MAR 29 1990

90-05A
Sec. 406(a)(1)(A), 407(d)(6)

Mr. O. Victor Edelbrock
Edelbrock Corporation
2700 California Street
P.O. Box 2936
Torrance, California 90509-2936

Re: Identification Number: F-4245A

Dear Mr. Edelbrock:

This is in response to your letter of January 5, 1989, in which you requested an advisory opinion regarding the application of the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA) to a contribution by an employer of real property to an employee stock ownership plan.

You represent that the Edelbrock Corporation Employee Stock Ownership Plan, Stock Bonus Portion (the Plan) is a stock bonus plan qualified under section 401(a) of the Internal Revenue Code of 1986 (the Code). The Plan, in conjunction with a money purchase pension plan, is intended to constitute an employee stock ownership plan under section 407(d)(6) of ERISA. As an employee stock ownership plan, the Plan is designed to invest primarily in stock of the Edelbrock Corporation (the Employer).[1]

You further represent that the Board of Directors has resolved to contribute two light industrial commercial buildings owned by the Employer to the Plan. The properties (known as Building #4 and Building #8) are located in the Edelbrock Chandler Business Park, Chandler, Arizona. The buildings are currently owned outright by the Employer, i.e., there are no mortgages or any other liens against them. The properties are tenant occupied subject to transferable leases expiring in 1991, and they are valued based on independent MIA appraisal taking into account the value of the existing leases. The contribution will not create any ongoing relationship between the Plan and a party in interest. Subsequent to the proposed contribution, real estate will comprise 10.4 percent of plan assets, cash and cash equivalents 5.2 percent, and qualifying employer securities will make up the remaining 84.4 percent of plan assets.

According to your representations, the Plan is funded at the discretion of the Board of Directors. The proposed contribution is purely voluntary, and would not relieve the Employer of an obligation to make a cash contribution to the Plan. In this regard, you have specifically represented that the proposed contribution of real property is not a substitute for a previously resolved cash contribution, and that no part of the contribution will be used to satisfy any required contribution to the related money purchase plan.

In effect, you request the following opinions:

1) that the contribution of real property to the Plan will not violate section 406 of ERISA, and

[1] In this regard, you indicate that the Plan has not borrowed funds in order to finance the purchase of employer securities under section 408(b)(3) of ERISA.

2) that the investment of 15.6 percent of the Plan's assets in investments other than qualifying employer securities will satisfy the requirement that an employee stock ownership plan be "designed to invest primarily in qualifying employer securities" for purposes of section 407(d)(6) of ERISA.

Section 406(a)(1)(A) of ERISA provides that a fiduciary with respect to a plan shall not cause a 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) of ERISA defines a "party in interest" to include a fiduciary, a person providing services to a plan, and an employer any of whose employees are covered by such plan.

With respect to the first issue, the Department of Labor (the Department) addressed the issue of employer contributions in kind in Advisory Opinion 81-69A (July 28, 1981). In that Opinion, the Department concluded that a contribution of unencumbered property by an employer to a defined benefit plan would be a prohibited transaction under section 406(a)(1)(A) of ERISA because the contribution of such property discharged the employer of its legal obligation to make cash contributions to the plan. In effect, the plan would be exchanging its legal right to the payment of the contribution for property other than cash.

In the Department's view, contributions in kind that relieve an employer of an obligation to make cash contributions to any plan subject to Title I of ERISA, including an employee stock ownership plan, are prohibited exchanges under section 406(a)(l)(A) of ERISA. If, however, an employer's contribution in kind is purely voluntary, it is the Department's further view that such contributions in kind would not be prohibited under section 406(a)(l)(A) of ERISA.

You represent that the contribution of the real property to the Plan is purely voluntary, and will not relieve the Employer of any obligation to make a cash contribution to the Plan. Based upon the facts and representations contained in your submission, it is the view of the Department that the contribution of real property to the Plan would not constitute a prohibited transaction under section 406(a)(1)(A) of ERISA.

With respect to the second issue, the term "employee stock ownership plan" is defined under section 407(d)(6) of ERISA to mean an individual account plan which is (i) a stock bonus plan which is qualified, or a stock bonus plan and a money purchase plan both of which are qualified, under section 401 of the Code, and (ii) is designed to invest primarily in qualifying employer securities, and (iii) meets such other requirements as the Secretary of the Treasury may prescribe by regulation.

29 CFR §2550.407d-6(a)(2) of the Department's regulations provides that to be an ESOP, a plan must be formally designated as such in the plan documents. 29 CFR §2550.407d-6(b) further provides that a plan constitutes an ESOP only if a plan specifically states that it is designed to invest primarily in qualifying employer securities. Although the regulation does not define the term "primarily", the regulation does state that a stock bonus plan or a money purchase pension plan constituting an ESOP may invest part of its assets in other than qualifying employer securities. In Advisory Opinion 83-6A (January 24, 1983), the Department stated that neither ERISA nor the applicable regulations promulgated thereunder contain maximum or minimum percentages of plan assets which must be invested in qualifying employer securities over the life of the ESOP in order to satisfy the "primarily" requirement of section 407(d)(6) of ERISA. The Department concluded that a plan provision requiring the plan to invest more than 50 percent of its assets in qualifying employer securities would not, in itself, contravene the requirement of ERISA section 407(d)(6) that an ESOP invest primarily in qualifying employer securities.[2]

[2] In this regard, we note that Advisory Opinion 83-6A emphasized the Department's belief that, in order to satisfy the ESOP requirements imposed by ERISA and applicable regulations, a plan must satisfy the "primarily"

Accordingly, it is the responsibility of the appropriate plan fiduciaries to determine, based on all of the relevant facts and circumstances, the composition of the plan's portfolio, including the percentage of plan assets to be invested in qualifying employer securities in any particular instance. In this regard, we note that compliance with a plan provision would not insulate the fiduciaries from liability under section 404 of ERISA should prudence or exclusive benefit requirements dictate an alternative investment course of action.

The Department notes that ERISA's general standards of fiduciary conduct would apply to your proposed contribution in kind. Section 404(a)(1)(B) of ERISA requires that a fiduciary discharge his duties to a plan solely in the interests of the participants and beneficiaries, and with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man would use in the conduct of an enterprise of a like character and with like aims. Accordingly, the fiduciaries of the Plan must act "prudently" and "solely in the interest" of the Plan's participants and beneficiaries when deciding whether to accept the contributions in kind. If accepting the contribution of the property by the Plan is neither "prudent" nor "solely in the interest" of the Plan's participants and beneficiaries, the fiduciaries of the Plan would be liable for any loss resulting from such breach of fiduciary responsibility, even though the contribution of the real property may not constitute a prohibited transaction under section 406 of ERISA.

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

Sincerely,

Robert J. Doyle
Director of Regulations and Interpretations

---

requirement of section 407(d)(6) over the life of the plan.