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# NEW PUERTO RICO GENERAL CORPORATIONS LAW

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On December 16, 2009, a new General Corporations Law was enacted in Puerto Rico. The new law became effective on January 1, 2010. Its provisions apply to all corporations, whether organized before or after the date of its effectiveness. However, all rights, privileges and immunities vested or accrued, as well as all suits pending, all rights of action conferred, and all duties, restrictions, liabilities and penalties imposed or required by and under laws enacted prior to the adoption of the new law are not impaired, diminished or affected by the new law.

The new law is not a complete reconceptualization of the prior law, but rather an amended and restated version of the prior law. The Statement of Motives of the new law states that the intention of the new law is to incorporate the amendments that have been made over the years to Delaware's General Corporations Law, which is the basis for Puerto Rico's General Corporations Law, particularly with respect to changes in communications and computer technology.

As a result, many of the changes are clarifications in drafting, or establish that meetings may be held remotely using communications technology, consents and notices may be approved or delivered by email and other electronic transmissions, and shareholders registries may be made available electronically. It is worth noting that unanimous consents of directors must comply with Puerto Rico's Electronic Signatures Act, while consents of shareholders and other communications apparently do not.

There are, however, certain other changes that the management of Puerto Rico corporations should be made aware of. Among these are the following:

1) Article 1.05(C) used to provide that persons who acted as a corporation "without being authorized to do so", would be jointly and severally liable for the debts and obligations incurred as a result of such acts, but only if such persons knew that they were acting without authorization. In the context of article 1.05, it appears that the law was not referring to persons purporting to act on behalf of a duly constituted and existing corporation without authorization, but rather persons who held themselves out as authorized to act on behalf of a corporation that did not exist (for example, because a certificate of incorporation was never filed, or because the certificate of incorporation was rejected by the Department of State and not re-filed, or the certificate of incorporation was revoked by the Department of State for failing to file its annual reports). The new law eliminates the element of knowledge, so persons may be inadvertently acquiring personal liability if they believe a corporation exists, when in fact it does not.

2) Article 4.08(J) provides in no uncertain terms that the indemnification of directors, officers, employees and agents of a corporation extends to such persons after they have left their positions, and extends to their heirs, trustees and administrators, unless otherwise provided in the indemnity agreement.

3) Generally, all provisions relating to the ownership of shares, the issuance of certificates and the transfer of shares have been deleted and instead a cross-reference has been made to article 8 of the Uniform Commercial Code. This has the benefit of eliminating potential inconsistencies between the two laws.

4) Dissolution of a corporation no longer requires proving to the Department of State, by means of no-debt certificates, that the corporation is not indebted to the Department of the Treasury and the Municipal Revenue Collection Center (CRIM).

5) Provisions have been added regarding merger of a domestic corporation into a limited liability company, conversion of a domestic corporation into a partnership, conversion of other entities into domestic corporations, and conversion of domestic corporations into other entities. These provisions track similar provisions currently applicable to limited liability companies.

6) There have been several changes to the provisions regarding annual reports, affecting both domestic corporations and foreign corporations authorized to do business in Puerto Rico. Annual reports used to have to be executed by the President or Vice-President and the Treasurer or Secretary. Now they only require the signature of a single authorized officer, or if there is none, of a director or the incorporator.

   Annual reports also used to be required to name all of the officers and directors of the corporation, whereas now they are only required to name two officers, one of which is the officer executing the annual report.

   In addition, until 2008, domestic corporations whose volume of business exceeded $1 million were required to file an audited balance sheet. If the volume of business did not exceed $1 million, the balance sheet could be signed by an officer, whose signature had to be notarized. In 2008, the threshold was raised to $3 million, which is favorable to small businesses who might not otherwise pay for audited financial statements. The new law keeps the $3 million threshold but adds the requirement that balance sheets for corporations whose volume of business is less than $3 million must be compiled by a CPA licensed in Puerto Rico, who is not an employee or shareholder of the corporation, along with such CPA's opinion. This new requirement is an additional burden on small businesses.

   Foreign corporations, on the other hand, were required to submit audited balance sheets regardless of their volume of business. The new law provides that if the volume of business in Puerto Rico is of less than $3 million, then the foreign corporation must file a balance sheet compiled by a CPA licensed in Puerto Rico, who is not a shareholder or employee of the corporation, along with such CPA's opinion.

   Interestingly, the law does not clarify a long-standing gray area regarding foreign corporations, which is whether the balance sheet must include all of the foreign corporation's financial information, or only that related to Puerto Rico (the latter being the consensus opinion among corporate attorneys).

   In general, the additional burden makes little sense, since limited liability companies are not required to file annual reports at all (although they do have to pay yearly fees of $100 – strangely, the due date for this fee has been changed from April 15, which is the due date for filing annual reports, to March 1). Given that LLCs are also not required to provide information regarding their officers and directors (or their equivalents), plus their greater organizational flexibility, one would suspect that most new business organizations would organize themselves as LLCs.

7) In Puerto Rico, there are many corporations that have not filed their annual reports in many years. Although prior versions of the General Corporations Law allowed the Department of State to revoke the Certificate of Incorporation of corporations that failed to file annual reports for two consecutive years, in practice this rarely occurred.

Thus, if a corporation desired a goodstanding certificate, it would be required to file annual reports (and pay the corresponding fees and fines) for all of the years that annual reports were not filed. Article 15.06 of the new General Corporations Law provides that for purposes of issuing a goodstanding certificate, only the annual reports corresponding to the last five years will be reviewed, and that once a goodstanding certificate is issued, no fines or any other action will be taken as a result of the failure to file prior year's annual reports.

8) The section relating to fees has been amended to give the Secretary of State greater flexibility in setting fees. Whereas before the law provided, for example, that annual reports filed by foreign corporation were required to pay $100, the law no provides that the fee shall not be less than $100. As a result, the Secretary of State may unilaterally raise fees across the board, although it may not lower them.

9) Professional services corporations no longer have to include the type of profession they are dedicated to in the corporations' name, which made for rather unwieldy corporate names (e.g., José del Pueblo Attorney at Law, P.S.C.).

10) An interesting change (at least for a lawyer) has been made to the LLC section of the General Corporations Law, perhaps reflecting the interests of the attorneys who drafted the changes. Puerto Rico and U.S. case law has long held that corporations may not offer professional services (i.e., services which require a license, such as attorneys, engineers and architects) because professionals may not escape personal professional liability by using the corporate form. Professional services corporations were created to allow professionals to incorporate, and enjoy limited liability other than with respect to professional liability (LLPs were also created for this purpose, but are rarely used as they do not offer any real benefits over PSCs). Over the past several years, several law firms reorganized as LLCs. The LLC statute did not specifically provide that LLCs could provide professional services, raising questions as to whether the courts would eventually hold that LLCs were analogous to corporations, and therefore prohibited from offering professional services. Article 19.06(A) of the new General Corporations Law has been amended to specifically provide that they can, putting to rest the uncertainty, but making PSCs, like LLPs, essentially pointless; the ugly stepsisters of corporations and LLCs.

11) Article 19.23 has been amended to provide that each member and administrator of an LLC has the authority to bind an LLC, unless otherwise provided in the LLC agreement. This is a potentially dangerous provision that must be addressed in all LLC agreements.

12) Article 19.46 used to provide that the dissolution, winding up, and distribution of assets of an LLC would follow the same procedures applicable to corporations. The new law now provides distinct procedures for LLCs. In general, an LLC shall now be dissolved upon: (i) the time specified in the LLC agreement; (ii) the occurrence of an event specified in the LLC agreement; (iii) unless otherwise provided in the LLC agreement, the affirmative vote or written consent of the members[1]; (iv) the time when there are no members; or (v) the entry of a judicial dissolution decree. Upon dissolution, unless otherwise provided in the LLC agreement, a manager who has not wrongfully caused the dissolution, or if none, the members[1] may wind up the affairs of the LLC.

[1] The drafting of these sections is unclear as to the percentage of membership interests that must approve the dissolution or winding up, respectively.

After dissolution, the assets of the LLC are distributed in the following order: (i) to creditors; (ii) except as otherwise provided in the LLC agreement, to members or former members in satisfaction of the LLC's distribution obligations; and (iii) except as otherwise provided in the LLC agreement, to members or former members, first, for the return of their capital contributions, and, second, in respect to their membership interests in the same proportion shared in distributions.

13) Finally, article 22.09 provides that the Secretary of State may, for a 5 month period, open a window where (i) non-profit corporations which have not filed annual reports may do so by paying twice the regular fee (currently $7) and without paying any fines and (ii) for profit corporations which have not filed annual reports may do so by paying three times the regular fee (currently $100) without paying any fines. This is a substantial benefit and all corporations that owe annual reports should be on the look-out for the opening of the window.

The foregoing is only a summary of the principal changes to the General Corporations Law, and those that are most likely to affect the directors and officers in the day to day operation of corporations. Other changes have also been made, so directors and officers should consult with their corporate counsel to confirm that specific procedures remain unchanged, or if changed, in exactly what way.

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About the author:

**Nikos Buxeda-Ferrer** is a graduate, cum laude, of Harvard University and earned his law degree at Stanford Law School, where he was editor of the Law and Policy Review.

He practiced corporate and securities law in New York at Curtis Mallet-Prevost Colt & Mosle, LLP and Morgan Lewis & Bockius, LLP.

Mr. Buxeda-Ferrer is experienced in drafting and negotiating documentation related to complex corporate and securities law transactions, such as mergers and acquisitions, private placements, preferred stock issuances, the organization of Puerto Rico mutual funds, debt issuances and restructurings and loan financings.

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