrative exemption:

> (a) The term "employee employed in a bona fide administrative capacity" in section 13(a)(1) of the Act shall mean any employee:
>
> > (1) Compensated on a salary or fee basis at a rate of not less than $455 per week (or $380 per week, if employed in American Samoa by employers other than the Federal Government), exclusive of board, lodging or other facilities;
> >
> > (2) Whose primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and
> >
> > (3) Whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.[173]

In this case, the there was no dispute that the plaintiffs met the first two prongs. Rather, the issue was whether they met the third prong. The sales managers' primary functions included coordinating the setup, design and execution of events and developing relationships with clients. Although they did not have the authority to make financial decisions, nor did they supervise other employees, the Court found that the plaintiffs "exercised sufficient discretion in their work" so as to be exempt employees under the FLSA. Basically, although they had guidelines and limited options, the sales managers had the authority to approach clients and potential clients and make deals with them, maintaining a relationship even once the contract was closed.[174] "The sales managers were the face of the businesses to prospective clients, and the judgment that they exercised concerned how best to represent the employers and to develop a proposal that would attract the

[173] *Id.* at 242 (quoting 29 C.F.R. § 541.200(a)).
[174] *Id.* at 243-247.

prospective clients to a contract with the venues."[175] Therefore, summary judgment was granted for the defendants. In reaching this conclusion, the First Circuit recognized and took into account a Supreme Court mandate that the FLSA should be narrowly construed. [176]

X. WHISTLEBLOWING

The Sarbanes–Oxley Act ("SOX"), provides protection to employees who report financial activities that they believe constitute violations to related federal laws.[177] In *Lawson v. FMR LLC*[178], the plaintiffs brought a retaliation suit against their employer, a corporation who provided advisory services to mutual funds. The District Court denied a Motion to Dismiss, holding that, under the applicable scope of review, the SOX protections were available to plaintiffs but certified the matter to the Court of Appeals.[179] The First Circuit determined that the whistleblower protections provided by Section 806(a) of the Act,[180] do not apply to employees working for private contractors or subcontractors that provide services to public companies, and therefore reversed, granting the motion to dismiss.[181]

The Court concluded that "the clause that reads 'officer, employee, contractor, subcontractor, or agent of such company', goes to *who* is prohibited from retaliating or discriminating, *not who is a covered* employee."[182] The Court also referenced other literal and textual parts of the U.S.C. and the Act itself, relying on such analysis to specify that only employees of public corporations fall under the statute.[183] Furthermore, the Court also noted that two earlier whistleblower statutes had explicitly extended their coverage to employees of contractors employed by the companies regulated by those statutes. This was construed to imply that if Congress had wanted to include the employees of contractors under SOX's protections then it would have explicitly specified so.[184] Finally, the Court noted that it has previously "admonished the lower federal courts not to give securities laws a scope greater than that allowed by their text."[185]

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[175] *Id.* at 247.
[176] Hines, 665 F.3d. at 242 (quoting Arnold v. Ben Kanowsky, Inc., 361 U.S. 388 (1960)).
[177] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.).
[178] Lawson v. FMR LLC, 670 F.3d 61 (1st Cir. 2012).
[179] For the USDC opinion, *see* Lawson v. FMR LLC, 724 F. Supp. 2d 141 (D. Mass. 2010).
[180] 18 U.S.C. § 1514(A)(a)(1).
[181] Lawson, 670 F.3d at 83.
[182] *Id.* at 69. (citing § 1514(A)) (emphasis added).
[183] For the full analysis, see *id.* at 69-74.
[184] *See id.* at 75 (mentioning as examples The Nuclear Whistleblower Protection provision of the Energy Reorganization Act, 42 U.S.C. § 5851(a)(1); and the whistleblower protection provision of the Pipeline Safety Improvement Act of 2002, 49 U.S.C. § 60129(a)(1)).
[185] *Id.*

After a brief discussion and analysis, the Court found even further support to conclude that the SOX protections are only available to employees of public companies in the legislative history of SOX.[186] The conclusion of the majority opinion clearly states: "[i]f we are wrong and Congress intended the term "employee" in § 1514A(a) to have a broader meaning than the one we have arrived at, it can amend the statute. We are bound by what Congress has written."[187]

It should be noted that this opinion is currently before the United States Supreme Court.[188]

XI. PUERTO RICO'S CONSTITUTIONAL PROPERTY INTERESTS

In *Alberti v. University Of Puerto Rico (U.P.R.)*,[189] the plaintiff presented a lawsuit claiming that she was deprived of her property when the administrative position and academic assignment she had were terminated without due process of law. The District Court granted a summary judgment, finding in favor of defendants. The Court found that the administrative position was a trust position which could be terminated at the will of the Chancellor because this type of position requires harmony and empathy between the employee who holds the position and the nominating authority, the Chancellor.[190] The Rules and Regulations of the U.P.R. specifically prohibit individuals who occupy teaching and managerial positions, like the plaintiff's, from attaining permanence (tenure) in the managerial position, and prohibit anyone from obtaining permanence in a position without first undergoing a probationary period for a minimum of five years. Since the plaintiff did not meet the established requirements, the Court concluded she did not have a property interest in the trust position she was assigned and did not comply with the requirement of five years in a teaching position to be able to become a permanent professor. In other words, the plaintiff did not reach "the required state level of a property interest in any of the two positions" and held against her.[191]

In a similar case, *Rojas-Velázquez v. Figueroa-Sancha*, the First Circuit concluded that there is no property right over specific duties that are part of

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[186] *Id*. at 77-80.
[187] *Id.* at 83.
[188] *See* Lawson v. FMR LLC, 133 S.Ct. 470 (2012).
[189] Alberti v. University of Puerto Rico, 818 F. Supp. 2d 452 (D.P.R. 2011).
[190] *Id.* at 465.
[191] *Id.* at 469.

a position.[192] The plaintiff was not terminated; he remained with his same position title and salary. The only real change was the elimination of some of his prior duties and a loss of certain benefits. These included having a cell phone and using an official car. The Circuit, confirming the USDC-PR, concluded that there is no proprietary right over specific duties of a position, since "Puerto Rico law cedes . . . no constitutionally protected property interest."[193] Therefore, the Court held that the plaintiff did not have a right of due process over that type of decision taken by his employer.[194]

The plaintiff in *Alberti v. UPR* also included a claim "that her removal and termination were executed by the individual defendants in violation of the First Amendment of United States Constitution."[195] The plaintiff further posited her termination "was performed in retaliation for engaging in protected speech as to matters of public concern."[196] The expressions that the plaintiff claims were protected were related to a student and to complaints about internal issues. The plaintiff argued "that these expressions constituted protected free speech regarding a matter of public concern"[197] but the Court held that the expressions made by a public employee, related to issues that are part of their employment, are not protected under the First Amendment.[198] The Court further held those types of comments are not excluded from an employer's disciplinary procedures. The First Amendment protects private citizens' expressions. "To establish an actionable claim of unconstitutional retaliation in a public employee's speech case, [plaintiffs] must meet three requirements."[199] They must (1) demonstrate that they was speaking as a citizen on a matter of public concern, (2) show that their interest in the speech outweighs the government's interest as an employer in avoiding disruption in the workplace, and (3) produce sufficient direct or circumstantial evidence from which a jury reasonably may infer that a constitutionally protected conduct was the substantial or motivating factor behind the adverse employment action. Even if a plaintiff fulfills those requirements, the employer can still defeat the claim by proving, by a preponderance of the evidence, that the governmental agency would have taken the same action against the employee even in the absence of the protected conduct.[200]

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[192] Rojas-Velázquez v. Figueroa-Sancha, 676 F.3d 206 (1st Cir. 2012).
[193] *Id.* at 212.
[194] In this case plaintiff claimed he was politically discriminated by the NPP, the party he was a member of, because he maintained relationships with members of other political parties.
[195] Alberti, 818 F.2d at 471.
[196] *Id.*
[197] *Id.*
[198] *See id.* at 472-477.
[199] *Id.* at 472.
[200] For the case law basis for such requisites and the exception, please see *id.*

XII. CONCLUSION

Although the First Circuit, the USDC-PR, and the U.S. Supreme Court were very active in labor and employment cases during this term, most of them reaffirmed or were based on well settled standards or principles. In our opinion, the most significant and impactful decisions were *Acosta-Ramírez v. Banco Popular de Puerto Rico*[201] and *Lawson v. FMR LLC*.[202] In *Acosta Ramírez* and *Alvarado-Rivera*, the USDC gave employers a way to avoid their responsibilities under Article 6 of Act 80, which created the successor employer legal doctrine.[203]

Considering that the successor employer is a state law figure, it is interesting that the USDC did not take into account the Puerto Rico Supreme Court case of *Rodríguez v. Urban Brands*.[204] In that case, it was held that buying assets free of liens through the Federal Bankruptcy Court does not by itself eliminate the buying company' liability as a successor employer. Citing a bankruptcy case, *In re American Hardwoods, Inc.*, the Supreme Court reasoned that such transactions under the Bankruptcy Court should not result in higher benefits to its participants than transactions made in the normal process of acquiring an operating business.[205] Considering the similarities between an insolvent bank and a bankrupt business, as well as the Puerto Rico Supreme Court's rationale in *Urban Brands*, it is surprising that the USDC did not at least cite to the case.

If one were to apply *Urban Brands*' rationale to the FDIC cases, the holdings may very well stay the same given the additional factors such as the temporary employee contracts. However, both FDIC cases cited the nature of the transactions -both were carried out after the bank was declared insolvent and liquidated- as the determining factor in their inquiries. That rationale goes against *Urban Brands* and it would have been useful for the USDC to at least justify why it effectively made a distinction between buying assets in an FDIC supervised liquidation and a U.S. Bankruptcy Court supervised liquidation.

In *Lawson*, the First Circuit effectively and significantly narrowed the protection Congress had attempted to provide for whistleblowers with the

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[201] Acosta-Ramírez v. Banco Popular de Puerto Rico, No. 10-2131, 2012 WL 1123602 (D.P.R. 2012).
[202] Lawson v. FMR LLC, 670 F.3d 61 (1st Cir. 2012).
[203] Wrongful Discharge Act, Act No. 80 of May 30, 1986, P.R. LAWS ANN. tit. 29, § 185a-185m.
[204] Rodríguez v. Urban Brands, 167 D.P.R. 509 (2004).
[205] *Id.* at 521 (citing In re American Hardwoods, Inc., 885 F.2d 621 (9th Cir. 1989)).

enactment of Sarbanes–Oxley Act.[206] In aspects so serious and delicate as the trust investors place on the financial information provided by companies where they invest, whistleblowers should have complete protection regardless of whether they work for public or private companies. Also, contractors should be protected if, during the process of providing services to a public company, they find and report illegal practices by said company. It will ultimately come down on how the U.S. Supreme Court construes the statutes and how much weight is placed on its legislative history.[207] The Supreme Court's opinion should be eagerly anticipated and have wide reaching repercussions.

With respect to the other cases that took place during the term, several interesting situations arose. For instance, it was also interesting to see in *Mena Valdez v. E.M. T-Shirt Distributors, Inc.*,[208] how a claim was filed under the ADA's "association provision" arguing that an employee was discriminated against by being denied a reasonable accommodation due to the stress caused by a medical condition of a daughter. Although a creative argument, the proper statute to bring the claim under was the FMLA. In our opinion, this was a longshot argument that was made as an alternative to the FMLA claim.

As to disability cases, the First Circuit set a firm precedent by finally joining most of the other circuits and explicitly rejecting individual liability in ADA claims in *Román-Oliveras v. PREPA*.[209] It is also worth mentioning with respect to that case that although the plaintiff failed to state a claim upon which relief could be granted, he did allege a mistake employers constantly repeat: not allowing workers to return to work after being authorized to do so by their health specialists. It is a mistake that could very well have cost PREPA a significant amount of money. Also, in *Ramos–Echevarría v. Pichis, Inc.*, it was interesting to see the extremely adverse effect that moonlighting with another employer in similar duties had on a plaintiff's ADA case.[210]

Another pattern that stood out to us was the number of Title VII and ADA cases that were filed in the federal courts without first exhausting administrative remedies. The fact that this is such a common occurrence, despite the law being so clear, is startling as it represents a waste of already stressed judicial resources and energies. These cases were usually resolved with summary judgment being granted for the defendant.

Another pattern that jumps out is that the majority of retaliation cases failed in the summary judgment stage. This may be a sign than courts are

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[206] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.).
[207] *See* Lawson v. FMR LLC, 133 S. Ct. 470 (2012) (granting of certiorari).
[208] Mena Valdez v. E.M. T-Shirt Distributors, Inc., 869 F. Supp. 2d 252 (D.P.R. 2012).
[209] Román-Oliveras v. PREPA, 655 F.3d 43(1st Cir. 2011).
[210] Ramos–Echevarría v. Pichis, Inc., 659 F.3d 182 (1st Cir. 2011).

applying stricter standards in evaluating adverse actions and their effect on the plaintiff, especially in claims that involves working environment conditions and discrimination as we saw in *Colón–Fontánez v. Municipality of San Juan*, *Ayala Sepúlveda v. Municipality of San Germán* and in *Gómez Pérez v. John E. Potter*.[211] However, it could also in part be due to lawyers submitting cases with no possibilities of success or without completely ascertaining the facts.

Although we understand that law is a dynamic field that changes over time, lawyers must place more attention on not consuming the courts' and parties' time and resources in cases that are bound to fail when the legal standards are very clear and well settled. If you are a plaintiff's lawyer, we exhort you to make an exhaustive legal analysis before filing a complaint that is doomed to fail and creating wrongful expectations in your clients. On the other hand, if you are defendant's lawyer, always be alert for ways to dismiss clearly frivolous cases as early as possible so as to save the Courts and your client money and resources.

[211] Colón–Fontánez v. Municipality of San Juan, 660 F.3d 17 (1st Cir. 2011); Ayala Sepúlveda v. Municipality of San Germán, 661 F. Supp. 2d 130 (D.P.R. 2009); Gómez Pérez v. John E. Potter, 452 F. App'x 3 (1st Cir. 2011).

WHERE ARE NATIONAL BANKS "LOCATED"?

JOSEPH LAM*

I. INTRODUCTION: A MATTER OF LOCATION AND INTERPRETATION

Federal courts have diversity jurisdiction whenever the parties to a case possess different state citizenship. The purpose of diversity jurisdiction has traditionally been to prevent and minimize bias against out-of-state parties; it is founded on "assurance to non-resident litigants of courts free from susceptibility to potential local bias."[1] Federal jurisdiction under 28 U.S.C. § 1332 requires complete diversity and an amount in controversy exceeding $75,000. Thus, in order to successfully invoke the precept, the statute mandates that all plaintiffs must be of different state citizenship than all defendants involved in a particular case.[2] For diversity purposes, a court determines the citizenship of a business association based on standards enacted by Congress, which vary. Under 28 U.S.C. § 1348, "[a]ll national banking associations shall, for the purposes of all other actions by or against them, be deemed citizens of the States in which they are respectively located."[3] The interpretation of this statutory text not only has jurisdictional consequences for national banks, but also implicates a longer-standing fundamental question about how to read the law.

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[1] Guaranty Trust Co. of N.Y. v. York, 326 U.S. 99, 111 (1945).

[2] *See* 28 U.S.C. § 1332; Lincoln Prop. Co. v. Roche, 546 U.S. 81, 84 (2005); Strawbridge v. Curtiss, 3 Cranch 267 (1806).

[3] 28 U.S.C. § 1348.

II. INTERPRETING THE STATUTE

A state bank is considered a citizen of both its state of incorporation as well as the state in which its principal place of business is located.[4] While state banks are typically chartered as corporate entities by a certain state, national banks, in comparison, are "corporate entities chartered not by any State, but by the Comptroller of the Currency of the U.S. Treasury."[5] In *Wachovia Bank v. Schmidt*, the U.S. Supreme Court held "that a national bank, for § 1348 purposes, is a citizen of the State in which its *main office*, as set forth in its *articles of association*, is located."[6] The Court's decision in *Wachovia Bank* was heavily centered on the definition of "located" set forth in § 1348.[7] The Court noted that "'located' is not a word of 'enduring rigidity,' but one that gains its precise meaning from context."[8] The word "located," as its appearances in the banking laws reveal, is a chameleon word; its meaning depends on the context in and purpose for which it is used."[9]

Focusing on jurisdictional parity, the Court rejected the overly broad notion that a national bank is "a citizen of every State in which it has established a branch."[10] Under such a definition, a national bank's access to a federal judicial forum would be severely limited in comparison to the access afforded to state banks and other state-incorporated entities; Congress created no such anomaly.[11] Therefore, the Court held that a national bank is a citizen of the state of its main office as stated in its articles of association.[12]

However, this definition is not necessarily exhaustive, as the Court acknowledged, but did not decide the issue of whether a national bank is also a citizen of the state where it maintains its principal place of business:

> To achieve complete parity with state banks and other state-incorporated entities, a national banking association would have to be deemed a citizen of both the State of its main office and the State of its principal place of business . . . The absence of a "principal place of business" reference in § 1348 may be of scant practical significance for, in almost every case, as in this one, the location of a

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[4] Wachovia Bank v. Schmidt, 546 U.S. 303, 306 (2006).
[5] *Id*.
[6] *Id*. at 307 (emphases added). Throughout the Comment, the author will refer to "main office" as the place set forth by a national bank's articles of association.
[7] *See id.* at 306 ("The question presented turns on the meaning, in § 1348's context, of the word 'located.'").
[8] *Id*. at 307 (citation omitted).
[9] *Id*. at 318.
[10] *Id*.
[11] *Id*.
[12] *See id.* at 307.

> national bank's main office and of its principal place of business coincide.[13]

However, despite the Court's practical assumption, exceptional cases have arisen in which the central issue is whether a national bank—whose main office is in a different state—is also "located" in the state of its principal place of business.[14]

In *Hertz Corp. v. Friend*, the Supreme Court established a principal-place-of-business jurisdictional test that would be "as simple as possible."[15] Assuming that the Supreme Court was correct in *Hertz*, and indeed a national bank's principal place of business could be easily determined, then the natural question that surfaces would be: is a national bank considered a citizen of the state where it has its principal place of business?

Various federal district and appellate courts have weighed in on the issue and reached different interpretations of § 1348's "located." The conclusive determination of this issue would ultimately decide the jurisdiction of many mortgage and foreclosure cases involving national banks. For a variety of reasons, national banks and other large organizations tend to favor cases in federal court. Therefore, a decisive determination of the definition of "located" would undoubtedly have implications on how national banks litigate foreclosure cases, where they conduct business, and finally, how restricted in their ability to remove cases to federal court.

III. BACKGROUND OF NATIONAL BANKS AND 28 U.S.C. § 1348

In *Wachovia Bank*, the Supreme Court gave a helpful and informative summary of the rules governing a national bank's jurisdiction.[16] Prior to 1882, national banks could sue and be sued in federal court solely because they were national banks. There was no need for diversity, a certain amount in controversy, or even the existence of a federal question.[17] However, state banks did not have the same automatic access to federal court; they could bring actions in federal court solely based on the existence of either diversity of citizenship or a federal question.[18]

In 1882, Congress drastically limited national banks' access to federal courts. A statute from that year stated:

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[13] *Id*. at 317, n.9.
[14] 28 U.S.C. § 1348.
[15] Hertz Corp. v. Friend, 559 U.S. ----, 130 S. Ct. 1181, 1186 (2010) (citations omitted).
[16] Wachovia Bank, 546 U.S. 303, 309-319.
[17] *Id*. at 309-310.
[18] *See id.*; *See also* Petri v. Commercial Nat'l Bank, 142 U.S. 644, 648-49 (1892).

> [T]he jurisdiction for suits hereafter brought by or against any association established under any law providing for national-banking associations . . . shall be the same as, and not other than, the jurisdiction for suits by or against banks not organized under any law of the United States which do or might do banking business where such national-banking associations may be doing business when such suits may be begun[.][19]

Consequently, national banks could not establish federal jurisdiction solely based on the bank's federal origin; instead, national banks were placed in the same category as banks not organized under the laws of the United States.[20]

In 1887, Congress replaced the 1882 statutory provision and for the first time made use of the "located" language seen in § 1348. The 1887 revision provided:

> [A]ll national banking associations established under the laws of the United States shall, for the purposes of all actions by or against them, real, personal or mixed, and all suits in equity, *be deemed citizens of the States in which they are respectively located*; and in such cases the circuit and district courts shall not have jurisdiction other than such as they would have in cases between individual citizens of the same State.[21]

Similar to the 1882 revision, the 1887 Act sought to limit national banks' access to federal courts to the same extent that state banks were.[22]

Furthermore, in 1911, Congress combined two discrete provisions regarding national banks, but retained the original clause deeming national banks to be "citizens of the States in which they are respectively located."[23] The current statute governing a national bank's citizenship arose as part of the 1948 Judicial Code, wherein Congress enacted the latest version of 28 U.S.C. § 1348.[24] Tracing this long history, one can see that the pertinent

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[19] Wachovia Bank, 546 U.S. at 310 (alterations in original) (quoting Act of July 12, 1882, § 4, 22 Stat. 163).
[20] Petri, 142 U.S. at 649; *See also* Wachovia Bank, 546 U.S. at 310.
[21] Wachovia Bank, 546 U.S. at 310-311 (alteration and emphases in original) (quoting Act of Mar. 3, 1887, § 4, 24 Stat. 554-555).
[22] *Id*. at 311; *See also* Mercantile Nat'l Bank at Dallas v. Langdeau, 371 U.S. 555, 565-566 (1963).
[23] Act of Mar. 3, 1911, § 24 (Sixteenth), 36 Stat. 1091-1093; *See also* Wachovia Bank, 546 U.S. at 311.
[24] Act of June 25, 1948, 62 Stat. 933; *See also* 28 U.S.C. § 1348; Wachovia Bank, 546 U.S. at 311-12.

"located" language of § 1348 surfaced in 1887, lasted through the multiple revisions of the 1900s, and endures to this day.

IV. THE CASE FOR PRINCIPAL-PLACE-OF-BUSINESS CITIZENSHIP

Two federal appellate cases, decided before *Wachovia Bank*, addressed the issue of what "located" meant in § 1348. The Fifth and Seventh Circuits, in *Horton v. Bank One*[25] and *Firstar Bank v. Faul*,[26] respectively, found it suitable to consider a national bank's citizenship as analogous to that of a state bank or state corporation.[27] As described in 28 U.S.C. § 1332(c)(1), a state corporation is a citizen of: (1) the state of incorporation; and (2) the state where the corporation has its principal place of business.[28] In *Firstar*, the Seventh Circuit held that the national bank analogue to the state of incorporation is the state listed in the bank's organization certificate: "we hold that for purposes of 28 U.S.C. § 1348 a national bank is 'located' in . . . the state listed in its organization certificate."[29] Likewise, in *Horton*, the Fifth Circuit kept in mind the principle of judicial parity, construing § 1348 in light of Congress's "intent to maintain jurisdictional parity between national banks on the one hand and state banks and corporations on the other."[30] In determining a national bank analogue to state of incorporation, the court found that "the definition of 'located' is limited to the national bank's principal place of business and the *state listed in its organization certificate and its articles of association*."[31]

District courts in the Ninth Circuit have also shown high regard for judicial parity when determining the definition of "located." In the 2011 case *Stewart v. Wachovia Mortg. Corp.*, the Central District of California court held that "[s]ince Congress wished national banks to have the same access to federal courts as state-chartered banks, interpreting § 1348 so as to foreclose the possibility that a national bank is 'located' where it maintains its principal place of business would not further Congress' purposes."[32] Judge S. James Otero of the Central District of California has held a similar view,

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[25] Horton v. Bank One, 387 F.3d 426 (5th Cir. 2004).
[26] Firstar Bank v.Faul, 253 F.3d 982 (7th Cir. 2001).
[27] *See* Horton, 387 F.3d at 436; Firstar, 253 F.3d at 993.
[28] 28 U.S.C. § 1332(c)(1).
[29] *See* Firstar, 253 F.3d at 994.
[30] Horton, 387 F.3d at 436; *See also id.* at 431 ("It follows that we should read section 1348 as retaining its objective of jurisdictional parity for national banks vis-á-vis state banks and corporations. . . . We are persuaded that this goal of jurisdictional parity is best served by interpreting 'located' as referring to a national bank's principal place of business as well as the state specified in the bank's articles of association.").
[31] *Id*. at 436 (emphasis added).
[32] Stewart v. Wachovia Mortg. Corp., No. 11-CV-06108, 2011 WL 3323115, 5 (C.D. Cal. Aug. 2, 2011).

finding that parity for national banks would be achieved by considering them citizens of both the "state where their articles of association list their main office" as well as the "state where their true principal place of business is located."[33] Otero found *Stewart* convincing, but he also considered the fact that national banks will not suffer the same type of prejudice in state court as would other types of outsiders; he notes that "one reason federal courts have subject matter jurisdiction over diversity cases is to alleviate the possibility that state courts will have a bias against 'outsiders.'"[34] In addition, the judge gave weight to the admonition that removal statutes should be strictly construed against removal jurisdiction.[35] Even though its district courts have weighed in, the Ninth Circuit has yet to decide whether a national bank is a citizen of the state in which it has its principal place of business.[36]

Many courts that read "located" in the aforementioned manner have invoked doctrines of caution, parity, and fairness to outsiders. Accordingly, if such notions were to change, the definition of § 1348 may consequently shift as well. If, later on, a state bank's citizenship were to hypothetically include its "secondary place of business," then doctrines of judicial parity and fairness would direct toward tweaking the definition of § 1348 without the need for legislative action. Courts that interpret § 1348 in such a way could very well point to the Supreme Court's acknowledgment that "located," as stated in § 1348, is not a word of "enduring rigidity," but instead a "chameleon" word.[37] Under this view, "located" can change over time depending on its particular context.

V. THE CASE AGAINST PRINCIPAL-PLACE-OF-BUSINESS CITIZENSHIP

In another Central District of California case, *Mireles v. Wells Fargo Bank*, the result came out the other way in opposition to principal-place-of-business citizenship.[38] Ironically, the judge in *Mireles*, Judge Margaret M. Morrow, also wrote the *Stewart* court order, which held that a national bank

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[33] Galindo v. Wells Fargo Bank, No. 12-CV-01256, (C.D. Cal. Feb. 27, 2012).
[34] *Id*.
[35] *See, e.g., id*.; *see also* Gaus v. Miles, Inc., 980 F.2d 564, 566 (9th Cir. 1992).
[36] Other district courts have also applied this approach, holding that a national bank is also a citizen of its principal-place-of-business state. *See*, *e.g.,* Taheny v. Wells Fargo Bank, N.A., No. 10-2123, 2012 WL 1120140, at *14 (E.D. Cal. Apr 03, 2012); Saberi v. Wells Fargo Home Mortg., 10-CIV-1985, 2011 WL 197860, at *2 (S.D. Cal. Jan. 20, 2011); Mount v. Wells Fargo Bank, N.A., No. 08-CIV-6298, 2008 WL 5046286, at *2 (C.D. Cal. Nov. 24, 2008). Indeed, the Ninth Circuit has specifically refrained from ruling on the issue. *See* Peralta v. Countrywide Home Loans, Inc., 375 F. App'x 784, 785 (9th Cir. 2010) ("The court declines to resolve the complex jurisdictional issue of a national bank's citizenship on a limited record, with abbreviated briefing, and a decisional deadline.").
[37] Wachovia Bank, 546 U.S. at 307, 318.
[38] Mireles v. Wells Fargo Bank, 11-CV-07720, 2012 WL 84723 (C.D. Cal. Jan. 11, 2012).

was also a citizen of its principal-place-of-business state.[39] In *Mireles*, Judge Morrow performed an about-face, holding that a national bank is *not* a citizen of the state in which it has its principal place of business.[40] Morrow recognized her change of heart and essentially abrogated *Stewart*: "[i]n a prior case [*Stewart*], this court decided, in ruling on an ex parte application to remand, that Wells Fargo was a citizen of California. In a later case, where the court had the benefit of fuller briefing, it reached the contrary conclusion."[41] In essence, the court changed course after considering what jurisdictional parity meant at the time of § 1348's enactment.

When enacting § 1348 in 1948, Congress did indeed intend to create parity;[42] however, during 1948, the citizenship of a state bank was determined *only by its state of incorporation*.[43] The concept that a corporation could be a citizen of its "principal place of business" came about with the enactment of 28 U.S.C. § 1332(c)(1) in 1958—approximately ten years after Congress had passed § 1348.[44] Many courts, including the Supreme Court, have held that the most relevant time period for discerning a statutory term's meaning is the time when the law was enacted.[45] Thus, the text of § 1348, which was enacted in 1948, could not be interpreted to include a citizenship concept that was enacted ten years later.

The Southern District of New York also ruled in comparable fashion, employing similar reasoning in *Excelsior Funds, Inc. v. JP Morgan Chase Bank*.[46] The *Excelsior* court wrote:

> . . . the statute does not suggest that the word "located" was intended to have a meaning in § 1348 that changed over time. The statute

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[39] Stewart v. Wachovia Mortgage Corp., No. 11-CV-06108, 2011 WL 3323115 (C.D. Cal. Aug. 2, 2011).

[40] *Id*.

[41] *Id*. at *18 n.115; *See also* Alexander v. Wells Fargo Bank, 11-CIV-05771 (C.D. Cal. Nov. 1, 2011) ("As a result, on further reflection, the court concludes that Wells Fargo is a citizen only of South Dakota, and not California.").

[42] *See* Act of June 25, 1948, 62 Stat. 933.

[43] Mireles, 2012 WL 84723, at *18; *See also* Excelsior Funds, Inc. v. JP Morgan Chase Bank, 470 F. Supp. 2d 312, 319. (S.D.N.Y. 2006) ("At the time § 1348 was enacted, a state bank was a citizen of only one state, the state in which it was incorporated. Thus, allowing a national bank to be sued in a single state in which it was located created jurisdictional parity between such a bank and a state bank.").

[44] *See* Act of July 25, 1958, Pub. L. No. 85-554, 72 Stat. 415.

[45] *See* MCI Telecomm. Corp. v. Am. Tel. & Tel. Co., 512 U.S. 218, 228 (1994); Mireles, 2012 WL 84723, at *18; Excelsior Funds v. JP Morgan Chase Bank, 470 F. Supp. 2d 312, 319 (S.D.N.Y. 2006).

[46] Excelsior Funds, 470 F. Supp. 2d at 319-320 ; *See also* id. at 319 ("The concept of 'principal place of business' as a test for corporate citizenship did not arise until 1958, when 28 U.S.C. § 1332(c)(1) was first enacted.").

> should thus be interpreted consistent with congressional intent at the time it was enacted . . .
>
> If Congress intended to achieve jurisdictional parity between national and state banks for all times in § 1348, and thus to include principal place of business as a location for a national bank when it became a basis for citizenship for a state bank, Congress could have provided for that in the statutory language.[47]

This sequence of events offers strong evidence that Congress did not intend that the word "located," as incorporated in § 1348, include principal place of business, since such a concept for corporate citizenship did not yet exist.[48]

Moreover, in *Wells Fargo Bank v. WMR e-PIN, LLC*, the Eighth Circuit held that a national bank is only a citizen of the state where its main office is located.[49] Adhering to a familiar line of reasoning, the Eighth Circuit concluded that Congress last amended § 1348 in 1948. At the time, Congress had not yet applied principal-place-of-business citizenship to banks, therefore, "located" referred to the main-office state.[50] Furthermore, when Congress did in fact apply principal-place-of-business citizenship to state banks and corporations under § 1332(c)(1), it did not refer to either jurisdictional parity, national banks, or § 1348. Finally, the court found that "nothing in § 1348 indicates that it would incorporate by reference any subsequent change in the statutes governing jurisdiction over state banks and corporations. Congress reconfigured the jurisdictional landscape of state banks and state corporations, but left that of national banks undisturbed."[51] Refusing to import the principal place of business jurisdictional concept into § 1348, the court found that such a notion was unknown to lawmakers at the time of the statute's adoption.[52]

It seems fairly well-established that courts should strongly consider judicial parity in the interpretation of § 1348. The courts that interpret "located" to include only the state that is listed in the national bank's articles of association are looking to notions of judicial parity. However, their interpretation of judicial parity involves an inquiry into what was fair and equitable at the time of enactment, not at the current time. Such an

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[47] Excelsior Funds, 470 F. Supp. 2d at 319 (citation omitted).

[48] Several other district courts have held that a national bank is a citizen only of the state in which it has its main office. *See*, *e.g.,* U.S. Bank Nat. Ass'n v. Polyphase Elec. Co., No. 10-CV-4881, 2011 WL 3625102, at *2 (D. Minn. Aug. 17, 2011); Tse v. Wells Fargo Bank, N.A., No. 10-CV-4441, 2011 WL 175520, at *3 (N.D. Cal. Jan. 19, 2011); Ngoc Nguyen v. Wells Fargo Bank, N.A., 749 F. Supp. 2d 1022, 1027 (N.D. Cal. 2010).

[49] Wells Fargo Bank v. WMR e-PIN, LLC, 653 F.3d 702, 709 (8th Cir. 2011).

[50] *Id*. at 708.

[51] *Id*.

[52] *Id*. at 709.

interpretation looks at the statute from the point of view of a reasonable person in 1948 rather than through the lens of a person from the present era.

VI. HOW TO INTERPRET "LOCATED": DUELING METHODS

After diving deeply into the statute, one ultimately concludes that the manner in which a reader interprets "located," ultimately sheds light on his method of interpretation. The main issue of whether a national bank is a citizen of the state in which its principal place of business is based, reveals how two different methods of interpretation can result in two distinct ways of defining "located" in § 1348.

One method of statutory interpretation is Purposivism.[53] In general terms, Purposivism emphasizes general legislative intent as the goal of interpretation. According to this view, enacted text represents the directives of legislators, who have been elected by the People; therefore, judges, citizens, and government agencies should observe said mandates in accordance with the intention of those legislators. Thus, it can be said that those who employ this method rely on Congress' *general intent or purpose* in enacting a statute. Purposive interpretation of statutes was a "conceptual hallmark of the New Deal" that Henry Hart and Albert Sacks explicated in their legal writing.[54] Purposivism does not go into any specific intent of the legislative body but instead inquires into the general goal that the legislature had.[55] Both Justice Brewer and Justice Brennan famously invoked the "spirit" of the law in order to support their respective opinions in *Holy Trinity Church v. United States* and *United Steelworkers of America v. Weber*.[56] At times, Purposivism can even lead to the fulfillment of the statute's purpose by going outside the letter of the law: "It is a familiar rule that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit nor within the intention of its makers."[57] According to William N. Eskridge, Jr., "Purposivism attempts to achieve the democratic legitimacy of other internationalist theories in a way that renders statutory interpretation adaptable to new circumstances."[58] Across the passing of time, different

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[53] The author recognizes that there are other types or degrees of Purposivism. He has tried to address the most typical and common one.

[54] WILLIAM N. ESKRIDGE, JR., ET AL., LEGISLATION AND STATUTORY INTERPRETATION 229 (2d ed. 2006); *See also* HENRY HART, JR. & ALBERT SACKS, THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW 1374-80 (1994).

[55] *See* ESKRIDGE JR. ET AL., *supra* note 54, at 229.

[56] United Steelworkers of Am. v. Weber, 443 U.S. 193, 201 (1979); Holy Trinity Church v. United States, 143 U.S. 457, 459 (1892).

[57] *Id.* at 459.

[58] *See* ESKRIDGE JR. ET AL., *supra* note 54, at 229 (Eskridge offers a detailed example of how the purpose of an author's intent can overrule the words of a directive). *See also* Kent

circumstances and unforeseeable problems arise that can change the meaning of a certain law even even as its text remains the same.[59]

The other method of interpretation, modern Textualism, stands in stark contrast to Purpositivism.[60] Justice Scalia has ardently defended and promoted this method of interpretation in his judicial opinions and lectures.[61] A Textualist focuses on what a reasonable reader of the English language, in the certain place and time of enactment of the statute, would have understood the enacted text to mean. Scalia claims that the plain meaning of a statute is both the "alpha and the omega" in a judge's interpretation, but he does not ignore context; instead he would define plain meaning as "that which an ordinary speaker of the English language . . . would draw from the statutory text."[62] The Textualist "is willing to consider various sources to provide context: dictionaries, especially those contemporaneous with the statute; other provisions of the statute and how competing interpretations fit with them; *how similar provisions in related or borrowed statutes have been interpreted*; and so forth."[63] For example, in his *Chisom v. Roemer* dissent, by employing Textualism, Justice Scalia concluded that the word "representatives" does not ordinarily include judges. Scalia remarked that "the ordinary speaker in 1982 would not have applied the word ["representatives"] to judges." [64] It can be said that Scalia essentially places himself in a certain time period and location in order to discern what a reasonable person would have understood certain words to mean.

As it is probably clear by now, the Purposivist would interpret "located," as stated in 28 U.S.C. § 1348, to include the states in which the national bank maintains its main office and principal place of business. Assuming that the general goal of Congress was to establish jurisdictional parity between the state banks and national banks, the definition of "located" should change as the state bank's citizenship requirements change. In 1948, jurisdictional parity meant that national banks were only citizens of the state in which its main office was located, since a state bank's citizenship was

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Greenawalt, From the Bottom Up, 82 CORNELL L. REV. 994, 1002-03 (1997) (quoting Eskridge).

[59] *See e.g.,* Train v. Colo. Pub. Interest Research Grp., Inc., 426 U.S. 1, 10 (1976); Nat'l Woodwork Mfrs. Ass'n v. NLRB, 386 U.S. 612, 619-620 (1967); United States v. Am. Trucking Assns., 310 U.S. 534, 543-544 (1940).

[60] The author recognizes that there are other types or levels of textualism. He will try to address the most typical one.

[61] *See* ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW (1997); Bank One Chi. v. Midwest Bank & Trust Co., 516 U.S. 264, 279 (1996) (Scalia, J., concurring in part); Chisom v. Roemer, 501 U.S. 380, 404 (1991) (Scalia, J., dissenting).

[62] WILLIAM N. ESKRIDGE JR., ET AL., CASES AND MATERIALS ON LEGISLATION, STATUTES AND THE CREATION OF PUBLIC POLICY 779 (4th ed. 2007) (quoting SCALIA, A MATTER OF INTERPRETATION).

[63] *See* ESKRIDGE JR. ET AL., *supra* note 54, at 236 (emphasis added).

[64] Chisom, 501 U.S. at 411 (Scalia, J., dissenting).

determined by the closely analogous state-of-incorporation criteria. However, as circumstances changed in 1958—when a state bank's citizenship also included the state in which it has its principal place of business[65]—the definition of "located" in § 1348 should have likewise shifted to include the principal-place-of-business state because doing so would continue to fulfill the general legislative goal of jurisdictional parity between state and national banks. The interpreter achieves democratic legitimacy "in a way that renders statutory interpretation adaptable to new circumstances."[66]

The Textualist is not a strict constructionist who only reads the "literal" meaning of a word; he would interpret § 1348 as a reasonable person would during the time of enactment.[67] Accordingly, the Textualist's definition would be frozen in the 1948 context. Since at the time of enactment, "located" was only understood to include "the state in which the national bank had its main office," the Textualist would interpret national bank citizenship as only comprising the national bank's main-office state—whether it was 1948 or 2048.[68] Under this paradigm, changing circumstances and times will not thaw the frozen definition.

VII. APPROACHING THE CROSSROADS

So what is a reasonable interpreter to do? On one hand, the Textualist method offers an attractively enduring and reliable definition that stands the test of time. After all, the rule of law should create rules that are predictable, since we do not want judges to change the meaning of a statute just because they think the circumstances have sufficiently changed. However, the Textualist method can seem awfully rigid and uncompromising in face of the most unfair results. Indeed, Alexander Hamilton acknowledged that in the case of "unjust and partial laws," courts should respond by "mitigating the severity and confining the operation of such laws."[69] Should there not be at least the potential to consider the equities in extreme circumstances? Notably, regarded scholars have acknowledged that the Framers generally supported an equity-based approach to statutory interpretation.[70]

Nevertheless, the Purposivist method also has its pitfalls. Does Congress—a large multi-member body—ever actually have one general purpose that can be attributed to the legislative branch? Is this less of an

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[65] *See* Act of July 25, 1958, Pub. L. No. 85-554, 72 Stat. 415.
[66] *See* ESKRIDGE JR. ET AL., *supra* note 54, at 229.
[67] SCALIA, *supra* note 61, at 23.
[68] *See* WMR, 653 F.3d at 708.
[69] Alexander Hamilton, The Federalist No. 78.
[70] DAVID EPSTEIN, POLITICAL THEORY OF "THE FEDERALIST" 188-190 (1984); *See also* FRANK B. CROSS, THE THEORY AND PRACTICE OF STATUTORY INTERPRETATION 127 (2009).

interpretative method and more of a practice in divination? In addition, a general purpose can also be achieved in various ways. In *Weber*, Justice Brennan upheld an affirmative action program because it was consistent with the spirit of the Civil Rights Act.[71] However, that same spirit may also be reasonably upheld through the creation of colorblind employment practices that offer "equality of opportunity, not equality of results."[72] Hence, the Supreme Court could have interpreted the statute in a more "conservative" light while invoking the same spirit. The problem with general purposes is that they are often too broad and oversimplified; thus, they allow numerous conflicting but legitimate interpretations to fit under the general purpose's umbrella. Accordingly, the interpretation that the judge opts for can sometimes be a matter of politics rather than law.

Because the author is not inclined to write an inconclusive there-are-good-arguments-on-both-sides paper, he shall choose a method of interpretation—imperfect as it may be—that strikes him as most well-reasoned and grounded in democratic ideals. The author finds that the Textualist theory of interpretation in regard to § 1348 is most appropriate in light of the need for consistency and dependability in the rule of law, and respect for the legislature's role to continually pass laws in accordance with the changing times. As Oliver Wendell Holmes stated: "We do not inquire what the legislature meant; we ask only what the statute means."[73]

Even though it has its noted weaknesses, compared to Purposivism, Textualism better restricts the potential of mischievous and willful judges substituting their policy preferences for those adopted by the legislature. Purposivism intentionally "sets the originalist inquiry at a higher level of generality."[74] When conducting the inquiry at such a general level, the analysis can become more abstract, and the general purpose can become so oversimplified that a jurist would have enough room to use his judicial opinion as a pretext for substituting personal political preferences.[75] Textualism may at times be overly rigid and harsh, but its more stringent methods are harder to circumvent with a straight face; the interpretation

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[71] Weber, 443 U.S. at 201.

[72] *See id.* at 254 (Rehnquist, J., dissenting); *See* ESKRIDGE JR. ET AL., *supra* note 54, at 230.

[73] *See* Oliver Wendell Holmes Jr., *The Theory of Legal Interpretation*, 12 HARV. L. REV. 417, 419 (1899); *See id.* at 417-18 ("Thereupon we ask, not what this man meant, but what those words would mean in the mouth of a normal speaker of English, using them in the circumstances in which they were used, and it is to the end of answering this last question that we let in evidence as to what the circumstances were."); Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384, 397 (1951) (Jackson, J., concurring) (agreeing with Holmes's view of statutory interpretation).

[74] *See* ESKRIDGE JR. ET AL., *supra* note 54, at 229.

[75] *See, e.g., id.* at 229-30 ("Most important, the Court [in Weber] oversimplified the statute´s purpose and suppressed possibly competing purpose.").

should always take place from the point of view of a reasonable reader at the time of the statute's enactment.[76]

Purposivism claims to allow for a more flexible reading of the statute that "nimbly addresses new or unforeseen circumstances" of the times.[77] However, such a role is reserved for and better-suited for the legislature, which in turn has the resources and ability to pass new laws that can specifically address new issues and unforeseen problems of the times. Legislators are equipped with analysts, staffers, and researchers who can help Congress pass new laws that are in tune with the People's will, whereas judges are staffed with law clerks who research the existing law of the land. If times are truly changing, it is in Congress's job description to address those changes with new policies.

In this particular case, analyzing the purpose of a statute can only go so far; as touched on before, if Congress decided to implement a secondary-place-of-business citizenship for state banks today, few would argue for the application of that citizenship to national banks. The reason is because we know that if Congress wanted to establish that type of citizenship for national banks, it would have then done so. Likewise, if Congress intended to promote jurisdictional parity for all time, it did not seize the opportunity in 1958 to perpetuate this goal when it enacted § 1332(c), which applied principal-place-of-business citizenship to state banks but not to national banks.[78] The Textualist approach is fitting when we have a legislative body that enacts two parallel laws and then changes one of those laws without changing the other; in that case, we should not impute the same meaning to both laws because the legislature acted discretely and chose to amend one law and not the other for its own democratically determined reason. Because Congress, when it enacted § 1348, did not understand "located" in the statute to include principal place of business, we should not confer that meaning on "located" now. Just as we would not want the terms in a contract to change meaning, we do not want future jurists changing the originally understood meaning of the text. As Judge Easterbrook wrote: "The fundamental theory of political legitimacy in the United States is contractarian, and contractarian views imply originalist, if not necessarily textualist, interpretation by the judicial branch. Otherwise a pack of lawyers is changing the terms of the deal, reneging on behalf of a society that did not appoint them for that purpose."[79] Therefore, although strong arguments can

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[76] *See id.* at 235-37.
[77] *See id.* at 229.
[78] *Id*. at 707-09; Excelsior Funds, 470 F. Supp. 2d at 319.
[79] Frank H. Easterbrook, *Textualism and the Dead Hand*, 66 GEO. WASH. L. REV. 1119, 1121 (1998); *See also* id. at 1125 ("In this vision courts serve to enforce laws and private bargains.").

be made on both sides, the preponderance of statutory and contextual evidence points to a static 1948 definition of "located" under § 1348.

VIII. CONCLUSION

The interpretation of "located" in § 1348 has important implications for foreclosure cases in both state and federal courts. However, the interpretation of that statute also reflects a more profound age-old battle between two dueling methods of interpretation. There are significant benefits and notable downsides to each method, which is precisely what makes the debate so lasting and contentious. Different brands of Purposivism and Textualism have been employed throughout American history, and though this Article does not settle the hoary issue by any means, the author hopes that he contributed to the continuous discussion.

PUBLIC UTILITIES AND THE EUROPEAN UNION'S "SERVICES OF GENERAL ECONOMIC INTEREST": FEUDAL ORIGINS OF THEIR MONOPOLY POWERS

LUIS ANÍBAL AVILÉS*

European Law affords special treatment to undertakings or firms that provide *services of general economic interest*. Article 14 of the Treaty on the Functioning of the European Union (hereinafter the "TFEU") states, in no uncertain terms that:

> Without prejudice to Article 4 of the Treaty on European Union or to Articles 93, 106 and 107 of this Treaty, *and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion*, the Union and the Member States, each within their respective powers and within the scope of application of the Treaties, shall take care that such services operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfill their missions. The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall establish these principles and set these conditions without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services.[1]

The Treaty on the European Union[2] (hereinafter the "TEU") and the TFEU do not define the term *services of general economic interest*. Apart from Article 14, only TFEU Article 106 (1) mentions "public undertakings and undertakings to which Member States grant special or exclusive rights"[3] and TFEU Article 106(2) speaks of "undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-

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[1] Consolidated Version of the Treaty on the Functioning of the European Union, art. 14, Oct. 26, 2012, 2012 O.J. (C 326) 49, 54 [hereinafter TFEU] (emphasis added).

[2] Consolidated Version of the Treaty of the European Union, Oct. 26, 2012, 2012 O.J (C 326) 13 [hereinafter TEU].

[3] *Id.*, art. 106 (1).

producing monopoly"[4] without defining any of these terms. Later on, TFEU Article 106 goes on to state that these types of undertakings "shall be subject to the rules contained in the Treaties, in particular to the rules of competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them."[5]

Since the Treaties do not define such types of undertakings, the European Commission and the Court of Justice of the European Union (ECJ) have been left with the difficult task of providing legal meaning to such term.[6] It is not our purpose in this short reflection to embark on the task of analyzing how the Commission and the ECJ have struggled to offer meaning to this term. For purposes of this article, it suffices to say that firms providing "services of general economic interest" include, without a doubt, the private and public undertakings known as public utilities.

The term *public utility* is not widely used in Europe. It is mostly used in the United States and the United Kingdom to describe private undertakings that provide essential public services such as telecommunications, public waters, electricity generation, transmission and commercialization, postal services, among others, which are almost always highly regulated by government. For purposes of convenience, we will refer to providers of "services of general economic interest" as "public utilities" during the rest of this article.

Given that this distinction is incomplete, we should stop at the point in Article 14 TFEU that aroused our curiosity in the first place. Why do *services of general economic interest* occupy a *place in the shared values of the Union?* Is that place a *special* one? If such is the case, why? A historical view of the origins or evolution of the concept of public utility in European history may offer part of the answer to those questions.

Our aim in this work is to attempt a brief historical exploration of the economic and legal phenomenon we currently know as public utility. The purpose of this article is to see if such historical exploration shines some light on the questions presented above. The relevancy of such historical investigation becomes more pertinent especially when considering the apparent contradiction of the existence of revenue-producing monopolies that provide services of general economic interest within European Union (EU) competition policy. In other words, one must question ultimately why the EU, which, since its inception has aimed at creating an internal market based on a *highly competitive social market economy*, allows for special

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[4] *Id.*, art. 106 (2).

[5] *Id.*;. *See also id.*, Protocol (No. 26) on Services of General Interest.

[6] *See* Commission Decision 2005/842, on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, 2005 O.J. (L 312) 67-73; Case C-320/91, Corbeau Case, 1993 E.C.R. I-2533.

treatment of undertakings that are the antithesis of competition: monopolies. There may be several reasons for this, but today we are most concerned about the historical reasons for the continued existence of revenue-producing monopolies in the European legal order.

In this work, we shall see that most attempts to define public utilities are at best phenomenological, that is, public utilities are defined based on certain economic and legal characteristics that separate them from other kinds of economic undertakings. We shall further see that these characteristics originated in the economic institutions arising from feudal relationships in the early Middle Ages. Furthermore, we shall observe that they were brought back into modernity by means of their American adoption of the English common law in the latter part of the 19th century.

Before delving into the possible historical precursors of the subject, we must begin the exposition by explaining the modern consensus about what a public utility is.[7] Public utilities generally refer to those kinds of undertakings (publicly or privately-owned) that provide the public with goods or services that, in the consensus of society, are of general or essential interest. Some public utilities operate as publicly owned businesses in the form of revenue-producing monopolies. Most undertakings, however, operate as privately owned businesses to which the government affords certain exclusive rights. The most prominent public utilities are undertakings that build and operate exclusive or semi-exclusive distribution networks in order to provide their services. Commencing in the latter part of the 19th Century, national governments have allowed these companies to operate as natural monopolies, within a defined territory, partly on the justification that economies of scale do not make it economically feasible to build parallel networks for the provision of such services. In the 20th Century, public utilities *de jure* or *de facto* exerted such economic power that they faced little or no competition in the territories where they operated.

The end of the 19th century saw the invention of the electric light bulb, the telephone, the widespread use of gas for home heating and the expansion of public transportation systems across the United States and Europe. While in the United States the exploitation of these technologies was achieved mostly by private enterprises, the story was different in Europe, where the national states quickly recognized the importance of those new services and took their development and exploitation upon themselves for the benefit of their citizens. The provisions of most public utility services in Europe remained in the hands of national companies for the most part of the

[7] *See* JOHN BAUER, EFFECTIVE REGULATION OF PUBLIC UTILITIES (The MacMillan Company 1925); ELIOT JONES & TRUMAN C. BIGHAM, PRINCIPLES OF PUBLIC UTILITIES (The MacMillan Company 1931).

20th century until the advent of the liberalization movement at the beginning of the 1990s.[8]

Why the United States and Europe chose such different paths to achieve the same objectives is a matter outside the scope of this paper.[9] However, suffice it to say that the federal system of government in the United States, and the lack of fiscal resources of State and Federal governments after the Civil War, may have had something to do with the historical preference for using private undertakings in order to achieve the network society.

These early American public utilities had several characteristics. First, they operated as private businesses that gave high demand services to the public. Second, given the high entry-capital investment required by such industries, they held legal or *de facto* monopoly or quasi-monopoly power over their markets. That is, they possessed the legal or market power to prevent competition for their services. Third, they tended to provide their services within fixed territories. Fourth, they had the duty of universal service: the duty to serve all members of the public for the service provided in a nondiscriminatory way. Fifth, they could charge the public prices in the form of tariffs or rates that had to be reasonable and commensurate with the services rendered. Finally, at least under English common law, the reach of the legal monopoly of such public utilities was interpreted narrowly by the courts in cases where the monopoly was faced with creative destruction brought on by the technological innovations of new market entrants with newer or better ways to provide services.[10]

The modern conception of the public utility business and its bridge to its centuries-old past comes not from Europe, but from an American case decided by the United States Supreme Court in 1876. It was was *Munn v. Illinois*.[11] The case was decided within the background of the end of the American Civil War and the approval of the 13th and 14th Amendments to the United States (US) Constitution. The 13th Amendment prohibits the institution of slavery in the US. The 14th amendment, among other things, prohibits States (as opposed to the Federal Government) from depriving persons of their liberty and property without due process of law. The case arose in the context of the States' assertion of their power to regulate the prices of services and goods provided by private parties. At stake in *Munn* was an Illinois law that purported the establishment of a maximum price in the tariffs charged by owners and operators of grain elevators in the City of

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[8] *See* Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, 1997 O.J. (L 027) 20.

[9] Marshall E. Dimock, *British and American Utilities: A Comparison*, 1 U. CHI. L. REV. 265 (1933).

[10] *See* FRED BOSSELMAN, ET AL., ENERGY, ECONOMICS AND THE ENVIRONMENT 46 (Foundation Press 3d Ed. 2010).

[11] Munn v. Illinois, 94 U.S. 113 (1876).

Chicago, Illinois. The plaintiffs in *Munn* asserted that the maximum price regulation was concomitant to the State of Illinois taking their private property in what is now known as a regulatory taking, without the payment of just and prompt compensation.

Chief Justice Waite, in upholding the constitutionality of the Illinois statute, forever enshrined in the American constitutional order a concept that had been dormant for almost two hundred years in the sources of English common law: the concept of a business *affected with the public interest*. Supporting Illinois' assertion of the regulation at hand, he went on to say:

> This brings us to inquire as to the principles upon which this power of regulation rests. . . . Looking, then, to the common law, from whence came the right which the Constitution protects, we find that when private property is 'affected with a public interest, it ceases to be *juris privati only.'* This was said by Lord Chief Justice Hale more than two hundred years ago, in his treatise *De Portibus Maris,* i Harg. Law Tracts, 78, and has been accepted without objection as an essential element in the law of property ever since.[12]

Munn, and its holding that States can regulate prices of private business *affected with a public interest*, was a deeply divided opinion and its 200 year-old legal reasoning was widely debated among legal scholars for the following half century, after its adoption.[13] It nonetheless provided a solid constitutional rock upon which States could regulate the price of business activities *clothed with a public interest* up until this date. Soon after the *Munn* opinion, the United States Congress established the Interstate Commerce Commission in order to regulate, among other things, interstate railroad tariffs. States followed the act by establishing public utility regulatory authorities currently known as Public Service Commissions (hereinafter the PSCs). PSCs have the legislative mandate to regulate tariffs of such businesses classified as *public utilities* by State legislatures. State PSCs issued certificates of convenience and necessity to public utilities in order to allow a private firm to enter into the regulated market and to grant them exclusive franchises. They also imposed upon such utilities the nondiscriminatory duty to serve all customers in their exclusive territories and applied the common law's *just and reasonable* standards to the utilities' consumer tariffs and rates, primarily through the so-called *cost of service* rate

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[12] *Id.* at 125-26.

[13] *See* Breck P. McAllister, *Lord Hale and Business Affected with a Public Interest*, 43 HARV. L. R. 759 (1930); Walton H. Hamilton, *Affectation with Public Interest*, 39 YALE L.J. 1089 (1930).

regulation. There is where the 20th century history of the regulation of public utilities begins.

However, the subject of this article is to look at those legal precepts *from time immemorial* that defined the category of *private property affected by the public interest* and understand some of its legal and historical characteristics. The question is where to look for those time immemorial traits of modern businesses affected with a public interest. Fortunately, Justice Waite gave us a solid reference into where to commence the search within English common law. Lord Hale, cited in *Munn v. Illinois*, described the common law principles effective in the operational aspects of wharfs in London circa 1690. In *De Porti Maris*, he said:

. . . .

> 2. A man for his own private advantage may in a port town set up a wharf or crane, and may take what rates he and his customers can agree for cranage, wharfage, housellage, pesage; for he doth no more than is lawful for any man to do, viz, makes the most of his own. And such are coal-wharfs, and wood-wharfs, and -timber-wharfs, in the port of London and some other ports. But such wharfs can not receive customable goods against the provision of the statute of I. Eliz. cap. ii.
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> 3. If the king or subject have a publick wharf, unto which all persons that come to that port must come and unlade or lade their goods as for the purpose, because they are the wharfs only licensed by the queen, according to the statute of I. El. cap. ii. or because there is no other wharf in that port, as it may fall out where a port is newly erected; in that case there cannot be taken arbitrary and excessive duties for cranage, wharfage, pesage, &c. neither can they be inhanced to an immoderate rate, but the duties must be reasonable and moderate, though settled by the king's license or charter. For now the wharf and crane and other conveniences are affected with a publick interest, and they cease to be *juris privati* only; as if a man set out a street in new building on his own land, it is now no longer bare private interest, but it is affected with a publick interest.
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> 4. But in that case the, king may limit by his charter and license him to take reasonable tolls, though it be a new port or wharf, and made publick; because he is to be at the charge to maintain and repair it,

> and find those conveniences that are fit for it, as cranes and weights.[14]

Lord Hale describes the existence of two types of wharfs: those existing pursuant to a license by the Queen, which we may call public, and those that were private, but that by virtue of certain circumstances became available to the public. In the latter case, Lord Hale argues for an "intermediate" status of private property, which he called property "affected with the public interest."[15] Moreover, Lord Hale talks of when a private wharf or crane could become one affected by public interest in the sense that under certain circumstances the private owner must give access to his private property to members of the public, and then he may charge not whatever his most greedy self-interest could allow under such circumstances, but only *reasonable* tolls.

This intermediate conception of property rights went into a head-on collision with the *laissez faire* conception of property rights predominant in 19th century America. This may be the reason why William Blackstone, the most influential commentator of English common law in America, did not mention this concept in his Commentaries on the Laws of England.[16]

In order to continue the search for the origins of the concept of public utility, we must look at the socio-economic system that gave birth to English common law in the Middle Ages: feudalism. In fact, this is what Dean Roscoe Pound urged us to do in his famous lectures in the 1920s on the spirit of the common law. There, he asked us to comprehend the common law from the vantage point of its origins in the feudal landlord-tenant relationship. In a famously quoted passage he said:

> While the strict law insisted that every man should stand upon his own feet and should play the game as a man, without squealing, the principal social and legal institution of the time in which the

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[14] A Treatise in Three Parts. "PARS PRIMA. *De Jure Maris.* PARS SECUNDA. *De Portibus Mari.* PARS TERTIA. Concerning the Custom of Goods imported and exported." From a MANUSCRIPT OF LORD CHIEF JUSTICE HALE IN I HARGAVE, COLLECTION OF TRACTS RELATIVE TO THE LAW OF ENGLAND 1-248 (1787). McAllister, *supra* note 11, at 764 (quoting Hale, De Portibus Maris cc. VIII, IX 77-78).

[15] *See* McAllister, *supra* note 13.

[16] *See* McAllister, *supra* note 13, at 766. ("It is interesting to note in passing that nowhere in Blackstone's Commentaries is there a word about anything being affected with a public interest. Blackstone, we may assume, read Lord Hale's Analysis with a trained and critical eye. Consequently, it is not without significance that when Blackstone formulated the rights of things he straightway divided them into things real and things personal and rejected Lord Hale's preliminary division into rights of things that are *juris publici* and those that are *juris private*."). *See also* 4 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 1765-69 (Wayne Morrison ed., Cavendish Publishing 2001) (1765-69).

> common law was formative, the feudal relation of lord and man, regarded men in quite another way. Here the question was not what a man had undertaken or what he had done, but what he was. The lord had rights against the tenant and the tenant had rights against the lord. The tenant owed duties of service and homage or fealty to the lord, and the lord owed duties of defense and warranty to the tenant. And these rights existed and these duties were owed simply because the one was lord and the other was tenant. The rights and duties belonged to that relation. Whenever the existence of that relation put one in the class of lord or the class of tenant, the rights and duties existed as a legal consequence. The first solvent of individualism in our law and the chief factor in fashioning its system and many of its characteristic doctrines was the analogy of this feudal relation, suggesting the juristic conception of rights, duties and liabilities arising, not from express undertaking, the terms of any transaction, voluntary wrongdoing or culpable action, but simply and solely as incidents of a relation.[17]

Thus, in order to understand the medieval economic institutions that provided the legal characteristics of the modern public utility, we must understand the role of the law and jurists during the early and latter Middle Ages. In his seminal work, *A History of European Law*,[18] Grossi provides an illuminating and authoritative description of the medieval roots of European Law. There, he describes the medieval period as one marked by the "profound discontinuity"[19] with the Roman Empire that preceded it. He considers the medieval era as politically incomplete, in the sense of its "inability, or unwillingness, to concern itself with controlling all forms of social behavior."[20] The medieval political order was not aimed at micromanaging the details of relationships between private individuals, like the Roman Empire did. As such, the concept of *state* in its modern conception cannot be applied to the political regimes of the Middle Ages.

The collapse of the Western Roman Empire in 474 A.D. left a vacuum of power that was filled *de facto* by the structures of the Roman Catholic Church, interspersed in a network of communities. In these communities, power was not centered around the figure of a Prince, but on the brute forces of the natural world. Rossi argues that the medieval civilization was reicentric, not anthropocentric like the Roman civilization that preceded it. Reicentrism, he says, is the belief in the central nature of the *res* (thing), as opposed to the centrality of man as master of nature. The medieval legal

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[17] ROSCOE POUND, THE SPIRIT OF THE COMMON LAW 20 (Marshall Jones Co. 1921).
[18] PAOLO GROSSI, A HISTORY OF EUROPEAN LAW 1 (Laurence Hooper trans., Wiley-Blackwell 2010).
[19] *Id*.
[20] *Id*.

order arose from the facts that emanated from man's place in the natural order, and the legal order's aim was to organize such accepted fact-centric norms commonly known as *consuetudo* or customs. Customs "synthesize the convictions and values that the new legal culture of the Middle Ages placed at its foundations, with the goal of winning its battle with history and guaranteeing its continued survival."[21] Early medieval law was not civil law; it was agricultural law, a field almost non-existent in Roman law. The preeminent jurist of the times was the Notary who had to effectively record the reality of the transactions appearing before him. The legal norms that emerged from such system were more concerned with the effectiveness of the norm than with their validity or compliance with an authoritative legal principle. Grossi concludes his distinction of the Roman and medieval system of property rights by stating that:

> The medieval legal system favours procedures that provide effective resolutions with regard to land, particularly where agricultural activity is involved. The Roman opposition between owner and occupier appears no to obtain in the medieval period. Many occupiers of land under licence – particularly those who seek to improve the land's productivity in the long term – gain a status of para-ownership thanks to an unobstrusive but continuous erosion of formal property rights. [22]

The England of the early middle ages was an almost perfect laboratory for the concoction of feudalism. For instance, Thorndike tells us that:

> With the disruption of Charlemagne's empire and the period of renewed invasions from all sides, we are no longer able to follow the fortunes of one ruler or of several fair-sized kingdoms; but find ourselves in the complicated tangle of feudalism, with its overlapping areas, its conflicting claims and titles to land and power, its minute subdivisions of sovereignty, its thousands of lords. *Feudalism in the strict sense of the word denotes the relationships which existed in the Middle Ages, especially from the ninth and tenth to the twelfth and thirteenth centuries, between the members of the fighting and landowning class.* In a broader sense it also covers the life of the subjugated peasantry upon the land dominated by the

[21] *Id.* at 10.
[22] *Id.* at 17.

> warriors, and all the other economic, social, political, and intellectual results and accompaniments of feudalism in the narrower sense.[23]

It is through this lens that we must see the recorded accounts of the economic institutions that developed the common law characteristics of modern public utilities. We must now look at the economic life of the early Middle Ages, which will bring us to the most important technological advance of such times: the widespread development of water mills.[24] Levine describes with fascination the importance of such medieval invention:

> Across the northwestern European countryside the ancient technique of harnessing the power of water, wind, and the tides through the use of mills greatly enhanced productivity and extended the division of labor. Deriving from a Roman invention, the waterwheel was the most important invention of the Middle Ages insofar as it replaced human energy with another power source. Tapping this source of inanimate energy meant that, for the first time in history, a complex civilization could be built on the foundation of something other than the sweating backs of slaves and/or dependent laborers. The ancient water mill was connected to complex systems of water transfer; most have been found in the immediate vicinity of aqueducts. The medieval waterwheels were, by way of contrast, located on streams of every size, and a few were even put to work on tidal inlets. Waterwheels were used primarily for flour milling, although by 1500 some were being applied to industrial processes, sometimes on a very substantial scale. Feudal-manorial societies in the northwest of Europe enthusiastically adopted water-powered milling as a means of fiscal extraction from dependent peasants. If the ancient world gave birth to the vertical water wheel and nurtured the earliest stages of its growth, it was the medieval West that brought it through adolescence and into adulthood.[25]

Given the Anglo-centric nature of this work, we do not want to give the wrong impression that water mills were predominantly an English

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[23] LYNN THORNDIKE, THE HISTORY OF MEDIEVAL EUROPE 232 (James T. Shotwell ed., Houghton Mifflin 1917) (emphases added).
[24] *See* RICHARD HOLT, THE MILLS OF MEDIEVAL ENGLAND (John Wiley & Sons 1988); JOHN LANGDON, MILLS IN THE MEDIEVAL ECONOMY: ENGLAND 1300-1540 (Oxford Univ. Press 2004).
[25] DAVID LEVINE, AT THE DAWN OF MODERNITY: BIOLOGY, CULTURE, AND MATERIAL LIFE IN EUROPE AFTER THE YEAR 1000 at 167 (Univ. of Cal. Press 2001).

phenomenon.[26] The former Western Roman Empire was full of water (and wind) mills during the Middle Ages:

> The Anglo-Norman conquerors' Domesday Book of 1086 recorded 6,082 water mills in the parts of southern England they surveyed—an average of one per fifty households. By the third quarter of the thirteenth century the number of water mills in England had probably doubled, and in the fifty years after 1275, there was another increase in mill building. In the northern French county of Picardy there were 40 mills in 1080, 80 in 1125, and 245 in 1175. In all of France, there were 20,000 water mills by the early eleventh century; nearly two centuries later, the number had doubled. It is estimated that there were 250,000 mills (of all types) in thirteenth-century Europe which combined to supply something on the order of one million horsepower. One million horsepower would be equivalent to more than three million slaves.[27]

Medieval manorial tenants were not slaves, but their relationship to the landlord was so *connected* that it could offend modern sensibilities about what we now consider slavery. "The feudal claims were coeval with the origin of the town, for in the earliest stage of its growth the townsfolk were in the position of manorial tenants, and accordingly were burdened with the onerous obligations incidental to villeinage. They owed agricultural service in the field and suit of court and suit of mill."[28]

Suit of mill refers to the obligation of tenants to resort to a special mill (usually that of their Lord) to have their grains ground. The suit of mill was a formal proceeding against manorial tenants who did not use the landlord's mills to grind their grain. It culminated in the confiscation of the convict's grain, a fine, or both.[29] In the workings of the suit of mill we can commence to allocate the distribution of rights and duties expected from the medieval service of general economic interest known as the water mill. Writing in the first part of the 19th century, Woolrych in his *Law of Waters*[30] treatise dedicates a short chapter to the subject of water mills. There, he offers a description of the common law suit of mill with reasonable fidelity:

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[26] *See also* PIOTR GÓRECKI, ECONOMY, SOCIETY, AND LORDSHIP IN MEDIEVAL POLAND 1100-1250, at 218 (Holmes & Meier 1992).

[27] LEVINE, *supra* note 25, at 168.

[28] 1 EPHRAIM LIPSON, THE ECONOMIC HISTORY OF ENGLAND 201 (Adam & Charles Black, 12th ed. 1959).

[29] *See* HOLT, *supra* note 24, at 38-40, 44- 45.

[30] HUMPHREY W. WOOLRYCH, A TREATISE OF THE LAW OF WATERS: INCLUDING THE LAW RELATING TO RIGHTS IN THE SEA, AND RIGHTS CONCERNING RIVERS, CANALS, DOCK COMPANIES, FISHERIES, MILLS, WATER-COURSES, ETC., WITH A NOTE CONCERNING THE RIGHTS OF THE CROWN TO THE LAND BETWEEN HIGH AND LOW WATER MARK (T. & A. W. Johnson 1853).

In ancient times, before the necessaries and conveniences of life were supplied in such profusion as at present, it became important to the settlers in and inhabitants of different districts, that they should have free access to some mill for the purpose of grinding their corn. This easement was indispensable, because they required in the first instance, sustenance for their families; and in some cases there might have been an obligation to grind the lord's wheat for his use. Lords of manors, therefore, for the purpose of meeting this exigency, erected mills on their respective domains for the public advantage; but they fettered their gift with this condition, that the inhabitants and residents within their respective seignories should bring their corn to be ground at the mill so built up; and this custom, which thus had a reasonable commencement, was called doing suit to the mill. Consequently whether the millers, to whom the respective lords conceded these advantages, make their claim by prescription, which supposes a grant from the lords, or by custom, it seems clear, that this old practice arose originally from a sense of general convenience; and in so strong a point of view does this seem to have been considered, that a man might have claimed the suit by prescription even from the villeins of a stranger.

In process of years, however, when commerce began to spread, and new erections were prospering on every side, many of the tenants and inhabitants, whose ancestors had derived benefit from the ancient mills, began to employ their own particular workmen, and the old millers found themselves deserted by degrees by those whose duty it was to have continued their support. They were, therefore, necessitated to seek redress, and the writ of *secta ad molendinum*, or *secta molendini*, was the ordinary remedy which they employed upon those occasions. The enforcing of this writ, which is now superseded by the modern action on the case, brought back the inhabitants to the suit and service which they owed.

Again, on the other hand, the millers would sometimes stretch their prerogative too far; and not content with the suit of the tenants and neighbours, would endeavour to lay claim to a more extensive limit than they ought, and thus it was that they were now and then defeated upon one side or the other to try the validity of their customs; or they would even trespass on the rights of the inhabitants, and instead of confining themselves to the usual demand of having all the corn ground at their mills which would be afterwards used in the family, they strove to include within their custom all the corn sold or spent in the neighbourhood. This being an unreasonable custom, was rejected by the Courts.

> These customs are appendancies to the mills to which they belong, so that he who is seised of the mill becomes of course entitled to the suit; Thus, where the Prior of Watton brought an action for suit to his mill against the Abbott of Meuz, it was said, on the part of the plaintiff, that the suit was claimed as appendant. And by the Court, whoever is seised of the mill, shall have the suit; and if the plaintiff have no title, that will come by way of reply. It was then claimed from time immemorial, and, therefore issue was joined.[31]

The above passage teaches us that the suit of mill was a reasonable custom that courts would uphold if the miller could prove the title to his privilege, be it by express grant from the lord or by custom. The custom was reasonable because it was convenient: lords spent considerable amounts of money to build these mills that were accessible to the tenants and the least they could expect from tenants was that they be bound to grind their corn at the lord's mill. The use of the mill would not be free. A tenant had to pay a fee that was called multure.[32] Moreover, the suit of mill was attached to the mill even if the mill's ownership changed. In a sense, the custom was similar to what today we know as an easement or *covenant that runs with the land*. As such, the mill was not only a productive asset, it was a bundle of rights and privileges that created a separate legal real property right over and above the fee simple property right of the owner of the mill (*domino*). Finally, we learn that common law courts would not expand on the original grant of the privilege when the unscrupulous millers wanted to extend their leash over new clientele. Common law courts interpreted grants of monopoly power in a restrictive way. The relationship between the landlord and the tenant could not become unreasonable. To that point, Woolrych tells us that:

> [T]he principle upon which these decisions have proceeded is, that lords of the manors, in the first instance, erected mills for the convenience of their tenants, and that the millers derived their title to the exclusive grinding either by prescription, which presupposes a grant from the lord, or a custom which was not considered unreasonable. When, however, they came to encroach, and endeavour to enlarge their rights, they were in their turn foiled and compelled to rest satisfied within the limits of their original grant.[33]

Monopolistic undertakings are very powerful market actors. The feudal regime evolved over the centuries, but well-maintained (although technologically outdated) water mills could also last many years. Millers

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[31] *Id.*, at 145-146.
[32] *See* HOLT, *supra* note 24.
[33] WOOLRYCH, *supra* note 30, at 151.

continued using the coercive power of the courts to hang on to their dated exclusive privileges. The Suit of Mill:

> …survived, indeed, long after all other incidents of feudal dependency had disappeared; so valuable, for example, were the Dee Mills of Chester that they passed into a proverb on extravagance. The monasteries in particular clung tenaciously to their monopoly, and could never be brought freely to relinquish its profits. When the burgesses of Barnstaple made a submission to the abbey, they bound themselves expressly to do suit at its mill and erect none of their own to its prejudice and hurt. Even on the eve of the dissolution the monastic establishments were drawing a considerable portion of their revenues from the mills.[34]

A solid *business* model does not die easily, and one with a grant of exclusive legal rights is perhaps the *most coveted* arrangement in the business world. Millers, with the help of skillful lawyers, continued using the suit of mill well into the times of Lord Hale:

> Suit of mill, which had always been difficult to enforce, had faded into disuse, though with at least a fifth of mills in decay after the mid-fourteenth century many communities had easy access to only one mill. Some mills seem to have escaped from the control of lords, in particular those originally built by a lord but which had been ill advisedly rented out (typically in the twelfth century) and had become freeholds, paying a nominal rent to a lord. Entrepreneurs built new mills in the later Middle Ages. At Gaydon in Warwickshire, for example, in 1539 a millwright was contracted to a free tenant, without apparent reference to the lord of the manor, to build a new windmill for £8. Independent mills of this type would not pay a rent to the lord, but would be subject to regulation by the court leet,[35] where the miller would be fined for taking excessive tolls, which often provides the only means of discovering their existence.[36]

An intriguing development described by Dyer is the entry of the private entrepreneur into the business of mills, which up to that point, was

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[34] LIPSON, *supra* note 28, at 202.

[35] Court leet was an English criminal court for the punishment of small offenses. The use of the word leet, denoting a territorial and a jurisdictional area, spread throughout England in the 14th century, and the term court leet came to mean a court in which a private lord assumed, for his own profit, jurisdiction that had previously been exercised by the sheriff. *See* Classic Encyclopedia, http://www.1911encyclopedia.org/Court_leet.

[36] CHRISTOPHER DYER, AN AGE OF TRANSITION? ECONOMY AND SOCIETY IN ENGLAND IN THE LATER MIDDLE AGES 163 (Clarendon Press 2005).

the private domain of lords and the Church. Throughout the Middle Ages and into modernity, common law courts never relinquished their jurisdiction to regulate the "reasonableness" of the prices charged by these mills to the public. One can only wonder if these common law courts held such entrepreneurs to a certain standard of service. We know that manorial lords and the Church had an ingrained responsibility towards the tenants and peasants in their manor. The new class of entrepreneurs who bought these old mills did not have incentives to improve their mills: the suit of mill was a one-way street in their favor.

In this article, we have attempted to study the historical origins of the modern public utility, an odd actor in our actual liberal economic system. The oddness we refer to has to do with the fact that modern public utilities are the possessors of exclusive rights that give them an almost monopolistic power, which is the anathema of liberal orthodoxy. We have seen the striking similarities between the legal duties and privileges of the modern public utility and those given to water mills by the feudal custom of the suit of mill. Feudal mills were operated for the convenience of the public. They had fixed territories, monopoly power, and the responsibility and faculty to provide a specific service to their clientele, while at the same time they were able to enforce their exclusive rights to operate such services on the people in their territory. They nonetheless could not exceed the bounds of the written or customary privileges granted to them, and had to charge reasonable prices much like modern public utilities. The legal characteristics of water mills were comparable to those of other services of general economic interest during the Middles Ages such as Innkeepers and ferry systems.[37] The legal duties and privileges afforded to water mills and similar businesses in the Middle Ages, led to the coinage of the term private property affected by the *public interest* by the English and American common law regimes, which in turn became the model for the modern system of public utility regulation.

The question thus remains: why does a free market of the European Union continues to protect *services of general economic interest*, even though these clearly possess feudal characteristics, which are a distinct reflection of the "incompleteness" of the political power at the time of their origin? Should nationalistic governments, with their complete assertion of political powers, not be the sole providers of such services? Or, at least, shouldn't these national governments formulate a modern channel for the provision of such services (such as the public-private partnerships) from a legal basis that emanates from the present constitutional order of such nations? Why have these feudal relics survived in the 21st century? As we said before, monopolies are very powerful economic (and political) actors.

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[37] *See* Jim Rossi, *The Common Law "Duty to Serve" and Protection of Consumers in an Age of Competitive Retail Public Utility Restructuring*, 51 VAND. L. REV. 1233 (1998).

THE NEW ERA OF FLOW-THROUGH TAXATION IN PUERTO RICO: OPPORTUNITIES AND CHALLENGES FOR CHOICE OF ENTITY STRATEGIES

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> *The distressingly complex and confusing nature of the provisions of subchapter K present a formidable obstacle to the comprehension of these provisions without the expenditure of a disproportionate amount of time and effort even by one who is sophisticated in tax matters with many years of experience in the tax field . . . . Surely, a statute has not achieved "simplicity" when its complex provisions may confidently be dealt with by at most only a comparatively small number of specialists who have been initiated into its mysteries.*[1]

> *Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.*[2]

I. INTRODUCTION

The origins of this story can be traced as far back as to the promises made during the campaign efforts leading to the 2008 general elections in Puerto Rico. However, it was not until February 4th, 2010, a significant date, in which a tax reform commission was appointed by the Governor of Puerto Rico and was quickly charged with the task of examining different alternatives to expeditously reform the Island's tax system.[3] Almost a year

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[1] Foxman v. C.I.R., 41 T.C. 535, 551 n.9 (1964).
[2] Comm'r. v. Newman, 159 F.2d 848, 850-51 (2d Cir. 1947) (Judge Learned Hand dissenting).
[3] Yanira Hernández Cabiya, *Configurado el comité que redactará la reforma contributiva,* EL NUEVO DÍA, Feb. 4, 2010, http://www.elnuevodia.com/Xstatic/endi/template/imprimir.aspx?

later, on January 31, 2011, a new Internal Revenue Code for Puerto Rico was enacted into law and became known as the Internal Revenue Code for a New Puerto Rico (hereinafter the "2011 PR Code").

Specifically, the statement of motives for Puerto Rico Act 1 of 2011 unequivocally points us to the general spirit encompassing the approval of the 2011 PR Code; "[h]istory has taught us that, indeed, a dollar in the hands of a citizen yields more than a dollar in the government's hands."[4] Furthermore, the statement of motives states that; "[b]y adopting this law, we put more money into the pockets of our workers, in recognition that the power to determine what is best for themselves and their loved ones is solely for them, and not the Government's."[5] Thus, we can note that the basic principle encompassing the approval of the 2011 PR Code was to provide *tax justice* for the common citizen of Puerto Rico by procuring a gradual reduction in the tax rates over the next couple of years.

The statement of motives of Puerto Rico Act 1 of 2011 sets forth an additional objective:

> [T]o facilitate doing business in Puerto Rico, this Act [Act 1 of 2011] reconciles the [tax] provisions relating to partnerships [in Puerto Rico] with the provisions of the federal code. For this reason, [Act 1] adds a new chapter for partnerships, which provides the new taxation rules for partnerships in Puerto Rico. This chapter provides that partnerships will not be taxed as separate entities from their partners and, hence, the partnership shall not be subject to income tax. The partners will be taxed on their corresponding share of income and expenses of the partnership.[6]

Therefore, it is important to understand that the secondary principle underlying the 2011 tax reform was to simplify or facilitate the process of conducting business transactions in Puerto Rico by modifying the applicable tax rules. In essence, the tax reform committee tried to achieve this objective by, as illustrated in the previous paragraph, harmonizing the tax

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id=667979&t=3 (informing that such committee was composed of "attorney Xenia Vélez as Director of the Executive Committee . . . Representative Antonio Silva, Senator Migdalia Padilla; Secretary of the Treasury Juan Carlos Puig; the President of the Government Development Bank, Carlos García; Secretary of Economic Development, José Ramón Pérez Riera, and the Governor's Chief of Staff Marcos Rodríguez Ema).

[4] 2011 P.R. Laws No. 1; as amended. Statement of Motives at 12. *See also* LUIS G. FORTUÑO, GOVERNOR OF THE COMMONWEALTH OF PUERTO RICO, Mensaje Especial sobre La Reforma Contributiva, Salud para Todos y Más Dinero en tu Bolsillo [Special message regarding the Tax Reform, Healthcare for All and More Money in your Pocket], Oct. 25, 2010, *available at* http://www.prfaa.com/espanol/docs/reformacontributiva/reformacontributiva2010.pdf.

[5] *Id.*

[6] *Id.* at 11.

consideration given in Puerto Rico to certain entities and transactions to the treatment given to those entities and transactions in the Federal Internal Revenue Code.[7] Thus, as done by other administrations in the past, the tax reform committee merely adopted the federal provisions pertaining to partnerships and partners by translating these provisions into Spanish and incorporating them into Chapter 7 of the 2011 PR Code. With certain exceptions, the 2011 PR Code came into effect as of January 1, 2011 (i.e. for taxable years commenced after December 31, 2010). Formerly, the applicable tax code in force was the Puerto Rico Internal Revenue Code of 1994[8] (hereinafter, the "1994 PR Code"), as amended, which was applicable to taxable years beginning after June 30, 1995. Additionally, it is important to note that at this time regulations promulgated and issued by the Puerto Rico Department of the Treasury based on the 1994 PR Code are still in effect until new regulations are promulgated under the 2011 PR Code.

Finally, it is important to understand that the Government of Puerto Rico currently enjoys and enforces a Primary Taxing Power. That is, the Island enjoys Fiscal Autonomy from that of the Government of the United States of America. Puerto Rico exercises this powerful tool of Primary Taxing Power by being the first and primary entity to tax the wealth generated within the island. ,This Primary Taxing Power arises from the constitutional developments that have characterized its relationship with the United States for more than a century.[9] Thus, it is because of this fiscal autonomy that the Government of Puerto Rico is able to develop, enact and enforce tax laws that are separately administered from those of the Government of the United States of America. This is the reason for having separate, but in some instances equal tax provisions in Puerto Rico, which in essence are inspired or copied from the provisions of the Federal Internal Revenue Code.

In this article, we will first describe the general notions regarding flow-through taxation and entity level taxation and we will include a discussion of the United States' version of flow-through taxation. Afterwards, we will describe the general change in the entities allowed to claim flow-through taxation for Puerto Rico tax purposes (i.e. who was allowed under the 1994 PR Code to claim flow-through taxation and what entities are now allowed under the 2011 PR Code) thus offering a general overview of the Special Partnership election and the Corporation of Individuals election

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[7] 26 U.S.C. §§.1-9834. *See also* I.R.C. §§ 701-777 (Subchapter K, "Partners and Partnerships").
[8] 1994 P.R. Laws No. 120; as amended.
[9] Felipe Rodríguez-Lafontaine, *Puerto Rico Act 154: The Beginning of the End? Effects of Act 154 on Future Economic Development*, 2 U.P.R. BUS. L. J. 216, 219 (2011) (discussing the conditions and historical events that granted the Primary Taxing Power bestowed on the Government of Puerto Rico). See also for a discussion of this topic Carlos Díaz Olivo, *The Fiscal Relationship Between Puerto Rico and the United States: A Historical Analysis*, 51 REV. COL. ABOG. P.R. 32 núm. 2-3, (1990) and Juan Carlos Méndez Torres, *The Internal Revenue Code's Role in Puerto Rico's Economic Development,* 15 J. INT'L TAX'N 22 (2004).

which were available in the 1994 PR Code. We will describe the recently enacted Chapter 7 ("Partnerships and Partners") of Subtitle A ("Income Taxes") of the 2011 PR Code. Shortly thereafter, we will discuss the consequences of these changes for business entities in Puerto Rico and will conclude with recommendations for future technical amendments.

II. DISCUSSION

A. Available Entities for Doing Business in Puerto Rico

The General Corporation Law of 2009, as amended, provides various alternatives in order to conduct trade or business in Puerto Rico. In my professional experience, the following entities are the most frequently organized under the laws of Puerto Rico:

- Corporation- The single most commonly used entity to conduct business in Puerto Rico.[10]

- Branch of a Foreign Corporation- A corporation not organized under the laws of Puerto Rico is considered a foreign corporation. A foreign corporation is required to register with the Department of State prior to conducting any business transactions in Puerto Rico by filing the Certificate of Authorization to do Business for a Foreign Corporation.[11]

- Closely Held Corporation- This is a corporation that shall have no more than 75 shareholders and its stock is subject to transfer restrictions and cannot be subject to a public offering. A closely held corporation will be subject to the laws of a regular corporation except for those provisions that are contrary to the special provisions applicable to closely held corporations.[12]

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[10] P.R. LAWS ANN. tit. 14, §§ 3501-3790 (2011).

[11] P.R. LAWS ANN. tit. 14, §§ 3801-3815 (2011). *See also* Puerto Rico Industrial Development Company, Recommended Tax Structures, http://www.offshorecorporation.com/puerto-rico/ (stating that "many companies have established their operations in Puerto Rico as profit centers to take advantage of special tax provisions." It is explained that a "U.S. Parent, under the Controlled Foreign Corporation ("CFC") structure, the Puerto Rico subsidiary, which will generate a maximum corporate income tax rate of 7% with no withholding tax, may use these profits to fund their foreign operations including the Puerto Rico operations." In the case of the European Union Parent under the European parent model, the European Union ("EU") parent has an affiliate in the Netherlands who in turn owns the Puerto Rico Corporation).

[12] P.R. LAWS ANN. tit. 14, §§ 3821-3839 (2011).

- Partnership- No less than two natural persons may organize this type of entity. As a general rule, each member of a partnership is liable for the debts of the business and is held liable for the partnership's obligations. Partnerships are subject to income taxes on the partnership's income. The liability for taxes applies regardless of whether the partnership's profits are distributed or retained.[13]

- Limited Liability Partnership- No less than two natural persons may organize this type of entity. This type of entity provides limited liability for its members. A limited liability partnership must register with the Department of State and renew such application on an annual basis.[14]

- Professional Service Corporation- This type of corporation is owned by professionals who perform a specific service and are licensed to do so. Only licensed individuals who perform these services may become stockholders.[15]

- Limited Liability Company- The limited liability company may be formed in Puerto Rico by filing the corresponding certificate at the Department of State. A foreign limited liability company may operate in Puerto Rico by requesting authorization to do business to the Department of State. This type of entity provides limited liability for its members.[16]

Business ventures before the approval of the 2011 PR Code could have chosen the entity classification they desired from a corporate law perspective because the type of entity chosen would not specifically dictate its tax treatment in Puerto Rico. Previously, the tax treatment depended only upon the business activities carried out by such entity in light of the provisions of the 1994 PR Code and other special laws, such as tax incentive laws.[17] These laws provided different tax benefits and/or consequences based on the type of business activities carried out.

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[13] P.R. LAWS ANN. tit. 31, §§ 4311-4324 (2011); P.R. LAWS ANN. tit. 10, § 1344 (2011).
[14] P.R. LAWS ANN. tit. 10, §§ 1861-1867 (2011).
[15] P.R. LAWS ANN. tit. 14, §§ 3921-3938 (2011).
[16] P.R. LAWS ANN. tit. 14, §§ 3951-4044 (2011).
[17] The first Industrial Incentives Act was 1953 P.R. Laws No. 6 of December 15, 1953, as amended, known as the "Industrial Tax Incentives Act of Puerto Rico of 1954" followed by 1978 P.R. Laws No. 26 of June 2, 1978, as amended, known as the "Industrial Tax Incentives Act of Puerto Rico of 1978", 1987 P.R. Laws No. 8 of January 24, 1987, as amended, known as the "Tax Incentives Act of Puerto Rico", 1997 P.R. Laws No. 135 of December 2, 1997, as amended, known as the "Tax Incentives Act of 1998" and the most recent installment of the Industrial Incentives Chapter in Puerto Rico 2008 P.R. Laws No. 73 of May 28, 2008, as amended, known as the "Economic Incentives Act for the Development of Puerto Rico".

B. Summary of Changes Introduced by the 2011 PR Code Regarding Flow Through Taxation.

The 2011 PR Code introduced several important changes to the Puerto Rican tax system, which present new planning opportunities for taxpayers. However, these same changes require, in some instances, immediate attention by entities operating in Puerto Rico because certain transition rules may result in unintended consequences for taxpayers if not managed in an adequately and timely manner.[18] For example, under the 1994 PR Code, major business entity forms (corporations, limited liability companies, partnerships, etc.) were taxed as corporations.[19] Previously, flow-through taxation was only available to entities through elections as either special partnerships or corporations of individuals. Additionally, it is very important to note that "under the 2011 PR Code no elections for special partnership status will be permitted for taxable years commencing after December 31, 2010."[20]

Specifically, "the 2011 PR Code defines partnerships separate from corporations and includes a new chapter for taxation of partnerships and their partners that incorporates rules similar to those found in the US Internal Revenue Code of 1986."[21] Additionally, "[u]nder the new rules, partnerships are not subject to tax on their income at the partnership level. Partners will be treated as undertaking the business of the partnership and will be subject to tax on partnership profits, whether or not such income is distributed."[22] Also, "although this will be the default treatment under the 2011 [PR] Code, partnerships in existence on January 1, 2011 may elect to continue to be treated as corporations for tax purposes."[23]

Finally, under de 2011 PR Code, LLCs will also be able to elect flow-through taxation. However, as a default, they will continue to be treated as corporations for tax purposes in the event that they do not choose flow-through taxation. If an LLC is treated as a flow through (or disregarded) entity under the law of another jurisdiction, it will also be treated as a partnership for Puerto Rico income tax purposes."[24]

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[18] *Choice of Entity Determinations Under the New Internal Revenue Code,* MCCONNELL VALDÉS TAX ALERT (McConnell Valdés LLC, San Juan, P.R.), Mar. 14, 2011, at 1, http://www.mcvpr.com/media/publication/80_Choice-of-Entity-Determination-under-new-Internal-Revenue-Code.pdf.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] *Id.* at 2.

C. Difference between Flow-Through Taxation and Entity Level Taxation

As noted by Professor Ribstein "[t]ax is the most obvious non-organization law influence on business associations."[25] Professor Ribstein has also pointed out that:

> [T]ax rules can influence not only choice of business form but also the choice of specific governance rules within forms. For example, following the IRS ruling clarifying that LLCs could qualify for partnership tax treatment, LLCs had an incentive to avoid corporate characteristics other than limited liability – that is, centralized management, free transferability and continuity of life. This prodded lawmakers to avoid these features in the developing LLC statutory form. As soon as the IRS passed the check-the-box rule, LLC statutes changed to provide for more continuity by default.[26]

Additionally, "a 'corporation' for federal income tax purposes includes not only incorporated entities but also unincorporated 'associations'."[27] As stated by the Supreme Court of the United States, the federal tax classification of an entity is distinct from its classification under applicable local law.[28] Therefore, "this decoupling of tax classification from local law classification offered taxpayers an opportunity to argue against their own form in search of tax benefits."[29] Furthermore, it has been generally understood by tax experts that "tax consequences are dependent on the rights and obligations of taxpayers as those rights and obligations are defined by non-tax rules and regulations."[30] Specifically, "the creation, use or liquidation of an entity disregarded for tax purposes has an indirect (and "indirect" should not suggest insignificant) effect on the taxpayers whose non-tax relationships are affected by the entity."[31]

Thus, it is now important to describe what exactly flow-through taxation encompasses. Tax professionals use various terms or phrases to refer to the entities that are allowed this form of taxation, for example some common phrases include: pass-through entities, flow-through entities or

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[25] LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 125 (1st ed. 2010).
[26] *Id.*
[27] Howard E. Abrams, Fred T. Witt & Lisa M. Zarlenga, *U.S. Income Portfolios: Other Pass-through Entities: Portfolio 704-1st: Disregarded Entities*, 704-1st T.M., Disregarded Entities (BNA).
[28] *Id.* (citing Morrissey v. Comm'r of Internal Revenue, 296 U.S. 344 (1935) (it was held that an unincorporated entity is taxable as an association if it more closely resembled a corporation than any other entity).
[29] *Id.*
[30] *Id.*
[31] *Id.*

disregarded entities. Therefore, what exactly is a *disregarded entity*? The answer to this question is that "[t]here is no statutory definition, but the phrase has come to mean an entity that is recognized under applicable state (or other local) law purposes but which is entirely ignored for federal income tax purposes."[32] However, where do partnerships fit in this scheme? Elliot Manning states that:

> Although there are many other business entities that are not taxable on all or part of their income, and serve as conduits, none do so as completely as partnerships. S corporations pass through income and deductions, but not liabilities, and, if they have a C corporation history, they are subject to additional taxes. Trusts and estates pass through distributed income, but are taxed on undistributed income, though grantor trusts pass through all income attributable to the grantor (or others with similar powers), and may be used as investment vehicles, including for pooled investments in tax-exempt securities. Similarly, regulated investment companies, real estate investment trusts, and real estate mortgage investment conduits pass through distributed capital gain, but not the tax attributes of other types of income. In addition, certain cooperatives avoid tax on patronage distributions to their members. Finally, the consolidated return provisions contain a mixture of entity and aggregate aspects in computing the tax results for consolidated groups.[33]

In the United States, a partnership is not a taxable entity. Its income, gain, loss, deductions, and credits are passed through to partners, who must account for them when computing their income tax. However, a partnership is considered an entity for purposes of engaging in transactions and holding property. A partnership can be considered both an entity separate from its partners or an aggregation of its partners without a separate existence. In general, an entity approach is used to compute and characterize taxable income, whereas an aggregate or conduit approach is used for the purpose of taxing the income. The application of the aggregate and entity principles in partnership taxation are intertwined:

> At the most fundamental aggregate level, a partnership, unlike a C corporation, is not a taxable entity; it is a conduit for its partners who pay all taxes attributable to partnership operations in their individual capacities. Not only the net results of partnership operations, but all tax-significant characteristics of those results pass

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[32] *Id.*

[33] Elliot Manning, *U.S. Income Portfolios: Partnerships: Portfolio 710-2nd: Partnerships – Conceptual Overview*, 710-2nd T.M., Partnerships – Conceptual Overview (BNA).

> through. As a matter of administrative convenience, the flow-through occurs only on the last day of the tax year of the partnership (and partner), but there are, predictably, limitations to prevent abuse. Although there is a similar flow-through for S corporations, the aggregate principle generally does not apply to other aspects of S corporation taxation. The partner's basis in the partnership interest is adjusted for the items of income, gain, loss, or deduction, thus preventing double taxation and double deduction.[34]

In contrast partnerships, as an entity (rather than an aggregate):

> [Are] a vehicle for determining the amount, character, and timing of the income, deductions, gains, losses, and credits generated by the partnership's activities, generally without regard to the identity, or tax characteristics, of its partners. For example, if a partnership sells an asset, the amount of the gain or loss realized on the sale is determined by reference to the partnership's inside basis in the asset and the amount realized by the partnership for the asset. The character of the gain or loss depends on the manner in which the asset was used in the partnership's activities. The year in which the gain or loss is reported is determined by reference to the partnership taxable year in which the asset was sold by the partnership. The partnership reports its transactions on Form 1065, U.S. Return of Partnership Income. The same principles generally apply to S corporations, except that they report on Form 1120S.[35]

III. ANALYSIS

A. Description of the General Changes in the Entities Allowed to Request Flow-Through Taxation for Puerto Rico Tax Purposes

As previously noted, in Puerto Rico, flow-through taxation under the 1994 PR Code was only available to entities through elections as either special partnerships or corporations of individuals.

1. Special Partnership Elections

A special partnership is one that meets certain requirements and has elected not to pay any income tax on its income, but instead, to have the partners pay the tax on it, even though the corresponding income is not distributed. Eligibility depends on the nature of the partnership's income.[36]

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[34] *Id.*
[35] *Id.*
[36] Puerto Rico Internal Revenue Code (P.R. I.R.C.), P.R. LAWS ANN. tit. 13 § 8630 (2011).

Additionally, a corporation engaged in an eligible activity in the magnitude required may elect special partnership treatment.[37] Special partnership treatment is available only if the electing partnership or corporation qualifies for such treatment. To qualify, the partnership or corporation must meet the following requirements: (1) derive during each taxable year at least 70% of its gross income from sources within Puerto Rico; and (2) derive at least 70% percent of its gross income from one of the following business activities:

- construction;
- land development;
- the substantial rehabilitation of buildings and structures;
- sale or rental of buildings or structures;
- manufacturing which generates substantial employment;
- tourism (including income from the operation of casinos);
- agriculture;
- exporting products or services to foreign countries;
- the production of long feature films;
- or a business for the construction, operation or maintenance of public roads and its adjoining facilities.[38]

The election of the special partnership status was made by filing a sworn statement with the Secretary of the Treasury within 90 days following the commencement of the partnership's or corporation's first taxable year for which the election is to be effective, or within 90 days following the creation, conversion or organization of the special partnership.[39]

2. Corporation of Individuals or an N Corporation Status

In essence, a corporation of individuals or an N corporation is a corporation or partnership that is eligible to choose N corporation status and whose shareholders or partners have all consented to the corporation's or partnership's choice of N corporation status.[40] Also, with limited exceptions, an N corporation is not taxed at the corporate level.[41] In its place, its items of income, loss, deduction and credit are passed through to, and taken into account by, its shareholders or partners in computing their individual tax liabilities.[42] In order to qualify, the corporation (or partnership) must meet *all* of the following requirements:

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[37] *Id.* § 8697(a)(3)(B).
[38] *Id.* § 8630.
[39] *Id.* § 8642(a).
[40] *Id.* § 8681(a)(2).
[41] *Id.* § 8682(a).
[42] *Id.* § 8683(a).

- It must be a domestic corporation (created under the laws of Commonwealth of Puerto Rico), or a U.S. corporation (created under the laws of any state of the United States or the District of Columbia), engaged in trade or business solely in Puerto Rico and it is not one of the following:
    - Taxable as an insurance company;
    - Taxable as a registered investment company;
    - Taxable as an employees-owned special corporation;
    - A corporation enjoying tax exemption under any of the industrial tax incentives acts;
    - A corporation exempt under P.R. I.R.C. §1101;
    - A financial institution under P.R. I.R.C. §1024(f)(4);
    - Or an entity licensed by the Commissioner of Financial Institutions pursuant to Act No. 3 of October 6, 1987, known as the Investment Capital Fund Act, as amended.
- It has no more than 75 shareholders (a husband and wife and their estates are treated as one shareholder);
- All shareholders must be individuals, decedent's estates, bankruptcy estates, voting trusts, or certain other qualified trusts;
- It must have only one class of stock.[43]

The election of N corporation status is made by having the electing corporation file a Form AS2640.1, signed by its authorized officer, with the required shareholder consents, together with the corresponding filing fee.[44] An N election for a tax year may be made during the preceding tax year, or by the 15th day of the fourth month of the tax year for which it is to be effective.[45] For each year an election is in effect, an N corporation is generally exempt from all income tax imposed on corporations.[46] As previously mentioned, instead, its items of income, loss, deduction and credit are passed through to, and taken into account by its shareholders or partners in computing their individual tax liabilities.[47]

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[43] P.R. I.R.C., P.R. LAWS ANN. tit. 13 § 8681(c) (2011).
[44] *Id.* § 8681(a); P.R. P.R. I.R.C. Reg. No. 5622, § 1391-1 (1998).
[45] P.R. I.R.C., P.R. LAWS ANN. tit. 13 § 8681(b)(1) (2011).
[46] *Id.* § 8682(a).
[47] *Id.*

B. Description of Chapter 7 ("Partnerships and Partners") of Subtitle A ("Income Taxes") of the 2011 PR Code.

1. Roadmap of the Provisions of Chapter 7

The taxation of partnerships, or better said, the rules setting forth flow-through taxation are set forth in Chapter 7 (Partnerships and Partners) of Subtitle A (Income Taxes) of the 2011 PR Code. Chapter 7 is composed of a general definitions section and five subchapters. Thus, the organization of Chapter 7 results as follows:

§ 1070.01 - Definitions

Subchapter A: Levying of Tax

§ 1071.01 - Levying of Tax on Partners and Not the Partnership
§ 1071.02 - Income and Credits of the Partners
§ 1071.03 - Partnership Computations
§ 1071.04 - Distributive Share of Partners
§ 1071.05 - Determination of the Basis of a Partner's Share
§ 1071.06 - Tax Years of Partners and Partnership
§ 1071.07 - Transactions between Partner and Partnership
§ 1071.08 - Partnership Continuity
§ 1071.09 - Organization and Syndication Expenses

Subchapter B: Computation of Contributions

§ 1072.01 - Non-recognition of Gain or Loss in Contribution of Property
§ 1072.02 - Basis of Contributing Partner's Interest
§ 1072.03 - Basis of Property Contributed to the Partnership
§ 1072.04 - Nature of Gain or Loss in the Contribution of Unrealized Credits, Items of Inventory and Capital Loss Property to a Partnership

Subchapter C: Computation of Distributions

§ 1073.01 -Recognition of Gain or Loss in Distributions Made by Partnerships
§ 1073.02 - Basis of Distributed Property Other than Cash
§ 1073.03 - Basis of the Interest of a Partner Receiving a Distribution
§ 1073.04 - Adjustment to the Partnership's Undistributed Property Basis with a §1075.04 Election or Substantial Reduction in Basis
§ 1073.05 - Nature of Gain or Loss in the Disposition of Distributed Property
§ 1073.06 - Payments to a Retiring Partner or Successors of a Deceased Partner

§ 1073.07 - Recognition of Pretax gain in the Case of Certain Distributions to the Contributing Partner

Subchapter D: Computation of Sales or Exchanges

§ 1074.01 - Recognition and Nature of the Gain or Loss in Sale or Exchange
§ 1074.02 - Basis of the Interest of a Partner Acquiring an Interest
§ 1074.03 - Special Rules in the Case of Constructive Losses and § 1075.04 Election

Subchapter E: Miscellaneous Provisions

§ 1075.01 - Inventory Items and Unrealized Credits
§ 1075.02 - Treatment of Certain Debts
§ 1075.03 - Payments to a Partner's Successor
§ 1075.04 - Form of Making Optional Election to Adjust the Basis of Partnership Property
§ 1075.05 - Basis Apportionment Rules
§ 1076.01 - Effect of Application of the Provisions of Chapter 7

"[T]he term 'partnership' includes a syndicate, group, common fund, joint enterprise or any other unincorporated organization through or by way of which any business, financial transaction or enterprise is carried on, and which is not, a corporation, trust or estate."[48] It also includes those LLCs that, under the provisions of § 1010.01(a)(3), are taxed under the provisions of Chapter 7. Also, "the term 'partner' means any member of a partnership" and "includes a member of a LLC subject to tax under the provisions of Chapter 7."[49]

Specifically, Subchapter A (Levying of Tax) sets forth all the relevant provisions regarding the taxations of partnerships and partners in Puerto Rico. Accordingly, "a partnership subject to the provisions of Chapter 7 shall not be subject to the income tax levied by subtitle A of the 2011 PR Code."[50] Thus, "[p]ersons carrying on a business as partners shall be liable for the income tax solely in their personal or individual capacities."[51] Additionally, "any partner of a partnership engaged in a trade or business in Puerto Rico shall be deemed to be engaged in a trade or business in Puerto Rico with

[48] 2011 P.R. Laws No. 1; as amended by 2011 P.R. Laws No. 232 and codified as the 2011 P.R. I.R.C., § 1070.01(a).
[49] *Id.* § 1070.01(b).
[50] *Id.* § 1071.01.
[51] *Id.*

respect to his distributive share in the income, gain, loss, deduction or credit of the partnership."[52]

Thus, when determining his tax liability, each partner shall separately take into account his distributive share in the partnership for any taxable year ending within or simultaneously with the partner's tax year, with respect to:

> (1) gains and losses in the sale or exchange of capital assets held by the partnership for not more than six (6) months;
> (2) gains and losses in the sale or exchange of capital assets held by the partnership for more than six (6) months;
> (3) gains and losses in the sale or exchange of properties described in Section 1034.01(i);
> (4) gains and losses in the sale or exchange of all assets in an exempt business under the Puerto Rico Tourism Development Act of 1993, the Puerto Rico Tourism Development Act of 2010, and any similar successor law;
> (5) charitable donations (subject to the provisions of Section 1033.10);
> (6) dividends subject to the provisions of Section 1023.06;
> (7) tax withheld on dividends under paragraph (6);
> (8) taxes described in Sections 1051.01, 1062.02, 1062.03 and 1062.04;
> (9) income or loss derived from activities covered by an exemption allowance or decree, as the case may be, under the Puerto Rico Tourism Development Act of 1993, the Puerto Rico Tourism Development Act of 2010, the Puerto Rico Economic Development Incentives Act of 2008 and any similar successor law;
> (10) net income or loss of the partnership, excluding items whose separate consideration is required under other paragraphs of this subsection, and
> (11) other items of income, gains, losses, deductions or credits, as established by the Secretary by regulation.[53]

Additionally, it is very important to understand that "the nature of any item of income, gain, loss, deduction or credit included in the distributive share of a partner shall be determined as if such item were realized directly at the source at which it was realized by the partnership or shall be accrued in the same way as it was accrued by the partnership."[54] Also, "in any case where it is necessary to determine the gross income of a partner, said gross

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[52] *Id.*
[53] 2011 P.R. I.R.C., § 1071.02(a).
[54] *Id.* § 1071.02(b).

income shall include his distributive share in the gross income of the partnership."[55]

At an entity level, the net taxable income of a partnership for any taxable year shall be determined as in the case of an individual, except that:

> (1) the items described in Section 1071.02(a) shall be reported separately;
> (2) and the following deductions shall not be allowed to the partnership:
> (A) the deduction for personal exemptions under Section 1033.18 (a);
> (B) net operating loss under the provisions of Section 1033.14;
> (C) taxes under the provisions of Section 1033.04 with respect to the taxes described in Section 1051.01;
> (D) the deductions allowed by Section 1033.15
> (3) it shall be entitled to the accelerated depreciation provided in Section 1040.12.[56]

The remaining provisions of Chapter 7 are designed to regulate the relationship between the partnership and the partners. Specifically, it controls their basis for contributions and distributions to and from the partnership, the corresponding basis in such property and the effects of subsequent dispositions of said property, which was in the hands of the partnership for purposes of conducting the partnership business. Therefore, it is extremely important to note that through the 2011 PR Code we have adopted the vastly complicated and extensively regulated provisions of Subchapter K of the Federal Internal Revenue Code. Thus, we have adopted the same provisions of § 704(b) whereas "all allocations [to partners] must have substantial economic effect."[58] If an allocation does not have substantial economic effect, a partner's distributive share of partnership items is determined in accordance to the partner's interest in the partnership. From this point on, Puerto Rico's Department of the Treasury will have to allow taxpayers to follow, as a substantive authority, the regulations and administrative decisions issued by the Internal Revenue Service or otherwise mount an enormous effort to promulgate similar guidance through their own regulations and administrative determinations.

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[55] *Id.* § 1071.02(c).
[56] 2011 P.R. I.R.C., § 1071.03.
[58] I.R.C., § 704(b).

2. Elections to Be or Not to Be a Flow-Through Entity

a. Existing Entities

In the case of existing partnerships, these entities may, "following the requirements prescribed by the Secretary of the Treasury, either by regulation, administrative determination or circular letter for such purpose, elect to continue to be treated as a corporation and will continue to file its income tax return in the same form and manner as a corporation."[59] In the case of existing LLCs, they are defined as those entities:

> [O]rganized under Chapter XIX of Act No. 164 of December 16, 2009, as amended, known as the "General Corporations Act," or those organized under the similar laws of any U.S. state of America or a foreign country. For the purposes of th[e 2011 PR Code], LLCs shall be taxed in the same form and manner as corporations; provided, however, that they may elect to be treated as partnerships for tax purposes under the rules applicable to partnerships and partners under Chapter 7 of this Subtitle, even when they are single-member companies. The Secretary shall establish by regulation the form and manner of making said election and the filing deadline thereof.[60]

For purposes of the 2011 PR Code, LLCs are subject to income tax in the same manner as regular corporations, unless they elect to be treated as partnerships under the rules set forth by Chapter 7 of the 2011 PR Code (regulations will be issued providing guidance on how to make the election). However, in the case of any LLC:

> [T]hat, by way of an election or provision of law or regulation under the Federal Internal Revenue Code of 1986, Title 26 of the United States Code, as amended, or similar provision of a foreign country, is treated as a partnership or whose income and expenses are attributed to its members for purposes of the federal or foreign income tax, shall be treated as a partnership for purposes of this Subtitle, subject to the provisions of Chapter 7, and shall not be eligible to be taxed as a corporation. [61]

Therefore, it is very important to visualize that in the case of foreign LLCs that have elected to be disregarded entities for federal tax purposes, the 2011 PR Code requires that the entity be treated in the same manner in

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[59] 2011 P.R. I.R.C., § 1061.03(e).
[60] *Id.* § 1010.01(a)(3).
[61] *Id.* § 1010.01(a)(3)(a).

Puerto Rico under the provisions of Chapter 7. These LLCs will be forcefully converted to disregarded entities and will be subject to numerous adjustments in order to correctly convert to flow-through treatment. However, this exception will not apply to LLCs that are covered by an "exemption decree issued under Act No. 73 of May 28, 2008, known as the 'Puerto Rico Economic Development Incentives Act,' or any prior law of a similar nature, or under Act No. 78 of September 10, 1993, known as the 'Puerto Rico Tourism Development Act,' as amended, and any other prior or subsequent law of a similar nature."[62]

b. New Entities

All newly created partnerships will, without exception, be subject to the flow-through provisions of Chapter 7 of the 2011 PR Code. This treatment is derived from the fact that the Code only provides the exception for partnerships already in existence as of the effective date of this Code. Hence, it is extremely important to keep this fact in mind when choosing the entity to conduct business transactions in Puerto Rico. In the case of new LLCs, if the entity is a domestic LLC then it will be taxed as a corporation by default unless it elects to be subject to the provisions of Chapter 7. However, foreign LLCs will be subject to the same tax treatment received in the United States.

c. Forced Conversions? Considerations for Partnerships and LLCs Converting to Pass-Through Entities

The 2011 PR Code explains the consequences for those foreign LLCs and partnerships that were previously taxed under the 1994 PR Code as corporations, but that are now forced under the 2011 PR Code to be treated as flow-through entities.[63]Consequently, these foreign LLCs and partnerships will be deemed as liquidated on the last day of the taxable year that began before January 1, 2011, and immediately thereafter, that the partners or members transfer their assets and liabilities to its members in the dissolution of the LLC and immediately after, the members transfer the previously distributed assets and liabilities to the newly formed partnership. No gain or loss will be recognized by the LLC or its partners/members on such liquidation/ reincorporation.[64]

The 2011 PR Code provides a process for accounting for additional adjustments and specific elections that had been utilized in the past by these

[62] 2011 P.R. I.R.C., § 1010.01(a)(3)(B).
[63] *Id.* § 1076.01.
[64] *Id.*

entities under the 1994 PR Code.[65] Specifically, in the case of LLCs that used Last In First Out (hereinafter LIFO) flexible depreciation or Accelerated Cost Recovery System (hereinafter ACRS) depreciation, long-term completed contract or the installment sales method for its last year as a corporation, must include a recapture amount as income with respect to these items.[66] Any tax related to these recaptures is payable with the final corporate income tax return, except for LIFO recapture which is payable in three equal installments over three tax years. In general, this recapture is payable with the Corporation Income Tax Return that is due April 15 of each year for calendar year taxpayers.

Additional adjustments are required for accumulated earning and profits. Specifically, it is established that all accumulated earnings and profits are deemed as distributed during the first two years of the LLC being treated as a partnership.[67] In addition, the LLC or partnership that was treated as a corporation may be subject to a built-in gains tax at the corporate level during the ten-year period (the *recognition period*) beginning on the first day of the corporation's first tax year as a partnership.[68] The tax is intended to affect unrealized gain, which arose before the conversion from a corporation to a partnership.[69] In general, any appreciation on an asset held prior to the liquidation/reincorporation will be subject to a corporate level tax, when and if, actually realized during the 10-year recognition period. The tax equals the highest corporate rate multiplied by the net recognized built-in gain.[70]

d. Election to Continue Being Taxed Under the Provisions of the 1994 PR Code

Based on the discussion above, it must be noted that the unexpected results of these transitory provisions can be avoided. Specifically, the 2011 PR Code states as follows:

> (a) Any taxpayer that is a corporation, including limited liability companies, shall be granted the option to compute the tax and file the return corresponding to its first tax year beginning after December 31, 2010 and before January 1, 2012, and during the 4 subsequent tax years, pursuant to the relevant provisions of [the 1994 PR Code], in effect as of December 31, 2010.

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[65] *Id.* (requiring the adjustments under 2011 P.R. I.R.C., § 1115.03(d), (e), (f), (g) and (h), and 2011 P.R. I.R.C., §1115.08).
[66] 2011 P.R. I.R.C., § 1115.03.
[67] *Id.*
[68] 2011 P.R. I.R.C., § 1115.08 (Built in gains tax).
[69] *Id.*
[70] *Id.*

> (b) Any partnership organized prior to the effective date of the Code, for purposes of Subtitle A, shall be allowed the option to compute the tax and file the return corresponding to its first tax year beginning after December 31, 2010 and before January 1, 2012, and during the 4 subsequent tax years, pursuant to the relevant provisions of [the 1994 PR Code], in effect on December 31, 2010.
>
> (c) The taxpayer shall elect the option provided in this section by filing the return for the first tax year beginning after December 31, 2010 and before January 1, 2012. Once the option is elected, it shall be final and irrevocable for the tax year in which the election was made and for each of the 4 subsequent tax years.[71]

Thus, taxpayers have the option to opt-out of the application of the 2011 Code and remain subject to the rules of the 1994 PR Code. Opting out may be achieved by electing it when filing the income tax return for taxable year 2011.[72] The election however is irrevocable for taxable years 2011, 2012, 2013, 2014 and 2015.[73]

3. Guidance Issued by the Puerto Rico Department of the Treasury: Administrative Determination 12-04

On February 14, 2012, the Puerto Rico Department of the Treasury ("PRDT") issued Administrative Determination 12-04[74] to establish guidelines for the election and conversion into a partnership.

a. Statutory Conversions

A partnership or LLC that during the taxable year that ended before January 1, 2011 was subject to tax as a corporation under the provisions of the 1994 PR Code and during the first taxable year commencing after December 31, 2011 is subject to tax as a partnership, will be treated as if it transferred its assets and liabilities to its partners in liquidation and, immediately thereafter, the partners contributed such assets and liabilities to a new partnership.

The provisions of the 2011 PR Code establish that no gain or loss is recognized on the aforesaid transaction, thus the new partnership receives such assets and liabilities with a carryover basis and holding periods.

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[71] 2011 P.R. I.R.C., § 1022.06.

[72] *Id.*

[73] *Id.*

[74] Puerto Rico Treasury Department Administrative Determination No. 12-04 (Feb. 14, 2012), available at http://www.hacienda.gobierno.pr/downloads/pdf/determinaciones/12-04.pdf.

However, such a conversion is subject to built-in gain provisions, and recapture rules on utilization of: LIFO, flexible depreciation, accelerated depreciation, long term contracts and installment sales. Furthermore, any accumulated earnings and profits as of the last day of the taxable year commencing before January 1, 2011, are deemed distributed.

Notwithstanding the above, if a partner in the partnership or LLC is a corporation that possesses at least 80% of the total combined voting power of all classes of stock entitled to vote and owns at least 80% of the total number of all other shares, then the transaction can be treated as an exempt liquidation. In such circumstances, the recapture rules, built-in gain provisions, and deemed distribution of accumulated earnings and profits do not apply. Moreover, all tax attributes shall carry over to the corporate partner. If the corporate partner is foreign (organized outside Puerto Rico) a ruling must be requested from the PRDT on or before June 30, 2012.

b. Election to Remain as Corporation Under 2011 PR Code

Partnerships existing as of January 1, 2011, that were subject to tax as a corporation under the 1994 PR Code, can elect to remain as a corporation under the 2011 PR Code. The election is made by attaching Form SC-6044, Entity Classification Election, to the income tax return. The election will be in effect as long as the partnership continues to exist.

c. Voluntary Conversion

A partnership that elected to be taxed as a corporation under the 2011 PR Code, or has an Option 94, can thereafter elect to convert into a flow-through partnership. An election, nevertheless, must be filed with PRDT on or before the last day of the third month of the taxable year for which the election is effective.

Also, an LLC subject to tax as a corporation under the 2011 PR Code can thereafter elect to convert itself into a flow-through partnership. An election must be filed with PRDT on or before the fifteenth day of the fourth month of the taxable year for which the election is effective. As a general rule, the liquidation/ reincorporation into a partnership is a fully taxable transaction. As such, recapture rules, built-in gain provisions, and deemed distribution of accumulated earnings and profits do not apply.

However, if a partner in the partnership is a corporation that possesses at least 80% of the total combined voting power of all classes of stock entitled to vote and owns at least 80% of the total number of all other shares, then the transaction can be treated as an exempt liquidation. In such circumstances, the recapture rules, built-in gain provisions, and deemed distribution of accumulated earnings and profits do not apply. Additionally,

tax attributes shall carry over to the corporate partner. If the corporate partner is foreign, a ruling must be requested from the PRDT.

d. LLCs One-Year Grace Period

An LLC that during its first taxable year commencing after December 31, 2011 is treated as a partnership must attach Form SC-6044, attesting to the statutory conversion, to its income tax return. Furthermore, an LLC may elect to be treated as a corporation only for the first taxable year commencing after December 31, 2011, thus deferring partnership treatment.

The election is made by filing Puerto Rico Department of the Treasury's Form SC-6044 with the income tax return for such year. Afterwards, it will be converted into a partnership in a taxable liquidation/reincorporation transaction.

e. Conversion of Special Partnerships (SE) and Corporations of Individuals (CI)

A partnership or LLC with a valid Special Partnership (hereinafter SE) or Corporations of Individuals (hereinafter CI) election can convert into a partnership. In this event, the SE or CI will be treated as contributing the assets and liabilities into the new partnership in an exempt transaction. Consequently, such assets will have carryover basis and the tax attributes of the SE or CI will transfer to the new partnership.

To have an effective conversion, the partnership or LLC must request a PRDT ruling during the first ninety (90) days of the taxable year for which the conversion is effective. Conversions for 2011 taxable years are due on or before April 30, 2012.

e. LLCs F Reorganization Election

An LLC that was treated as a corporation pursuant to the 1994 PR Code, but because of the provisions of 2011 PR Code must be treated as a partnership, can convert into a corporation in an F reorganization. The reorganization must take place on or before December 31, 2012, and a ruling request must be filed no later than ninety (90) days after the reorganization. The ruling must request retroactive effect.

f. New Filing Due Dates - Partnerships

The 2011 PR Code states that "any partnership shall file a return for each tax year stating the items of gross income and deductions allowed, the names, addresses and account numbers of the partners who are to share in the gain or loss of the partnership for said tax year, and the amounts of said

gain or loss."[75] Furthermore, "returns filed [...] on a calendar year basis shall be filed no later than March 15 following the calendar year end and returns filed on a fiscal year basis shall be filed no later than the fifteenth (15th) day of the third (3rd) month following the close of the partnership tax year."[76] Additionally,

any partnership required to file a return for any tax year shall, no later than last day of the third (3rd) month following the end of its tax year, supply each person who is a partner in said partnership a report containing the information to be included on the partner's return, including the partner's distributive share, the initial contribution and any additional contributions made by the partner to the partnership equity, the distributions made by the partnership and any other additional information required by regulation.[77]

However,

an automatic extension shall be granted to file the return required, provided that the rules and regulations prescribed by the Secretary to allow said extension are met and this automatic extension shall be allowed for a period of three (3) months from the date provided in subsection (a) for the filing of the return, provided that the partnership makes a request to such effect no later than said return filing date.[78]

g. New Filing Due Dates - LLCs

Similarly the 2011 PR Code states that any limited liability company shall file a return for each tax year, stating the items of gross income and deductions, the names, addresses and account numbers of the members who are to share in the gain or loss of the limited liability company for said tax year, and the amounts of said gain or loss.[79] Thus, the "returns filed under this section on a calendar year basis shall be filed no later than March 15 following the calendar year close."[80] Also, any limited liability company required to file a return for any tax year shall, no later than the last day of the third (3rd) month following the close of its tax year, supply each person who is a member of said LLC with a report containing the information required to be included on the member's return, including the member's distributive share, the initial contribution and any additional contributions made by the member to the equity of the limited liability company, distributions made by the LLC and any other additional information required by regulation.[81]

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[75] 2011 P.R. I.R.C., § 1061.03(a).
[76] *Id.*
[77] 2011 P.R. I.R.C., § 1061.03(b).
[78] 2011 P.R. I.R.C., § 1061.03(c).
[79] 2011 P.R. I.R.C., § 1061.04(a).
[80] *Id.*
[81] 2011 P.R. I.R.C., § 1061.04(b).

As in the case of partnerships, "an automatic extension shall be granted to file the return, provided that the rules and regulations prescribed by the Secretary to allow said extension are met and the automatic extension shall be allowed for a period of three (3) months from the date provided in subsection (a) for the filing of the return, provided that the LLC makes a request to such effect no later than said return filing date."[82]

Hence, it is important to note that previously, under the provisions of the 1994 PR Code, both partnerships and LLCs had until April 15th to file their corresponding income tax returns. Additionally, these entities could request an extension of time to file their returns which granted 90 additional days and thus moved their filing due date until July 15th. These new provisions will certainly create difficulties for partners and members wishing to file their final individual income tax return by April 15th, because the vast majority of partnerships and LLCs may not have the adequate financial information necessary to complete an accurate return by this date and thus, extensions will be requested.

h. New Filing Requirements - Estimated Income Tax for Partnerships and LLCs

The partnership or LLC shall determine and pay an amount equal to: (1) thirty-three percent (33%) of the estimated amount of the distributive share in the income of the partnership or LLC of a member or partner who is an individual, estate or trust; and in the case of a corporation, an amount equal to thirty percent (30%) of the estimated amount of the distributive share of income of the partnership or LLC.[83] Thus, the 2011 PR Code establishes that to these ends, the estimated tax shall be ninety percent (90%) of the tax of said taxable year or the total of the determined tax, as it may appear on the income tax return filed for the preceding taxable year, whichever is less.[84]

It is very important to keep in mind that because from now on estimated taxes will be filed on behalf of the member/partner and not the LLC/partnership, any existing overpayments within the partnership/LLC which arose before the conversion to a pass-through entity, will not be available to be used as estimated tax payments made on behalf of the member, unless, a ruling request is filed with the Secretary of the Treasury.

LLCs and partnerships shall file a return and pay the tax determined no later than the fifteenth (15th) day of the fourth (4th), sixth (6th), ninth (9th) and twelfth (12th) month of the tax year of said partnership or LLC. Any balance left unpaid at the end of the fiscal year must be paid no later

[82] 2011 P.R. I.R.C., § 1061.04(c).
[83] 2011 P.R. I.R.C., § 1061.21.
[84] 2011 P.R. I.R.C., § 6041.10.

than the fifteenth (15th) day of the fourth (4th) month following the close of the tax year.[85] If the partnership or LLC fails to make the withholding, the amount that should have been determined and paid shall be charged directly to the LLC unless the member pays the tax directly to the Secretary. Any person who fails to comply with his liability to determine and pay the income tax, shall be subject to penalties. Particularly, in the case that a payment of the estimated tax fails to be paid within the prescribed term or an incomplete payment of an estimated tax payment is carried out, the ten percent (10%) of the unpaid amount of said term shall be added.[86] An exception may be found if it is shown, to the satisfaction of the Secretary, that the owing is due to a reasonable cause and not to voluntary negligence. Finally, when it is demonstrated to the Secretary's satisfaction, or when the Secretary determines, that the withholding would cause an undue burden, without practical purpose, because the amounts so withheld would have to be refunded to the taxpayer or because said withholding would be excessive, the Secretary may, under the rules and regulations prescribed, release the withholding agent from making such withholding in whole or part.

i. New Income Sourcing Rules for Partners and Members

It is of great importance to mention that pursuant to the new provisions of the 2011 PR Code, all partners and members of a partnership or and LLC treated as a partnership which are engaged in trade or business in Puerto Rico, will be treated as engaged in trade or business in Puerto Rico with respect to their distributive share in the partnership.[87] This is very important because, previously, the 1994 PR Code did not consider non-resident individuals as engaged in trade or business due to the mere fact of holding an interest in a partnership or an LLC engaged in trade or business in Puerto Rico. Therefore, based on this new provision in the 2011 PR Code, these partners and members would be subject to filing an individual income tax return in Puerto Rico in order to subject their distributive share of partnership or LLC income to tax in Puerto Rico. However, recently amended sec. 1062.07 states that the tax obligation set forth in sec. 1071.01 may be satisfied with a withholding at source. Nevertheless, this situation still creates various problems for foreign partnerships and LLCs since these entities will be required to withhold and remit the tax to the Department of the Treasury and prepare and distribute informative returns to all their partners and members for the amounts withheld.

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[85] 2011 P.R. I.R.C., § 1062.07.
[86] *Id.*
[87] 2011 P.R. I.R.C., § 1071.01.

IV. CONCLUSION

In sum, with these new opportunities there may come some new and additional risks. A careful assessment of current business structures and the impact of the 2011 PR Code must be undertaken in order to avoid unexpected tax consequences relating to the new flow-through provisions. As noted in our discussion, the enactment of these provisions broadens the range of activities and entities eligible for flow-through treatment when compared to the 1994 PR Code and, as stated, presents new planning opportunities for taxpayers. These changes may, nonetheless, be far from elective for some taxpayers. As transitory rules, existing partnerships and LLCs that had been taxed as corporations and either do not elect to continue such treatment or are ineligible to elect such treatment, will be treated as having been liquidated as of their last taxable year under the 1994 PR Code. This forced conversion may bring undue hardship to many entities and business ventures. Thus, as stated by Robert Carroll:

> In evaluating how to go about reforming our tax system it is useful to start with a set of objectives. It is easy enough to agree on a broad set of principles such as a tax system that is simple, fair and pro-growth. But, as we begin to scratch the surface, to dig more deeply, a more complex and fundamental set of issues need be addressed. For example, should the tax system focus on taxing income or consumption, what constitutes a fair distribution of the tax burden, and to what extent should citizens be relieved of having to remit taxes to the government at all?[88]

In order to correctly conclude if the amendments introduced by the 2011 PR Code effectively facilitate doing business in Puerto Rico, we must question if, in fact, the actual application and enforcement of the provisions results in a tax system that is simple, fair and stimulates growth. At this time we can only wait and see if the new flow-through provisions can become an example of how the Government of Puerto Rico using its current fiscal autonomy powers to affect the overall economic wellbeing of its people and its economy in a positive way.

However, it is still amazing to see how much things can change in a relatively short amount of time. Even though much has changed, these changes come with numerous opportunities. Specifically, these changes level the playing field for many young practicing certified public accountants and

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[88] Tax: Fundamentals in Advance of Reform, Before the S. Comm. On Finance, 110th Cong. (April 15, 2008) (statement of Robert J. Carroll, Vice President for Economic Policy, Tax Foundation; Executive-in-Residence, School of Public Affairs, American University).

tax attorneys who will now be in the same position as many experienced professionals for whom the provisions of Chapter 7 and flow-through taxation may always constitute a mystery. Therefore, it is the time to take advantage of these new set of circumstances and contribute to the development of flow-through entities in Puerto Rico in order to develop another tool that can positively impact the overall economic wellbeing of our people and our economy.

LA NATURALEZA JURÍDICA DEL PRÉSTAMO BANCARIO

JOSÉ RAFAEL DÁVILA ACEVEDO*

I. INTRODUCCIÓN

El ordenamiento jurídico en Puerto Rico no ha definido con claridad la naturaleza jurídica del préstamo bancario. Dicha figura no aparece estrictamente regulada por nuestro Código de Comercio o la Ley de Bancos, y como se discutirá a través de este artículo, la jurisprudencia solo ha creado incertidumbre sobre la naturaleza civil o mercantil de esta. Este artículo defiende la postura que afirma la naturaleza mercantil del préstamo bancario. Para lograr este propósito se examinan los motivos que separan el ordenamiento mercantil del derecho civil; el derecho positivo y la doctrina jurisprudencial en Puerto Rico sobre el préstamo mercantil y pagarés mercantiles; y la doctrina europea-continental de donde provienen nuestros Códigos. Finalmente, se ofrece una tesis defendiendo la naturaleza mercantil del préstamo bancario.

II. SEPARACIÓN DEL DERECHO MERCANTIL

El derecho mercantil tiene sus inicios históricos en la costumbre jurídica utilizada por los antiguos gremios y asociaciones comerciales, que ante la insuficiencia e inadaptación del Derecho civil respecto a las

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El autor quisiera extender sus más sinceros agradecimientos a su profesor y antiguo presidente de la Universidad de Puerto Rico, el Profesor Antonio García Padilla, por sus comentarios y dirección durante el proceso de investigación y redacción de este artículo.

necesidades del comercio, fueron creando sus propias normas para fomentar la protección jurídica del tráfico comercial. En efecto, varias de las instituciones comerciales eran desconocidas por el ordenamiento civil, tales como las sociedades anónimas y las letras de cambio, mientras otras figuras nacidas en el ordenamiento civil fueron modificadas al ser adaptadas a las necesidades del tráfico mercantil, como es el caso de la compraventa y el préstamo.[1]

Hoy día, la separación de los ordenamientos se justifica por la necesidad de regular la realización de actos jurídicos en masa inherentes al comercio, que tienen exigencias de rapidez y uniformidad, distinto a los actos aislados con vida a *tempo lento*[2] que regulan las normas del Derecho civil. A tales efectos, son de especial relevancia los largos periodos de prescripción contenidos en el Código Civil de Puerto Rico, frente a los plazos prescriptivos significativamente más cortos del Código de Comercio.[3] En el caso de un préstamo de naturaleza civil, el acreedor tiene un periodo de 15 años para efectuar el cobro, mientras que en un préstamo de carácter mercantil, este solo dispondría de tres años con perjuicio de que la acción de cobro prescriba por inacción. El Código de Comercio prohíbe además, el pacto de anatocismo, mientras que el Código Civil lo avala.[4]

III. DERECHO VIGENTE EN PUERTO RICO

A. Derecho positivo

Para defender la naturaleza mercantil del préstamo bancario es necesario aclarar que el mismo es considerado como un acto de comercio. El art. 2 del Código de Comercio de Puerto Rico nos dice:

> Los actos de comercio, sean o no comerciantes los que los ejecuten, y estén o no especificados en este Código, se regirán por las normas contenidas en él; y en su defecto, por los usos del comercio observados generalmente en cada plaza, y a falta de ambas reglas, por las del derecho común.

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[1] 1-I JOAQUÍN GARRIGUES, TRATADO DE DERECHO MERCANTIL 32-34 (1947).

[2] *Id.*

[3] El Código Civil de Puerto Rico provee un término de quince años, 31 LPRA § 5294, mientras que el Código de Comercio dispone un término de tres años, 10 LPRA § 1908.

[4] Además del término de prescripción, el Código de Comercio, si bien permite mediante pacto capitalizar al principal los intereses líquidos y no satisfechos, prohíbe el llamado anatocismo o pacto imponiendo intereses sobre intereses vencidos. A esos efectos, el art. 235 dispone: "[l]os intereses vencidos y no pagados no devengarán intereses. Los contratantes podrán, sin embargo, capitalizar los intereses líquidos y no satisfechos, que como aumento de capital, devengarán nuevos créditos." Art. 235 CÓD. COM. PR, 10 LPRA § 1657.

> Serán reputados actos de comercio los comprendidos en este Código, y cuales otros de naturaleza análoga.[5]

Este artículo preceptúa la concepción objetiva de nuestro derecho mercantil, a tenor con la cual "…pasa a ser más bien el derecho de una clase de actos, los actos de comercio, los cuales no son únicamente los realizados por los comerciantes".[6]

Por su parte, el art. 229 del mismo Código contiene los requisitos necesarios para que un préstamo se repute mercantil. Según dicho precepto, es necesario que concurran los siguientes requisitos:

1) que alguno de los contratantes fuere comerciante y;

2) que las cosas prestadas sean destinadas a actos de comercio.[7]

El primer inciso del artículo refleja nociones subjetivistas que conciben el derecho mercantil como "el derecho de una clase de personas: los comerciantes",[8] mientras el segundo, responde a la concepción objetivista que rige en Puerto Rico en virtud del art. 2. De entrada surge la problemática de calificar el préstamo bancario como un acto de comercio, cuando los fondos entregados por el banco no son destinados a actos de comercio. Esto ocurre con la mayoría de los préstamos que otorgan los bancos, los préstamos personales. Si los requisitos enunciados en el art. 2 del Código de Comercio han de interpretarse de forma disyuntiva, entonces no habría problema alguno en sostener la naturaleza mercantil del préstamo bancario. Por otro lado, si los preceptos de dicho artículo han de interpretarse de manera copulativa, se hace más difícil, aunque no imposible, la calificación mercantil del mismo.

B. Jurisprudencia en Puerto Rico

El texto del art. 2 del Código de Comercio no parece dar margen a la interpretación disyuntiva al prescribir ambos requisitos de manera concurrente.[9] No obstante, a principios del siglo pasado, en *Rosaly v.*

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[5] Art. 2 CÓD. COM. PR, 10 LPRA § 1002.
[6] Pescadería Rosas, Inc. v. Lozada Rivera, 116 DPR 474 (1985).
[7] Art. 229 CÓD. COM. PR, 10 LPRA § 1651.
[8] *Pescadería Rosas*, 116 DPR en la pág. 479.
[9] *Véase* Franceschi v. Rivera, 44 DPR 664, 665 (1933). El Tribunal Supremo confirmó la determinación de instancia que reputó la naturaleza civil de un préstamo porque "aunque se demostró que una de las partes contratantes era comerciante, no se estableció que el dinero

Alvarado,[10] el Tribunal Supremo sostuvo el carácter mercantil de un pagaré suscrito a la orden, por dinero recibido a préstamo por un particular. Aunque este caso no trataba de un préstamo bancario, *Rosaly* y la jurisprudencia sobre la naturaleza civil o mercantil de los pagarés son de especial relevancia para la discusión del préstamo bancario debido a las diferentes interpretaciones del art. 2 del Código de Comercio que hizo el Tribunal para fundamentar decisiones contradictorias en diferentes casos.

En *Rosaly*, a pesar de concluir que el demandante acreedor no era comerciante, el Tribunal no consideró el carácter del demandado ni tomó en consideración el destino de los fondos prestados al sostener la naturaleza mercantil del pagaré suscrito. Al interpretar el art. 2, indicó que "[e]l Código de Comercio no fu[e] aprobado para regir transacciones entre comerciantes, sino para regular negociaciones de comercio entre todo el mundo. No fu[e] un Código establecido para beneficio de cierta clase de personas sino para beneficiar a todos con relación a determinada clase de negociaciones".[11] El Tribunal concluyó que el hecho de que se hubiese suscrito un pagaré a la orden, sin más, era suficiente para calificarlo como mercantil. Citando una sentencia del Tribunal Supremo de España, nuestro más alto foro determinó que "[l]a expedición de pagarés a la orden y sus endosos deben reputarse actos mercantiles con arreglo al art. 2… por ser de los expresamente definidos en dicho cuerpo legal, habiendo por tanto la presunción de que proceden de operaciones de comercio salvo prueba en contrario."[12] Tratándose de una presunción *juris tantum*, parece extraño que el Tribunal no hubiese indagado sobre la naturaleza civil o mercantil del préstamo objeto del pagaré.

Rosaly fue confirmado en *Justo Barros v. Viuda de Gaos*, donde el Tribunal determinó que: "un pagaré expedido a la orden puede decirse que se considera universalmente como una operación comercial, [sic] por la costumbre de todas partes". [13] El Tribunal finalizó la opinión concluyendo que:

> Si una persona toma dinero prestado a préstamo y suscribe un pagaré a la orden, surge la cuestión de si no está ella expresamente comprendida en el párrafo 2 (del art. 229). Si se da un pagaré a la orden el que lo expide puede decirse que ha convertido un simple préstamo en una operación mercantil. En ese caso los pagarés a la orden quedarían comprendidos enteramente en el campo de las

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prestado por el demandante se destinara a actos de comercio". *Véase además* Luengo v. Fernández, 83 DPR 636, 638 (1961).

[10] Rosaly v. Alvarado, 17 DPR 109 (1911).

[11] *Id.* en la pág. 111.

[12] *Id.*

[13] Justo Barros v. Viuda de Gaos, 35 DPR 258, 262 (1926).

> operaciones mercantiles… nos inclinamos al parecer de que en Puerto Rico dar un pagaré a la orden constituye por sí una operación mercantil.[14]

Según lo dispuesto en *Justo Barros* y *Rosaly*, no siempre ha sido necesario que los fondos recibidos de un préstamo se destinen a actos de comercio, siendo suficiente que se suscriba un pagaré a la orden sobre el préstamo para reputar su *naturaleza* mercantil. Sin embargo, el Tribunal se distanció de dicha interpretación y en 1931, un año antes de la publicación del nuevo Código de Comercio, declaró que "el hecho de firmarse un pagaré a la orden no convierte un simple préstamo en mercantil ni constituye por si una operación de comercio".[15]

Cuatro años más tarde, en *Barceló & Co., S. En C. v. Olmo*[16] el Tribunal Supremo se contradijo al negar el carácter mercantil de un pagaré, a pesar de concluir que los fondos fueron destinados a la constitución de una sociedad mercantil y a la compra de mercancía. El caso tiene la particularidad de que el prestamista, le prestó a su yerno una suma de dinero para que este formara una sociedad mercantil con su hermano. En la escritura de sociedad, sin embargo, aparecía el prestamista acreedor como miembro nominal en lugar de su yerno, por este ser menor de edad. Luego de considerar y descartar como irrelevante el hecho de que ninguna de las partes era comerciante al momento de otorgarse el préstamo, el Tribunal indicó que:

> El mero hecho de que el préstamo fuese otorgado con el fin de permitir al prestatario que se dedicara a un negocio y de que el producto del mismo se utilizara para la compra de mercancías, confundiéndose así en los negocios mercantiles… no convirtieron el préstamo en una transacción mercantil. *La naturaleza del préstamo depende del carácter de la transacción misma, conforme lo revelan las circunstancias que rodean el caso o los hechos que la preceden, más no el fin para el cual se hace ni la forma en que su producto era invertido o utilizado.*[17]

Barceló fue confirmado cuatro años más tarde en *Banco de P.R., Liquidador v. Rodríguez*,[18] donde el Tribunal Supremo expresamente indicó que los bancos no solo realizan préstamos mercantiles, por lo que "[l]a

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[14] *Id.* en las págs. 263-264.
[15] Pierluisi v. Monllor, 42 DPR 7, 13-17 (1931). *Véase* Blondet v. Garáu, 47 DPR 863 (1935).
[16] Barceló & Co., S. En C. v. Olmo, 48 DPR 247 (1935).
[17] *Id.* en la pág. 249 (énfasis suplido).
[18] Banco de P.R., Liquidador v. Rodríguez, 53 DPR 451 (1938).

circunstancia de que uno de los otorgantes fuera un banco… no determina necesariamente la naturaleza mercantil del [pagaré]."[19]

Posteriormente, la jurisprudencia mantuvo consistencia respecto al requisito de que el pagaré hubiese surgido de operaciones de comercio para calificarlo como mercantil, así como sobre la interpretación copulativa del art. 229 del Código de Comercio.[20] La única excepción surgió en *Costas v. G. Llinás & Co.*,[21] un caso un tanto confuso en el cual, ante la duda sobre si procedía o no el anatocismo pactado en un contrato de préstamo, el Tribunal Supremo concluyó que "[e]stablecido que la demandada… es una sociedad mercantil, el préstamo que ésta hizo a la demandante es de carácter mercantil a tenor con el art. 229 del Código de Comercio".[22] El Tribunal cita expresamente el inciso número uno del art. 229 pero se ve obligado a omitir por irrelevante el inciso número dos, [23] así como la jurisprudencia contradictoria anterior a su decisión. De esta manera, sostuvo la naturaleza mercantil de un pagaré suscrito a favor de una sociedad mercantil considerando irrelevante cuestionar el destino de los fondos. Un dato conspicuo en *Costas*, es que el pagaré suscrito por la deudora a favor de la sociedad mercantil, tenía como parte de su objeto la asunción de deuda por la sociedad mercantil de otro pagaré, suscrito a su vez por la deudora, y garantizado por la sociedad a favor del Banco Crédito y Ahorro Ponceño.[24] En otras palabras, el pagaré a favor de la sociedad mercantil tenía como parte de su objeto el pago de un préstamo bancario.

Treinta y nueve (39) años tardó el Tribunal en revocar la decisión anómala de *Costas*. Lo hizo en la nota al calce número cuatro de *Pescadería Rosas v. Losada Rivera*[25] donde, al negar el carácter mercantil de un préstamo otorgado para reparar una embarcación no destinada a la navegación comercial, el Tribunal estableció que para invocar la prescripción que dispone el artículo 948 del Código de Comercio "en el caso de un *préstamo*

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[19] *Id.* en la pág. 455.

[20] *Véase* Luengo v. Fernández, 83 DPR 636, 638; Pescadería Rosas, Inc. v. Lozada Rivera,, 116 DPR en la pág. 476. Sobre los pagarés, en la actualidad, por lo menos un tratadista puertorriqueño ha afirmado que "[e]l préstamo puede ser civil pero, si para reconocer el mismo se suscribe un pagaré, este último es un instrumento negociable mercantil. El préstamo civil no lo priva de su carácter mercantil. Esta es la misma posición de la Ley de Instrumentos Negociables". RAFAEL SOTERO PERALTA & JORGE J. OPPENHEIMER MÉNDEZ, DERECHO MERCANTIL 256-257 (7ma ed. 1999). *Véase además* Ley de Instrumentos Negociables, Ley Núm. 176 de 31 de agosto de 1996, 19 LPRA §§ 501-755.

[21] Costas v. G. Llinás & Co., 66 DPR 730 (1946).

[22] *Id.* en la pág. 748.

[23] *Id.* ("[E]l Art. 229 del Código de Comercio, que en lo pertinente prescribe: 'Art. 229.--Se reputará mercantil el préstamo, concurriendo las circunstancias siguientes:
'1. Sí alguno de los contratantes fuere comerciante.
'**2. . . ....**") (énfasis suplido). *Costas*, 66 DPR en la pág. 748 (1946).

[24] *Id.* en la pág. 736.

[25] Pescadería Rosas, Inc. v. Lozada Rivera, 116 DPR 474, 478 n.4 (1985).

por una entidad no bancaria para la reparación de una nave… debe en consecuencia demostrarse que se trata de un acto mercantil".[26] Es decir, el Tribunal confirma la interpretación copulativa del art. 229 para casos en los cuales el prestamista no es una entidad bancaria y deja en *quare* dicha interpretación para los préstamos bancarios. No obstante, en la nota al calce número ocho, el Tribunal indica, contrario a lo establecido en *Banco de P.R., Liquidador*, que la opinión no prejuzga la naturaleza civil o mercantil de un préstamo bancario cuyos fondos no son destinados a actos de comercio.[27] En dicha nota, el Tribunal examina varias fuentes doctrinales y jurisprudenciales españolas. Hagamos un análisis sobre esto.

IV. DOCTRINA EUROPEA-CONTINENTAL (ESPAÑA Y FRANCIA).

Hacia mediados del siglo XIX, la Corte de Casación francesa estableció la naturaleza mercantil del préstamo bancario como excepción al sistema que determina la naturaleza civil o comercial del préstamo en consideración al prestatario.[28] Es decir, como excepción a un sistema como el nuestro, en el que la concepción objetiva requiere que el prestatario destine los fondos a actos de comercio para que un préstamo se repute mercantil; el préstamo bancario se reputa mercantil en función de la calificación del prestamista como entidad bancaria. Tal excepción fue acogida por el Tribunal Supremo de España en su *sentencia de 9 de mayo de 1944*, en la cual declaró:

> . . . si bien, el artículo 311 del Código de Comercio (229 de nuestro Código) señala, con un criterio finalista, como una de las circunstancias para que el contrato de préstamo pueda merecer la calificación de mercantil, la que de las cosas prestadas se destinen a operaciones de comercio, ello no obsta la posibilidad de que siempre que los contratos de esta clase revistan el carácter de operaciones bancarias puedan ser conceptuados como mercantiles, al amparo del art. 2º, en relación con el 175 y algunos otros como el 177 y el 212 del propio Código, aún cuando el préstamo se haga a favor de

[26] *Id.* en la pág. 481 (énfasis suplido).
[27] *Id.* n.8. ("Sobre los préstamos bancarios, los cuales han generado gran controversia, no nos estamos expresando en esta ocasión. Véanse: Langle y Rubio, op. cit ., T. III, págs. 312-315; S. de 9 de mayo de 1944, núm. 73, 2da serie, VI Jurisprudencia Civil 645; S. de 1ro de febrero de 1980, núm. 529, Aranzadi, 47 Jurisprudencia Civil 405; Contra: Banco de P.R., Liquidador, Etc. v. Rodríguez, 53 D.P.R. 174, 451 (1938)".).
[28] JOAQUÍN GARRIGUES, CONTRATOS BANCARIOS 224 n.3 (2da ed. 1975).

> personas ajenas al comercio, que no se propongan emplear el objeto recibido en operaciones mercantiles.[29]

El Tribunal Supremo español encontró apoyo en los artículos 175,[30] 177 y 212[31] del Código de Comercio español. El artículo 177 establece que corresponderá principalmente a los bancos de emisión y descuentos las operaciones de "[d]escuentos, depósitos, cuentas corrientes, cobranzas, préstamos, giros y los contratos con el gobierno o corporaciones públicas".[32]

Sobre la naturaleza mercantil de los préstamos bancarios, el tratadista Sánchez Calero, de acuerdo con la decisión del Tribunal Supremo Español, añade que el requerir ambos requisitos de manera concurrente:

> entraña un elemento de inseguridad importante, ya que para saber la disciplina aplicable a un determinado contrato ha de desentrañarse el elemento intencional de conocer el destino que ha de dar el prestatario las cosas recibidas en préstamo, y en segundo término, que aplicar tal criterio implica negar el carácter mercantil de los préstamos concedidos por los [b]ancos, que unas veces serían civiles.[33]

En Francia,[34] el artículo L110-1 del *Code de Commerce* indica que serán mercantiles:

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[29] Sentencia del Tribunal Constitucional de España, en adelante STS, 9 de mayo de 1944 (España). *Véase* 3 EMILIO LANGLE Y RUBIO, MANUAL DE DERECHO MERCANTIL ESPAÑOL 312-315 (Bosch-Barcelona 1959); 4 JOAQUÍN GARRIGUES, CURSO DE DERECHO MERCANTIL 144-146 (reimp. de la 7ma ed. 1987); RODRIGO URÍA, AURELIO MENÉNDEZ ET AL., LECCIONES DE DERECHO MERCANTIL 648-650 (3ra ed. 2005).

[30] El artículo 175 del Código de Comercio español dispone en lo relevante:
"Corresponderán principalmente a la índole de [las] [c]ompañías [de crédito] las operaciones siguientes:
…
7º Prestar sobre efectos públicos, acciones u obligaciones, géneros, frutos, cosechas, fincas, fábricas, buques y sus cargamentos, y otros valores, y abrir créditos en cuenta corriente, recibiendo en garantía efectos de igual clase". Art. 175 CÓD. COM. (ESPAÑA).

[31] El art. 212 del Código de Comercio español: Corresponderá principalmente a la índole de [los Bancos y sociedades agrícolas]: 1º Prestar en metálico o en especie, a un plazo que no exceda de tres años, sobre frutos, cosechas, ganados u otra prenda o garantía especial; 2º Garantizar con su firma pagarés y efectos exigibles al plazo máximo de noventa días, para facilitar su descuento o negociación al propietario o cultivador. Art. 212 CÓD. COM. (ESPAÑA).

[32] Art. 177 CÓD. COM. (ESPAÑA).

[33] II FERNANDO SÁNCHEZ CALERO, INSTITUCIONES DE DERECHO MERCANTIL 303-304 (19na ed. 1996). *Véase además* LANGLE Y RUBIO, *supra* nota 29, en la pág. 314.

[34] En Francia, cuando un banco contrata con un prestatario que no destina los fondos a actos de comercio se considera un acto mixto. 2 JOSEPH HAMEL, GASTON LAGARDE ET AL., TRAITÉ DE DROIT COMMERCIAL, §1782, en las págs. 817-818 (Dalloz, Paris, 1966). Los actos mixtos "son realizados por comerciantes con otras personas no comerciantes…"; 1 GEORGES RIPERT,

…

7° Toute opération de change, banque et courtage;

8° Toutes les opérations de banques publiques;

9° Toutes obligations entre négociants, marchands et banquiers. [35]

Es decir, siempre se reputan mercantiles las transacciones de intercambio, banca y corretaje, así como todas las operaciones de los bancos públicos y las obligaciones entre negociantes, comerciantes y banqueros.[36]

V. NATURALEZA MERCANTIL DEL PRÉSTAMO BANCARIO EN PUERTO RICO.

En Puerto Rico, la Ley Núm. 42 de 25 de abril de 1930 derogó, entre otros, los artículos 175 a 217 del antiguo Código de Comercio, los cuales eran análogos a los que utilizó el Tribunal Supremo Español para apoyar su conclusión sobre la naturaleza mercantil de los préstamos bancarios. No obstante, al publicar el nuevo Código de Comercio de 1932, la Comisión Codificadora[37] incorporó la Ley de Bancos[38] en el Apéndice del Código[39] cuyo primer párrafo explica que el mismo contiene:

TRATADO ELEMENTAL DE DERECHO COMERCIAL § 290, en la pág. 215 (Felipe de Solá Cañizares trad., Tipográfica Editora 1954). La calificación del acto como mercantil o civil para estos efectos es relevante para determinar la corte con jurisdicción y para efectos del peso de la prueba. Sin embargo, "[e]l acto de por sí mismo no es mixto y este vocablo no significa nada". *Id.*

[35] Art. L110-1 175 CÓD. COM. FR. Este artículo proviene del artículo 632 del antiguo Código de Comercio francés. La traducción en inglés lee:

"The law deems the following to be commercial transactions:

…

7. all Exchange, banking and Brokerage operations;

8. all the operations of public Banks;

9. all obligations between merchants, traders and bankers…" PHILIP RAWORTH, THE FRENCH COMMERCIAL CODE IN ENGLISH (West, M.N., ed. 2011).

[36] Traducción suplida.

[37] La Comisión Codificadora fue creada por la Ley Núm. 50 de 28 de abril de 1928. La misma fue compuesta por tres Senadores nombrados por el Presidente del Senado y tres Representantes nombrados por el Portavoz de la Cámara. El presidente de la Comisión fue nombrado mediante acuerdo de los presidentes de cada cámara.

[38] Ley de Bancos, Núm. 18 de 10 de septiembre de 1923, p. 83, según enmendada por las Ley Núm. 68 de 1 de agosto de1925, p. 353; Ley Núm. 28 de 19 de abril de1929, p. 191; Ley Núm. 26 de 23 de abril de 1930, p. 255. En el presente los Bancos se encuentran regulados por la Ley de Bancos Núm. 108 de 28 de agosto de 1997, 7 LPRA § 1.

> . . . leyes vigentes que son, total o parcialmente, de índole mercantil, pero que no han podido ser incorporadas a este código, debido a que contienen también preceptos de carácter penal y administrativo y de procedimiento civil, y se ha considerado más convenientes insertarlas íntegramente en este apéndice, antes de dividir sus disposiciones en dos o más códigos que no han de ser publicados al mismo tiempo.[40]

Es decir, la separación de la regulación de los bancos del Código de Comercio no se debe a que la naturaleza de las operaciones bancarias no sea de carácter mercantil. La Comisión Codificadora[41] reconoció expresamente que las operaciones bancarias son total o parcialmente operaciones mercantiles, pero decidió separarla del Código porque la regulación bancaria contenía además disposiciones de distinta naturaleza. No obstante, la Comisión encontró conveniente publicar la Ley de Bancos en el apéndice del Código de Comercio para facilitar la lectura y no tener que dividir las disposiciones mercantiles de las penales o procesales.

Además del historial legislativo del nuevo Código de Comercio, cuya Comisión Codificadora reconoció el carácter mercantil de las operaciones bancarias, en *Pescadería Rosas*, el Tribunal Supremo propició una interpretación extensiva que permite clasificar el préstamo bancario como uno de naturaleza mercantil, al interpretar el art. 2 del Código de Comercio como una definición doctrinal del acto de comercio que "abre ancho campo a la evolución del concepto conforme a los cambios que ocurran en la realidad económica".[42]

Sin embargo, los tribunales inferiores no han provisto respuesta satisfactoria a la interrogante planteada en la nota al calce número 8 de *Pescadería Rosas*, sobre la naturaleza mercantil de los préstamos bancarios. Por ejemplo, en *Banco Santander v. Specialty Chemical Corp.*,[43] el Tribunal de Apelaciones revocó una sentencia del Tribunal de Primera Instancia, declarando prescrito un pagaré suscrito a favor del Banco Santander por este no haber instado la acción durante el periodo prescriptivo de tres años que dispone el art. 946 del Código de Comercio. Al revocar a Instancia, el tribunal estimó que "a la luz de la jurisprudencia… sabemos que la determinación del

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[39] CÓD. COM. P.R., Ap., pág. 386 (1932) (La publicación original está disponible en la biblioteca de la Asamblea Legislativa y en la sección de libros raros de la biblioteca de Facultad de Derecho de la Universidad de Puerto Rico.).

[40] *Id.* en la pág. 326.

[41] La Ley Núm. 50 de 28 de abril de 1928 creó la Comisión Codificadora compuesta por tres miembros nombrados por los Presidentes de cada Cámara y el Presidente de la Comisión fue nombrado mediante acuerdo de los Presidentes de cada Cámara.

[42] Pescadería Rosas, Inc. v. Lozada Rivera, 416 DPR 474, 479 (1985).

[43] Banco Santander v. Specialty Chemical Corp., 2007 PR App. LEXIS 3431, KLAN2007-0278 (TA 2007).

carácter de esta obligación depende en gran medida de las circunstancias que rodearon el perfeccionamiento del pagaré y el destino del dinero prestado".[44] En ese caso, el Tribunal de Apelaciones hace caso omiso a la nota número ocho de *Pescadería Rosas* y devuelve el caso a Instancia para que determine si los fondos prestados por el banco habían sido utilizados para fines comerciales.

Por otro lado, la Corte Federal de Distrito para el Distrito de Puerto Rico ha reconocido la posibilidad de reputar mercantiles todos los préstamos bancarios en *Garita Hotel v. Ponce Federal Bank*.[45] En dicho caso, el Juez Domínguez reconoció que aunque el Tribunal Supremo de Puerto Rico no había determinado si todos los préstamos bancarios eran de naturaleza comercial, existen fuentes de autoridad (refiriéndose a tratadistas españoles) para afirmar que todos los préstamos otorgados por bancos están revestidos de un carácter mercantil. El Tribunal apreció que la interpretación del Tribunal Supremo de España en su *sentencia de 9 de mayo de 1944* le otorgó cierta uniformidad a la figura,, lo cual es bienvenido en esta área del derecho.[46]

Según *Pescaderías Rosas*, al considerar figuras jurídicas que son objeto de regulación tanto civil como mercantil, como lo son el préstamo y la compraventa:

> [E]l criterio de diferenciación es en efecto múltiple, entremezclándose elementos objetivos, subjetivos y de otra índole. No existe en nuestra tradición jurídica un concepto unitario del acto de comercio. Cada situación debe ser objeto de examen separado. Los efectos definitorios de la naturaleza, comercial o civil, de una transacción varían de caso a caso. … [E]xiste no obstante, un hilo conductor, un elemento común entre diversos actos mercantiles: su *finalidad, su conexión con el tráfico mercantil, su habitualidad [y] su atención al valor permutable de las cosas*.[47]

El préstamo bancario siempre reúne al menos tres de los cuatro componentes del llamado *hilo conductor*: la habitualidad, la conexión con el tráfico mercantil y el valor permutable. La finalidad podría entrar en la figura del préstamo bancario si se estimase como una determinada actividad económica de los bancos y no como el destino de los fondos prestados.[48] Los bancos, en su actividad crediticia, actúan como intermediarios del comercio

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[44] *Id.* en la pág. 9.
[45] Garita Hotel v. Ponce Federal Bank, 954 F. Supp. 438 (1996).
[46] *Id.* en la pág. 453.
[47] *Pescadería Rosas*, 416 DPR en las págs. 480-482 (énfasis suplido).
[48] STS, 9 de mayo de 1944 (España).

proveyendo fondos tanto para comerciantes como para no comerciantes. En efecto, un comerciante que se dedica a la venta al detal se beneficia de que el consumidor disponga de fondos para efectuar el pago de los bienes vendidos. En este sentido, "el préstamo será mercantil cuando se realice por quien tenga como objeto de su actividad la concesión de préstamos o cuando, cualquiera que sea el prestamista, se reciba por un empresario con destino al comercio o industria que realiza."[49]

No se puede interpretar el art. 229 de manera tan restrictiva que excluya de la legislación comercial la mayoría de los préstamos que celebran los bancos en su actividad crediticia. Una interpretación literal del artículo "llevaría al absurdo de negar carácter mercantil a los préstamos realizados por entidades especialmente dedicadas al comercio de préstamos…".[50] No podemos olvidar que, respecto a los actos de comercio, el derecho común es supletorio, no sólo al Código de Comercio, sino además a los usos del comercio.[51]

Tanto el historial legislativo del nuevo Código de Comercio, así como la interpretación extensiva que le da el Tribunal Supremo a los actos de comercio, permiten que los préstamos bancarios se puedan calificar como mercantiles. Esto así, en atención al uso continuo, uniforme y persistente de los mismos, y a la identidad del prestamista, como una entidad bancaria cuya actividad económica envuelve la concesión de préstamos en masa y que claramente se reputa comerciante para efectos del Código de Comercio. Ello, debido a que los préstamos bancarios, incluyendo los préstamos personales, se realizan con una frecuencia significativamente mayor que los actos aislados de préstamos entre particulares y por ende, merecen la seguridad, uniformidad y rapidez que ofrece la legislación comercial para la contratación en masa.

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[49] RODRIGO URÍA, DERECHO MERCANTIL 832 (23ra ed. 1996).

[50] *Id.* en la pág. 831.

[51] El art. 2 de nuestro Código de Comercio dispone en lo relevante: "Los actos de comercio,… estén o no especificados en este Código, se regirán por las disposiciones contenidas en él; y en su defecto, por los usos del comercio observados generalmente en cada plaza, y a falta de ambas reglas, por las de derecho común". 10 LPRA § 1002.