U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20216

Reply to the Attention of:
Neil Grossman
(202) 523-6915

OPINION 81-46A
408(e)

MAY 27 1981

Mark A. Vogel, Esquire
Weil, Gotshal & Manges
767 Fifth Avenue
New York, New York 10022

Re: Kenyon & Eckhardt, Inc.
Identification Number: F-1622A

Dear Mr. Vogel:

By letter dated July 21, 1980, you requested an advisory opinion under the Employee Retirement Income Security Act of 1974 (ERISA). The letter and accompanying submissions include the following facts and representations.

Kenyon & Eckhardt, Inc. (the Company) adopted the K & E Employees' Profit-Sharing Plan (the Plan) in 1968. The Plan permits the Company to contribute shares of its stock to the Plan. The Company proposes to contribute approximately 85,000 shares of Company common stock to the Plan. The stock will be subject to a Shareholder's Agreement, which, among other things, requires that a shareholder wishing to sell his stock first offer it to the Company. The purchase price for stock under the Shareholder's Agreement is based on the book value of the stock as it appears on the consolidated financial statement of the Company, with certain adjustments, reflected on the last day of the fiscal year of the Company preceding the date of the transaction.

The trustees of the Plan, who are also officers and directors of the Company, propose to enter into an agreement with the Company whereby the Company will purchase one-third of the stock from the Plan annually in each of the years from 1983 to 1985. The purchase price of the stock will be determined under the Shareholder's Agreement at the time of actual sale. The agreement to purchase the stock will be contingent on the earnings of the Company exceeding a certain minimum level for each of the years. In the event of the sale to a third party of substantially all of the assets of the Company or substantially all of the stock of the other shareholders, or in the event that the common stock of the Company becomes publicly traded prior to the time of

purchase by the Company, the agreement with respect to the purchase by the Company of the remaining shares of stock held by the Plan will be null and void.

You seek an opinion that

(1) The act of purchasing the stock from the Plan is not a prohibited transaction under section 406 of ERISA by virtue of section 408(e) of ERISA, and

(2) The act of entering into the agreement pursuant to which the Company will purchase the stock from the Plan is not a prohibited transaction under section 406 of ERISA.

On October 15, 1980, you attended a conference in this office with representatives of the U.S. Department of Labor (the Department), at which time the questions raised in your request were discussed more fully.

Section 406(a)(1)(A) of ERISA prohibits a fiduciary with respect to a plan from causing the plan to engage in a transaction if he knows or should know that such transaction constitutes a direct or indirect sale or exchange or leasing of any property between a plan and a party in interest. Section 3(14)(C) of ERISA defines the term "party in interest" as an employer any of whose employees are covered by an employee benefit plan. The Company is a party in interest with respect to the Plan because it is an employer of employees covered by the Plan.

Section 406(b)(1) and 406(b)(2) of ERISA are intended to deter fiduciaries from exercising their responsibilities on behalf of plans when they have interests which conflict with the interests of the plans for which they act. Section 406(b)(1) prohibits a fiduciary from dealing with the assets of a plan in his own interest or for his own account. Section 406(b)(2) prohibits a fiduciary from acting in any transaction involving the plan on behalf of a party, or representing a party, whose interests are adverse to the interests of the plan.

Therefore, absent a statutory or administrative exemption, the Company's purchase of the stock from the Plan would constitute a prohibited transaction within the meaning of section 406(a)(1)(A), section 406(b)(1), and section 406(b)(2) of ERISA.

Section 408(e) of ERISA, however, provides, in pertinent part, that section 406 does not apply to the sale by a plan of qualifying employer securities (as defined in section 407(e)(5)), if the following three conditions are satisfied:

(1) the sale is for adequate consideration,

(2) no commission is charged with respect to the sale, and

(3) the plan is an eligible individual account plan (as defined in section 407(d)(3)).

Section 3(34) of ERISA defines an "individual account plan" as a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains, and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account. Based on the facts and representations contained in your letter and in accompanying submissions, it is the opinion of the Department that the Plan is an "individual account plan" within the meaning of section 3(34) of ERISA.

Section 407(d)(3) of ERISA defines an "eligible individual account plan" to include an individual account plan which is a profit-sharing, stock bonus, thrift, or savings plan, and which explicitly provides for the acquisition and holding of qualifying employer securities.

Section 407(d)(5) of ERISA defines the term "qualifying employer security" to mean an employer security which is stock or a marketable obligation. Section 407(d)(1) of ERISA, in pertinent part, defines the term "employer security" to mean a security issued by an employer of employees covered by the plan. Under section 3(20) of ERISA, a security has the same meaning as the term has under section 2(1) of the Securities Act of 1933. Since the Company is an employer of employees covered by the Plan, and the shares of Company common stock are securities, as defined in section 2(1) of the Securities Act of 1933, the shares are "qualifying employer securities" within the meaning of section 407(d)(5) of ERISA.

Based on the facts and representations contained in your letter and in accompanying submissions, the Department has determined that the Plan is an individual account plan which is a profit-sharing plan, that the Plan explicitly provides for the acquisition and holding of qualifying employer securities, e.g., the Company's common stock, and that the Plan is, consequently, an "eligible individual account plan" within the meaning of section 407(d)(3) of ERISA.

Given these determinations, the prohibited transaction restrictions of section 406 of ERISA would not apply to the Company's purchase of the stock from the Plan, provided that the Plan receives adequate consideration for the stock, and provided that no commission is charged to the Plan in connection with the purchase.

Section 3(18) of ERISA defines the term "adequate consideration" for purposes of part 4 of subtitle B of title 1 of ERISA. Under section 3(18)(B), "adequate consideration" means, in the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by the trustees or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Department. At present, no regulations have been published under section 3(18).

The Department generally will not opine as to whether a particular transaction is for adequate consideration. See section 5 of ERISA Procedure 76-1 (41 FR 36281, August 27, 1976). Rather, the Department believes that such determinations should be made by appropriate fiduciaries on

the basis of relevant facts and circumstances. Thus, whether the price the Plan receives for the stock, as established under the formula contained in the Shareholder's Agreement, constitutes "adequate consideration" within the meaning of section 3(18) is a determination which must, at the time of each purchase, be made in good faith by the trustees of the Plan.

With regard to the proposed agreement whereby the Company would purchase the stock from the Plan, to date, the Department has not published regulations relating to the question of when a fiduciary would be deemed to cause a plan to engage in a transaction within the meaning of section 406 of ERISA. We are thus unwilling to opine as to whether the execution of the agreement would, in itself, constitute a prohibited transaction under section 406(a)(1)(A), section 406(b)(1), or section 406(b)(2) of ERISA, should the relief afforded by section 408(e) of ERISA be unavailable. See section 5 of ERISA Procedure 76-1 (41 FR 36281, August 27, 1976). However, we note that, pursuant to Temporary Pension Excise Tax Regulations section 141.4975-13, the Internal Revenue Service (the Service) has adopted certain sections of the Private Foundation Excise Tax Regulations for the purpose of computing the excise taxes imposed under sections 4975(a) and (b) of the Internal Revenue Code of 1954 (the Code). With respect to the question of when a prohibited transaction occurs, section 53.4941(e)-1(a)(2) of those regulations provides, in part, that

> "An act of self-dealing occurs on the date on which all the terms and conditions of the transaction and the liabilities of the parties have been fixed."

We wish to point out that ERISA's general standards of fiduciary conduct would also apply to your proposed transactions. Section 404(a)(1)(B) of ERISA requires that a fiduciary discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries, and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. Accordingly, the trustees of the Plan must act "prudently" and "solely in the interest" of the Plan's participants and beneficiaries, when deciding whether to accept the contribution of stock subject to the restrictions on marketability set forth in the Shareholder's Agreement, and when deciding whether to cause the Plan to enter into the agreement whereby the Company would purchase the stock from the Plan under the terms and conditions proposed. If the acquisition of the stock by the Plan or the execution of the agreement for the purchase of the stock by the Company are not "prudent" and "solely in the interest" of the Plan's participants and beneficiaries, the trustees of the Plan would be liable for any loss resulting from such breach of fiduciary responsibility, even though the acquisition of the stock and the execution of the agreement may be exempt from the prohibited transaction restrictions of ERISA by virtue of section 408(e). See Department of Labor Reg. section 2550.408e (29 CFR 2550.408e).

For your information, the Service has, in the past, taken the position that the contribution by an employer of its restricted stock to a trust, created for the exclusive benefit of its employees, may adversely affect the tax qualification of the trust. Rev. Rul. 57-372,1957-2 C.B. 256, addressing

the question of whether a stock bonus plan qualifies under section 401(a) of the Code where its assets are stock of the employer, which, under state law, are held in escrow by the commissioner of corporations, states that

> "it is the established policy of the Internal Revenue Service to require unrestricted marketability with respect to stock or securities of the employer corporation contributed to an employees' trust."

Under Reorganization Plan No. 4 of 1978 (Executive Order 12108, 44 FR 1065), the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Code has been transferred, with certain exceptions, which include subsections relating to the enforcement of the prohibited transaction excise taxes, to the Secretary of Labor, and the Secretary of the Treasury shall be bound by the rulings issued by the Secretary of Labor pursuant to such authority. Therefore, it is the Department's position that the opinion set forth herein applies, to the extent relevant, to section 4975 of the Code.

This letter is an advisory opinion under ERISA Procedure 76-1, and is, accordingly, issued subject to the provisions of that procedure, including section 10 thereof, relating to the effect of advisory opinions.

Sincerely,

Alan D. Lebowitz
Assistant Administrator for Fiduciary Standards
Pension and Welfare Benefit Programs