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The International Comparative Legal Guide to:

Mergers and Acquisitions 2015

9th Edition

A practical cross-border insight into mergers and acquisitions

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Contributing Editor
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Group Consulting Editor
Alan Falach

Group Publisher
Richard Firth

Published by
Global Legal Group Ltd.
59 Tanner Street
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Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
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EDITORIAL

Welcome to the ninth edition of *The International Comparative Legal Guide to: Mergers & Acquisitions*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of mergers and acquisitions.

It is divided into two main sections:

Four general chapters. These are designed to provide readers with an overview of key issues affecting mergers and acquisitions, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in mergers and acquisitions in 55 jurisdictions.

All chapters are written by leading mergers and acquisitions lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor Michael Hatchard of Skadden, Arps, Slate, Meagher & Flom (UK) LLP for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.co.uk.

Alan Falach LL.M.
Group Consulting Editor
Global Legal Group
Alan.Falach@glgroup.co.uk

Chapter 46

Puerto Rico

Fernando J. Rovira-Rullán

Ferraiuoli LLC

Yarot T. Lafontaine-Torres

1 Relevant Authorities and Legislation

1.1 What regulates M&A?

The Commonwealth of Puerto Rico ("Puerto Rico") is an unincorporated territory of the United States of America ("United States") with a republican government system. The official currency of Puerto Rico is the United States dollar. Puerto Rico enjoys United States constitutional, legal, financial and regulatory protection, including for intellectual property, securities (SEC, FINRA) and Homeland Security matters. Its banking system is regulated under United States laws and regulations and bank deposits are insured by the Federal Deposit Insurance Company and our geographic access points are protected by the United States Customs and Border Patrol. Puerto Rico has its own United States District Court and its decisions are subject to appeal to the First Circuit Court of Appeals in Boston, Massachusetts and then to the United States Supreme Court.

The Puerto Rico General Corporations Act of 2009 (the "General Corporations Act") is modelled on the Delaware General Corporations Act and is the principal and most comprehensive statute in connection with the constitution, governance and dissolution of corporate entities in Puerto Rico. The Puerto Rico Supreme Court has stated that judicial decisions from Delaware courts in connection with the interpretation of the Delaware General Corporations Act are highly persuasive and illustrative before Puerto Rico courts.

Besides the General Corporations Act, the following local statutes are generally applicable to merger and acquisition transactions:

- The Puerto Rico Civil Code: The Puerto Rico Civil Code (the "Civil Code") regulates matters related to the creation, perfection, interpretation and validity of contracts; the rights and obligations of the parties thereto; and the remedies available to the parties in the event of a breach.
- The Puerto Rico Commercial Code: The Puerto Rico Commercial Code (the "Commercial Code") contains a statute which is similar to Article 6 of the Uniform Commercial Code (Bulk Sales). The Commercial Code requires that parties to an asset purchase transaction prepare a complete inventory of the assets being sold and that the seller's creditors be notified of the sale and the terms of the sale prior to the closing of the transaction.
- The Puerto Rico Commercial Transactions Act (modeled on the Uniform Commercial Code): The General Corporations Act states that the sale or transfer of securities shall be governed by the provisions of Chapter 8 of the Puerto Rico Commercial Transactions Act.
- The Puerto Rico Monopoly Act: The Puerto Rico Monopoly Act governs the antitrust considerations that could arise in connection with the purchase or sale of an ongoing concern.
- Act 80 of 1976 (Employee Severance): Pursuant to Act 80 employees who are discharged without just cause have a right to severance pay based on the length of their employment. If the purchaser does not retain the employees of the target company, the purchaser must retain an amount sufficient to satisfy the employees' severance payments from the purchase price.
- The Puerto Rico Internal Revenue Code: On the tax front, Puerto Rico enjoys fiscal autonomy. The United States Internal Revenue Code excludes Puerto Rican entities from the definition of "United States Person" and treats them as foreign entities. Therefore, Puerto Rican entities and entities organised outside the United States doing business in Puerto Rico are not subject to United States income tax, except to the extent that they (a) engage in trade or business within the United States, or (b) derive certain categories of investment income from United States sources.

1.2 Are there different rules for different types of company?

Yes. The main difference would be between Puerto Rican publicly traded companies and private companies. As discussed below, distinct rules may apply for transactions involving: (a) Publicly Traded Companies; (b) Professional Service Corporations; (c) Insurance Companies; and (d) Banks.

(a) If the target company is one of the few publicly traded companies registered under the Exchange Act (as of January 2014 only six companies headquartered in Puerto Rico are publicly traded), then the purchaser must comply with applicable United States federal securities laws and regulations.

(b) Similar to Delaware, Professional Service Corporations can only merge or consolidate with other Professional Service Corporations organised under the General Corporations Act.

(c) The following rules apply, among others, to insurance companies organised under the Puerto Rico Insurance Code: (1) the plan for the merger or consolidation and the proposed agreement between the insurers must be submitted and approved by the Puerto Rico Insurance Commissioner in advance of the merger or consolidation; and (2) insurance companies can only merge with other insurance companies of the same classification.

(d) Although fairly similar to the merger requirements under the General Corporations Act, the Puerto Rico Bank Act contains particular requirements for bank merger or consolidation transactions, including: (1) the merger or consolidation transaction has to be approved by two-thirds of the outstanding shares entitled to vote; and (2) the Commissioner of Financial Institutions of Puerto Rico has to evaluate and approve the merger or consolidation.

1.3 Are there special rules for foreign buyers?

The Foreign Investment and National Security Act of 2007 and the Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988 apply to Puerto Rico. The aforementioned legislation provides the Committee on Foreign Investment in the United States with the authority to investigate and paralyse transactions that may threaten the national security of the United States.

1.4 Are there any special sector-related rules?

Please refer to question 1.2 above, as to the special rules applicable to insurance companies and banks. Other industries such as hotels and casinos, and cooperatives are subject to industry-specific rules, regulations and approvals.

1.5 What are the principal sources of liability?

The parties to a merger or acquisition agreement could be subject to the following sources of liability:

- The agreement's own indemnification provisions in connection with: (1) false or misleading representations and warranties; and (2) breach of contract.
- The Supreme Court has ruled that a party may be liable for certain damages suffered by the other party such as out of pocket expenses if it negligently terminates negotiations. The Supreme Court determined that a seller who has terminated ongoing negotiations upon learning of the tax implications of the contemplated transaction is liable for the expenses incurred by the prospective purchaser in connection with the negotiations.

A purchaser could be subject to substantial penalties if the proposed transaction triggers a filing under the Hart-Scott-Rodino Act and the purchaser does not comply with the Act's provisions.

2 Mechanics of Acquisition

2.1 What alternative means of acquisition are there?

The principal means for acquiring a private company in Puerto Rico are: (a) a statutory merger; (b) a share or ownership interest purchase; or (c) an asset purchase. A purchaser could perform a straight share or asset purchase or it could perform a triangular merger in order to limit acquisition risks.

A stock purchase requires the consent of the selling shareholders and the Board of Directors of the purchaser. The sale of substantially all of the assets of a target company requires the approval of its Board of Directors and its shareholders. Merger transactions typically require the approval of the Boards of Directors of the constituent companies and a vote from the shareholders of the constituent companies. If the purchaser holds at least 90% of the target company's shares it could perform a "short-form merger" which does not require the approval of the target company's Board of Directors or the shareholders holding the remaining 10% of the target company's shares.

In many cases, the purchaser organises a new company to undertake the stock or asset purchase. In a triangular merger, the target company is merged into the new company resulting in the survival of the new company as a subsidiary of the purchaser. On the other hand, the target company could be the surviving entity when its contracts, permits, licences or tax treatment or other attributes cannot be legally transferred to the new company. In an asset purchase, the purpose of the new company is to limit the potential liability that may be assumed by the acquisition of certain assets.

2.2 What advisors do the parties need?

The main advisors in merger and acquisition transactions are typically legal and financial advisors. Legal advisors are typically in charge of performing due diligence investigations of the target company regarding corporate, labour, litigation, tax, intellectual property, and other matters, structuring the transaction from a legal perspective and drafting and/or negotiating the closing documents.

2.3 How long does it take?

The duration of a transaction from the initial negotiations to the actual closing will depend on its size, industry and structure. A typical transaction could begin with private discussions between the parties in connection with the general terms of a potential agreement. In the event that the parties are interested in proceeding with the negotiations they will execute a letter of intent and a non-disclosure agreement which could take any amount of time from a few days to several weeks. Subsequently, the parties begin the due diligence process (the duration of which could span from one to six months). During the course of the due diligence process, the parties will negotiate the transaction documents, which may take one or two months at a minimum, three to six months on average and up to one year or longer for very large and complex transactions.

2.4 What are the main hurdles?

The main hurdle would be the negotiation process with the target company. This is particularly common in Puerto Rico since most companies are family or closely held businesses and if they are interested in selling, they will most likely have a price at which to close the deal and if said price is not met the transaction could fail. Additional hurdles to a transaction could be potential antitrust issues and obtaining applicable local government consents and permits.

2.5 How much flexibility is there over deal terms and price?

Pursuant to the Civil Code, the parties to any contract may establish the terms and conditions which they deem advisable, provided that they do not contravene the law, morals or public order.

2.6 What differences are there between offering cash and other consideration?

The main difference between offering cash and other consideration, such as securities, would be the availability of appraisal rights to dissenting shareholders. In Puerto Rico, as in Delaware, if the consideration offered in a merger transaction is cash, the shareholders who do not approve the transaction and comply with other statutory requirements are entitled to appraisal rights. Dissenting shareholders do not have appraisal rights if: (a) the target company shares are listed on a national stock exchange; (b) the target company has over 2,000 shareholders; or (c) the target company's shareholders receive shares of the acquiring company as consideration for their shares.

2.7 Do the same terms have to be offered to all shareholders?

There is no statutory requirement that prevents a purchaser from offering different terms to a particular shareholder (e.g. control premiums) when acquiring a private company.

2.8 Are there obligations to purchase other classes of target securities?

There is no statutory requirement that would require a purchaser to acquire other classes of securities issued by the target company. Notwithstanding, a target company could have other classes of securities that may include "tag-along" rights, thus requiring that the purchaser acquires all or a portion of such other classes of securities together with the securities that the purchaser originally intended to acquire.

2.9 Are there any limits on agreeing to terms with employees?

When a purchaser acquires an ongoing business and retains its employees, the purchaser must credit the employees' period of employment with the target company for purposes of computing their severance payment in the event of a future dismissal.

2.10 What role do employees, pension trustees and other stakeholders play?

If there is no provision to the contrary in a collective bargaining agreement, sellers and buyers are not required to consult with or obtain the approval of their respective employees regarding any potential acquisition transaction. Generally, the same will be the case with respect to pension trustees and other stakeholders.

2.11 What documentation is needed?

All transactions generally require a letter of intent, a non-disclosure agreement, and a definitive purchase or merger agreement. In an asset purchase transaction, each asset must be transferred pursuant to either a bill of sale, deed of purchase and sale or assignment agreement.

2.12 Are there any special disclosure requirements?

There are no statutory requirements regarding special disclosures other than the disclosure requirements applicable to publicly traded companies under federal securities laws and regulations.

2.13 What are the key costs?

The principal costs are the legal and financial fees and any applicable regulatory fees, such as securities or Hart-Scott-Rodino filing fees. In an asset purchase transaction that involves the acquisition of real property one of the key costs will be the fees associated with the recording of the change of ownership in the Puerto Rico Registry of Property.

2.14 What consents are needed?

The consents that may be required for a transaction will depend on the transaction's particular circumstances. Typically, a transaction may need consents from third-parties and from local government agencies. If a transaction involves a publicly traded company, certain consents from the Securities Exchange Commission are required. If the transaction triggers a Hart-Scott-Rodino filing the transaction will be subject to a "waiting period" while the Federal Trade Commission and the Federal Department of Justice reviews the filing.

2.15 What levels of approval or acceptance are needed?

A stock purchase requires the approval of the selling shareholders and the approval of the purchaser's Board of Directors.

A sale of substantially all of the assets requires the approval of the majority of the shareholders, the Board of Directors of the target and the Board of Directors of the purchaser.

A merger requires the approval of the Board of Directors and the majority of the shares of the target company. If the purchaser holds at least 90% of the shares with voting rights, the company may perform a "short-form" merger which shall only require the approval of the Board of Directors of the purchaser.

2.16 When does cash consideration need to be committed and available?

There is no legal requirement to have the cash consideration committed and available prior to the closing of the transaction. It is common for target companies to require proof of availability of funds or access to financing sources.

3 Friendly or Hostile

3.1 Is there a choice?

Due to the private nature of companies in Puerto Rico, transactions in Puerto Rico are friendly in nature. Hostile acquisitions are only possible in the context of publicly traded companies and Puerto Rico only has a handful of publicly traded companies.

3.2 Are there rules about an approach to the target?

There is no legal requirement or limitation as to the manner in which to approach a target company. Nonetheless, similarly to the United States, after the initial approach by a potential purchaser, the parties will execute a Non-Disclosure Agreement before the commencement of the due diligence process.

3.3 How relevant is the target board?

The Board of Directors of a target company is relevant to the extent that their approval is required to undertake a transaction.

3.4 Does the choice affect the process?

Please refer to question 3.1.

4 Information

4.1 What information is available to a buyer?

Potential purchasers of private companies in Puerto Rico have access to the following public information sources:

(a) Corporate records filed with the Puerto Rico Department of State:

(i) Certificate of Incorporation.

(ii) Annual reports containing certain information about the officers and directors and financial statements.

(iii) Good-Standing Certificate.

(b) UCC Financing Statements.

(c) Pending litigation.

4.2 Is negotiation confidential and is access restricted?

Negotiations are not confidential by virtue of statute yet access to information can be restricted pursuant to a Non-Disclosure Agreement.

4.3 When is an announcement required and what will become public?

There is no local statutory requirement to make a public announcement of a transaction. However, for a merger or consolidation transaction to be effective, the merger or consolidation agreement must be filed with the Corporation's Registry of the Puerto Rico Department of State, which is public. *In lieu* of filing said agreements, a certificate of merger may be filed containing very limited information as set forth in the General Corporations Act.

4.4 What if the information is wrong or changes?

Typically, sellers have the obligation to inform purchasers if representations made in the purchase agreement are wrong or change before the closing. It is also common practice in Puerto Rico to include "material adverse changes" provisions. In both cases, the purchaser generally has the right to terminate the agreement and in some instances it may have the right to close and either waive the misrepresentation or file a post-closing indemnity claim against the seller.

5 Stakebuilding

5.1 Can shares be bought outside the offer process?

As previously discussed, given that the majority of companies in Puerto Rico are private, buying shares outside the offer process is not a viable alternative. In the unlikely scenario that the company has no restrictions on the transfer of its shares such as a right of first refusal then it could be possible for a buyer to acquire a stake in a private company outside the offer process.

5.2 Can derivatives be bought outside the offer process?

Similarly to question 5.1, due to the private nature of the vast majority of Puerto Rico companies, derivatives are not available. On the other hand, if the target is one of the few local companies that are publicly traded and there are derivative securities available for purchase they may be bought outside the offer process.

5.3 What are the disclosure triggers for shares and derivatives stakebuilding before the offer and during the offer period?

There are no statutory disclosure triggers applicable to private companies in Puerto Rico. Notwithstanding, as discussed in question 1.2, insurance companies and banks contemplating a merger transaction must disclose their plans and obtain the approval of the Puerto Rico Commissioner of Insurance and the Puerto Rico Commissioner of Financial Institutions, respectively.

Notwithstanding, if a buyer is building a stake in one of the few local companies that are publicly traded, then it must comply with Section 13(d) of the Exchange Act of 1934 which requires the filing of a statement before the Securities Exchange Commission (Form 13-D) if a person acquires a beneficial ownership of greater than 5% of a class of registered equity securities. Pursuant to Rule 13d-3(a), beneficial ownership of a class of registered equity securities is imputed to a person who has the right (e.g. call options, convertible notes) to acquire such equity securities within 60 days.

5.4 What are the limitations and consequences?

Please refer to question 5.1.

6 Deal Protection

6.1 Are break fees available?

Yes, break fees can be available in Puerto Rico if they are agreed to between the parties and they are commonly used in more complex transactions. Break fee provisions provide purchasers with certain compensation, payable by the target company if the transaction is not completed due to the target company withdrawing from the transaction or accepting a competing offer from a third-party. Additionally, the agreement may provide for "reverse break fees" pursuant to which the purchaser is obligated to pay a monetary payout to the target if the transaction is not completed.

6.2 Can the target agree not to shop the company or its assets?

Yes, target companies may agree to a "No-Shop" or exclusivity provision and they are, in fact, fairly common in merger and acquisition transactions in Puerto Rico. The purpose of "No-Shop" provisions is to prevent a target company from seeking other potential buyers after they have agreed to be acquired by the acquiring company. A typical "No-Shop" provision prohibits a target company from engaging in the solicitation of other acquisition offers, provide information or engage in discussions with other potential buyers.

6.3 Can the target agree to issue shares or sell assets?

There is no statutory limitation that prohibits or restricts a target company from issuing shares or selling assets. Nonetheless, a potential acquirer will require that the target company manage the company in the "ordinary course of business" and that it will not issue shares and sell assets during the course of the negotiations.

6.4 What commitments are available to tie up a deal?

The parties could enter into a binding letter of intent, making the obligation to close mandatory if certain conditions precedents are met. Failure to close as required in the binding letter of intent may result in monetary damages and the claimant could demand specific performance.

7 Bidder Protection

7.1 What deal conditions are permitted and is their invocation restricted?

As discussed in question 2.5 above, the parties have total flexibility in the negotiation of the terms and conditions that will be applicable to the transaction, including objective conditions imposed by a bidder in connection with its offer. Among the most common terms and conditions included in acquisition agreements as conditions precedent to closing are the following: no material adverse change or effect; Board of Directors and/or shareholder approval; financing availability; due diligence; and third-party and regulatory consents.

7.2 What control does the bidder have over the target during the process?

Unless contractually agreed to the contrary, the purchaser does not generally have any sort of control over the target company during the negotiation process. It is common practice to include covenants that require the target company's Board of Directors and management to continue to operate in the "ordinary course of business" after the signing of the agreement and until the closing of the transaction.

7.3 When does control pass to the bidder?

In general, the purchaser gains control when it acquires a majority stake in the target company.

7.4 How can the bidder get 100% control?

Please refer to question 7.3.

8 Target Defences

8.1 Does the board of the target have to publicise discussions?

There is no statutory requirement that requires the Board of Directors to inform the target company's shareholders that an offer to buy the company has been received. Nonetheless, fiduciary duties towards the company and to other shareholders (particularly minority shareholders that may not be represented in the Board of Directors) come into play when the Board of Directors receives an offer for the purchase of the company.

8.2 What can the target do to resist change of control?

Due to the private nature of most Puerto Rican companies, the final decision to sell and relinquish control of the company rests on the target company's shareholders. If the target company shareholders do not want to sell the company there is little that the purchaser could do to gain control.

8.3 Is it a fair fight?

As mentioned in question 8.2 above, the final decision to sell a company belongs to the shareholders.

9 Other Useful facts

9.1 What are the major influences on the success of an acquisition?

Some of the major factors that could influence the success of an acquisition include: (a) the purchase price and payment terms; (b) obtaining the necessary approvals from the stakeholders, third parties and regulators (if applicable); (c) tax considerations; and (d) pre-existing business/personal relationships between the parties.

9.2 What happens if it fails?

Generally, there are no consequences to the parties if the transaction fails besides the costs incurred by them in the negotiation process, which are mostly legal and financial advisor fees. Notwithstanding the foregoing, as discussed in question 1.6, if the transaction fails due to the fact that one of the parties desists from completing the transaction and a "break-up" fee was agreed upon, then the party responsible would need to pay the applicable fee. Additionally, if the transaction fails due to a breach of a representation or warranty, the defaulting party could be liable for indemnity payments and/or it could be ordered to restitute costs and other damages to the other party in a breach of contract action.

10 Updates

10.1 Please provide a summary of any relevant new law or practices in M&A in Puerto Rico.

For decades, the Government of Puerto Rico has offered aggressive tax incentives to businesses within certain industries that establish operations in Puerto Rico, making the island an attractive environment for conducting business. In 2012, the Government of Puerto Rico enacted a number of statutes to foster the economic development of the island by attracting foreign capital. Among them, Act No 22 of 2012, known as the Act to Incentivize the Transfer of Investor Individuals to Puerto Rico, the goal of which is to attract persons who have not been residents of the island to relocate and establish their residence in Puerto Rico. Pursuant to a recent amendment to Act 22, in order to be eligible for the benefits under Act 22 an individual must be an investor who has not been a resident of Puerto Rico at any time during the six-year time period preceding January 2015 and who becomes a resident of Puerto Rico on or before December 31, 2035. Prior to the amendment the required time period was 15 years. The main benefits under Act 22 are: (a) 0% Puerto Rico income taxes on all interest and dividend income (no federal income taxes on Puerto Rico source interest and dividend income); and (b) 0% Puerto Rico and federal capital gains tax on income attributable to the increase in value of securities occurring after establishing residence in Puerto Rico. The incentives offered to investors under Act 22 have been a catalyst for M&A activity in Puerto Rico as wealthy foreign investors (including many from the mainland United States) have made substantial investments in the island in order to create Puerto Rico source equity and reap the benefits of Act 22.

Furthermore, in late 2014, the Governor of Puerto Rico signed law Act 185, known as the Private Equity Funds Act, which establishes the framework for the creation and taxation of (i) Puerto Rico Private Equity Funds, and (ii) Private Equity Funds (collectively a "Fund" or "Funds"). The Funds are intended to provide a financial alternative to private Puerto Rican companies that do not have access to public capital markets, such as start-ups and companies in financial distress. To achieve its purpose, the Act provides preferential tax treatment to (i) the Funds, (ii) the Fund's Accredited Investors, (iii) the Fund's General Partner, and (iv) the Fund's Registered Investment Advisor. For example, Funds are exempt from dividends, interest income, and capital gains taxes while Accredited Investors are only subject to a 10% fixed tax rate (or exempt if realised from Puerto Rico sources). A Fund's General Partner and the Registered Investment Advisor are subject to a 5% fixed tax rate on dividend and interest income and a 2.5% fixed tax rate on capital gains. In addition, Puerto Rico residents (including those who became residents pursuant to Act 22) who invest in a Puerto Rico Private Equity Fund (as defined in Act 185) may deduct up to 60% of the initial investment within a maximum period of 15 years, provided that the maximum deduction does not exceed 30% of the investor's net income prior to the deduction. On the other hand, Puerto Rico residents who invest in a Private Equity Fund (as defined in Act 185) may deduct up to 30% of the initial investment within a maximum period of 10 years, provided that the maximum deduction does not exceed 15% of the investor's net income prior to the deduction.

Fernando J. Rovira-Rullán
Ferraiuoli LLC
221 Ponce de León Avenue, 5th Floor
Hato Rey
Puerto Rico 00917

Tel: *+1 787 766 7000*
Fax: *+1 787 766 7001*
Email: *frovira@ferraiuoli.com*
URL: *www.ferraiuoli.com*

Mr. Rovira-Rullán is a Capital Member of Ferraiuoli LLC and Chair of its Corporate and Real Estate Department. He joined Ferraiuoli LLC in 2004 after serving as the Senior Vice President and Deputy General Counsel of a publicly traded financial institution. Before that, Mr. Rovira-Rullán worked as an associate in the Corporate Department of another leading Puerto Rico law firm from 1998 until 2002.

Mr. Rovira-Rullán is admitted to practice in Puerto Rico and New York. His principal areas of practice include general corporate law, mergers and acquisitions (he has local and cross border experience), real estate, commercial lending, securities, intellectual property, and tourism and hospitality.

Since 2010, Mr. Rovira-Rullán has been rated by Chambers & Partners in its Global and Latin America editions as a Leader in Corporate and Commercial areas of practice. He serves as an adjunct professor at the University of Puerto Rico School of Law, where for more than a decade he has offered advanced courses such as Business Organization and Mergers and Acquisitions.

Yarot T. Lafontaine-Torres
Ferraiuoli LLC
221 Ponce de León Avenue, 5th Floor
Hato Rey
Puerto Rico 00917

Tel: *+1 787 766 7000*
Fax: *+1 787 766 7001*
Email: *ylafontaine@ferraiuoli.com*
URL: *www.ferraiuoli.com*

Mr. Lafontaine-Torres has been an Associate in the Corporate Department of Ferraiuoli LLC since October 2012. His main practice areas include general corporate law, securities, mergers and acquisitions, and financial regulation.

Prior to joining Ferraiuoli LLC, Mr. Lafontaine-Torres was a financial analyst in a local distressed asset management firm from 2008 to 2010. Also, during the summer of 2008, Mr. Lafontaine-Torres was an analyst in the investment bank Lehman Brothers, Inc.

Mr. Lafontaine-Torres obtained his Juris Doctor degree from the University of Puerto Rico School of Law in 2012. During his legal studies Mr. Lafontaine-Torres was the Editor-in-Chief of the Third Volume of the University of Puerto Rico Business Law Journal.

FERRAIUOLI LLC

Ferraiuoli LLC is one of the leading corporate law firms in Puerto Rico. The firm provides value added comprehensive legal advice to industry-leading private and publicly owned companies on corporate, mergers and acquisitions, intellectual property, labour and employment, energy and land use, litigation, tax and other regulatory matters.

Ferraiuoli has received international recognition in the legal field by Chambers & Partners, a London-based legal directory firm that publishes, on an annual basis, the leading directories of the legal profession identifying the world's top lawyers and law firms. In its 2010-2014 Latin America and Global editions, Chambers ranked Ferraiuoli as a leader in both Corporate and Intellectual Property and several firm attorneys were named "Leaders in their fields" by the publication. Ferraiuoli has further been honoured as one of Puerto Rico's outstanding firms by Chambers & Partners as it was shortlisted as one of the candidates for Puerto Rico's Law Firm of the Year for the years 2011-2014.

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GLG
Global Legal Group

59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: sales@glgroup.co.uk

www.iclg.co.uk