

U.S. Department of Labor

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



Reply to the Attention of:
Carol Gold
(202) 523-8971

Opinion 81-83A
Sec. 408(b)(2), 408(c)(2), 3(14)(A), 2(14)(B)

November 30, 1981

Lawrence J. Hass
Attorney for the _____ Pension Trust Fund
Groom and Nordberg
Suite 450
1775 Pennsylvania Avenue N.W.
Washington, D.C. 20006

Re: Identification Number F-2009A

Dear Mr. Hass:

This is in response to your request for an advisory opinion from the Department of Labor concerning the application of the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA) to certain payments by the _____ Pension Trust Fund (the Fund) to Mr. _____, former Executive Director of the Fund.

Your letter contains the following facts and representations. The Fund is a jointly-administered multiemployer pension plan currently covering more than _____ participants. The Fund is maintained by more than _____ contributing employers in _____ states. The Board of Trustees of the Fund (the Trustees) is composed of an equal number of representatives of contributing employers and representatives of the _____. As of December 31, 1980, the Fund held total assets in excess of \$ _____.

From its inception in 1955 until 1979 the Fund did not have an office of Executive Director. In 1979, the Fund Trustees established the office of Executive Director of the Fund, pursuant to recommendations provided in independent studies of the Fund's administrative procedures and practices. An executive committee of the Trustees was formed to locate and recruit candidates. The executive committee received and reviewed more than 300 applications for the position. Various candidates were interviewed, and, acting on the executive committee's recommendation, the Trustees unanimously selected Mr. _____ as Executive Director of the Fund in July, 1979. Mr. _____ accepted immediately, and resigned from his position as Assistant to the Secretary-Treasurer of the _____ in the _____ headquarters. At that time, the

specific terms of his employment had not been negotiated. During these negotiations, differences arose concerning compensation benefits and the duration of the contract. Ultimately, a two-year contract was entered into effective November 1, 1979 with the understanding that Mr. _____'s employment would be extended if the arrangement proved to be satisfactory.

The contract provided that Mr. _____ would report and be subject to the supervision of the Chairman and Co-Chairman/Secretary of the Board of Trustees and that he would be responsible for implementing trust policy as established by the Trustees from time to time. The contract further provided that Mr. _____ would receive a salary of \$65,000 during the first year of the contract and \$95,000 during the second year, and other retirement and fringe benefits.

Disagreements relating to Mr. _____'s duties and responsibilities as Executive Director arose almost from the beginning of his employment with the Fund. These problems intensified and caused differences of opinion between the Fund's employer and employee Trustees. Finally, the Fund Trustees and Mr. _____ entered into an employment termination agreement on March 1, 1981.

Paragraph 1. of the agreement provides:

1. "Effective March 1, 1981 _____ shall be placed on a leave of absence, with pay, until October 31, 1981, when his employment by the Trustees shall cease. It is understood and agreed that this Agreement amends, supersedes and replaces that certain Employment Agreement dated November 2, 1979, between Trustees and _____."

Paragraph 2. of the agreement provides:

2. " _____'s salary for the period March 1, 1981 through October 31, 1981, in the amount of \$63,615.38, shall continue to be paid bi-weekly or at the option of the Trustees, in a single lump sum, less all regular payroll deductions, including those for taxes and social security."

In addition, under the agreement Mr. _____ will receive many of the retirement and other benefits which were accorded to him under his original employment contract.

The agreement also provides that Mr. _____ (or his surviving spouse and children) will receive an additional \$260,500 payable in three annual installments of \$93,500 in 1982, 1983 and 1984.

Payment of these amounts, however, is conditioned on and shall not be made until and unless the Trustees have received an exemption or advisory opinion from the Department of Labor that such payments do not constitute a prohibited transaction under section 406 of ERISA and section 4975 of the Internal Revenue Code of 1954 (the Code).

_____, in consideration of the agreement, promises to release and discharge the "Fund, its Trustees and all its service providers, and the agents and successors in interest of each, from and against any and all claims, liabilities and damages of any nature whatsoever, directly or indirectly based upon or arising out of his employment as Executive Director of the Fund."

You have asked for an advisory opinion that the additional payments under the employment termination agreement between the Fund and Mr. _____ constitute "compensation" and "compensation for services rendered" for purposes of section 408(b)(2) and (c)(2) of ERISA, respectively. Alternatively, you request that the Department grant an exemption for such payments under section 408(a) of ERISA and section 4975(c)(2) of the Code from the restrictions of section 406(a) of ERISA and section 4975(c)(1)(A) through (D) of the code.

Section 3(14)(A) of ERISA defines the term party in interest with respect to an employee benefit plan to include an employee of an employee benefit plan. In addition, a person providing services to a plan is a party in interest with respect to such plan under section 3(14)(B) of ERISA (and is a disqualified person with respect to such plan under section 4975(e)(2)(B)) of the Code. Therefore Mr. _____ is a party in interest (and a disqualified person) with respect to the Fund¹.

Section 406(a)(1)(D) of ERISA and section 4975(c)(1)(D) of the Code prohibit the direct or indirect transfer of any assets of a plan to, or use of such assets by or for the benefit of, a party in interest (disqualified person).

Section 408(b)(2) of ERISA provides that the prohibitions of section 406 shall not apply to contracting or making reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan if no more than reasonable compensation is paid therefore. Department regulations section 2550.408b-2(c) provides that no contract or arrangement is reasonable within the meaning of 408(b)(2) of ERISA if it does not permit termination by the plan without penalty to the plan on reasonably short notice. The regulation also provides that a provision in a contract or other arrangement which reasonably compensates the service provider for loss upon early termination of the contract is not a penalty.

Section 408(c)(2) of ERISA provides that nothing in section 406 shall be construed to prohibit any fiduciary from receiving reasonable compensation for services rendered.

¹ In addition, Mr. _____ appears to have been a fiduciary of the Fund by reason of his duties as its Executive Director, see section 3(21) of ERISA. A fiduciary of a plan is also a party in interest and a disqualified person. See section 3(14)(A) of ERISA and section 4975(e)(1)(A) of the Code.

Section 408(a) of ERISA enables the Department to grant administrative exemptions for transactions that are administratively feasible in the interests of the plan and of its participants and beneficiaries; and protective of the rights of participants and beneficiaries of the plan.

Mr. _____'s services for the Fund terminated as of March 1, 1981. The proposed payments to him contemplated by the termination agreement do not constitute compensation for services rendered for purposes of section 408(c)(2) of ERISA. While amounts due under the original employment contract for the period of March 1, 1981 through October 31, 1981 may be compensation for loss upon early termination of the contract for purposes of section 408(b)(2) of ERISA and section 2550.408b-2(c) of the regulations, the Department will not provide an opinion regarding the extent, if any, that payment of the amount representing, or in lieu of, Mr. _____'s regular salary until October 31, 1981, would be in the nature of reasonable compensation for loss upon early termination of the contract because of the inherently factual nature of the issues involved. See section 5.01 of Advisory Opinion Procedure 76-1 (41 FR 36281, August 27, 1976).

Moreover, it is the Department's opinion that payments in excess of the amount due under the original employment contract are not "compensation" for purposes of section 408(b)(2) of ERISA, nor are they "reasonable compensation for services rendered" for purposes of section 408(c)(2) of ERISA.

As an alternative to an advisory opinion, you have requested an administrative exemption. In November, 1979 the Trustees entered into a two year contract with Mr. _____ with the understanding that the arrangement would be continued if it proved satisfactory. The probationary nature of the original contract appears to have represented a determination on the part of the Trustees that a long term contract would not be in the interests of the plan and of its participants and beneficiaries nor would it be protective of the rights of participants and beneficiaries of the plan. The Department finds no basis for a determination that the proposed payments, in excess of the amount contracted for, are in the interests of the plan and of its participants and beneficiaries and protective of the rights of participants and beneficiaries of the plan. ERISA Exemption Procedure 75-1 provides that an applicant for an administrative exemption may have a conference in the event it appears the requested exemption will not be granted. On Tuesday, November 17, 1981 representatives of the Department met with you to indicate the reasons for our tentative denial of your request and to give you an opportunity to present additional facts and reasons why such an exemption should be granted. The Department has decided to deny the request for an administrative exemption under section 408(a) of ERISA.

We would like to note that this situation raises additional questions that continue to be of concern to the Department. Advice with respect to the application of the exclusive purpose standards of section 403(c)(1) and 404(a)(1)(A) of ERISA and the application of the provisions of section 410 of ERISA to the employment termination agreement was not requested, and the Department's advisory opinion does not deal with these issues. You should be aware that in an advisory opinion dated June 15, 1981 the Department stated that a gratuitous payment by plan

trustees to the widow of a plan fiduciary would constitute a violation of the exclusive purpose standards of section 403(c)(1) and 404(a)(1) of ERISA in that it would not be accurate to characterize the payment as compensation nor would it be a reasonable expense of administration.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 (issued August 27, 1976). Accordingly, this letter is issued subject to the provisions of the 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