

U.S. Department of Labor

Office of Pension and Welfare Benefit Programs
Washington, D.C. 20210



OPINION NO. 84-28A
Sec. 414(c)(2), 414(c)(3)

JUN 25 1984

Douglas O. Kant
Associate Counsel
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P.O. Box 111
Boston, MA 02117

Identification Number F-2828

Dear Mr. Kant:

This letter is in response to your request on behalf of John Hancock Mutual Life Insurance Company (the Company) for an advisory opinion that certain equity interests in real properties acquired by the Company in 1982 on behalf of both its general account and a separate account are held "pursuant to a binding contract in effect on July 1, 1974" within the meaning of section 414(c)(2) of the Employee Retirement Income Security Act of 1974 (ERISA). These interests were acquired in a foreclosure auction that resulted from defaults on pre-1974 mortgages secured by the same properties.

In summary, you represent the following. The Company's general account and its Separate Account No. 2's Real Estate Class (the Class), which comprises assets of the Employee's Retirement and Benefit Plan of Schenley Industries, Inc. (the Plan), jointly own two parcels of real property acquired as the only bidder at a 1982 foreclosure sale that resulted from defaults on mortgage loans on the properties. The conversions from debt to equity were made in accordance with the Company's rights under the secured notes and deeds of trust executed before July 1, 1974. The respective interests of the two accounts were not altered by the transfer of title, although the loans were converted into equity interests. The Company is a fiduciary of the Plan's assets that comprise the Class.

You also indicate that the Plan's investment committee has recently expressed serious interest in liquidating the Plan's remaining interests in the Class. Under the terms of its contract with the Company, the Plan has a right to do so after providing 90 days' notice to the Company. If the Plan exercises this option, the Company will have to liquidate the equity interests allocated to the Class relatively quickly. Due to the nature of these investments, the most desirable course of action would be to sell these equity interests to the Company's general account.

Finally, you represent that on June 24, 1983 the Department issued an advisory opinion to the Company regarding the sale of similar shared mortgage interests to the general account from a pooled separate account of the Company. In that opinion, the Department concluded that the mortgage interests were "joint uses" of property under section 414(c)(2) of ERISA. The non-pooled nature of the Class does not appear to you to have any material effect on this conclusion regarding the mortgage interests allocated to the Class, and therefore you expect the Company to proceed in accordance with this position.

Because the Company is a fiduciary of plan assets of the Class by reason of its investment discretion, it is also a party in interest with respect to the Plan, which owns the entire interest in the separate account, under section 3(14)(A) of ERISA. Section 406 of ERISA generally prohibits sales of property between a plan and a party in interest. Under section 414(c)(3), however, section 406 does not apply to sales of property described in section 414(c)(2) between a plan and a party in interest if certain conditions are satisfied. We assume for purposes of this letter, without opining, that the mortgages you describe are property described in section 414(c)(2).

The Department's regulations under section 414(c)(2) do not address the question of when property that substitutes for property held before July 1, 1974 itself is property held "pursuant to a binding contract in effect on July 1, 1974." While the Department's regulations do not address this situation, the Department has stated in the preamble to its final regulations under section 414(c) that:

In the Department's view, the principal purpose of the transitional rule contained in section 414(c)(3) is to prevent undue hardship that might result if a plan could not sell property to the best available buyer because the property is subject to a lease or joint use between the plan and a party in interest. 46 FR 7320, January 23, 1981.

For this reason and based on the representations in your letter, it is the Department's view that equity interests in real property of a party in interest acquired after July 1, 1974 by a plan in a foreclosure auction that resulted from defaults on mortgages held on that date which were secured by such property are held pursuant to a binding contract in effect on July 1, 1974. Therefore, it is the Department's opinion that the equity interests you describe are held "pursuant to a binding contract in effect on July 1, 1974" within the meaning of section 414(c)(2) of ERISA.¹

This letter is an advisory opinion under ERISA Procedure 76-1. Section 10 of the Procedure explains the effect of an advisory opinion.

Sincerely,

Alan D. Lebowitz
Deputy Administrator for Program Operations

¹ In this regard, the Internal Revenue Service faced a similar question under section 101(1)(2)(C) of the Tax Reform Act of 1969 (83 Stat. 533). This section is a transitional rule that provides an exemption from the self-dealing rules of section 4941 of the Internal Revenue Code, which apply to disqualified persons with respect to private foundations. Under section 101(1)(2)(C), a lease or loan had to be held "pursuant to a binding contract in effect on October 9, 1969 (or pursuant to renewals of such a contract)" in order to qualify for transitional rule treatment. In regulations under that section, the Service stated that indebtedness of a disqualified person acquired after October 9, 1969 by a private foundation in exchange for stock or securities that the foundation held on that date and at all times thereafter would be treated as an extension of credit pursuant to a binding contract in effect on October 9, 1969. 26 CFR 53.4941(d)-4(c)(4)(i). The Department's position with respect to the equity interests described herein is consistent with the Service's position regarding the indebtedness described in the Service's regulation for transitional rule holding period purposes.