U.S. Department of Labor Pension and Welfare Benefits Administration
Washington DC 20210

December 18, 1992

Ms. Cindy V. Schlaefer
Proskauer Rose Goetz & Mendelsohn
1585 Broadway
New York, NY 10036

92-27A
ERISA SECTION
407

Dear Ms. Schlaefer:

This is a response to your correspondence requesting an advisory opinion regarding the application of section 407(f)(1)(B) of the Employee Retirement Income Security Act of 1974 (ERISA) to the proposed investment by the Johnston Industries, Inc. Salaried Employees' Pension Plan and the Johnston Industries Inc. Hourly Employees' Pension Plan (collectively, the Plans) in employer securities.

Your submission contains the following facts and representations. The Plans are sponsored by Johnston Industries (the Company). The Plans are each defined benefit pension plans within the meaning of sections 3(2)(A) and 3(35) of ERISA, with assets of approximately $10,776,000. The Board of Directors of the Company, as provided by the Plans' documents, has approved amendments to each Plan which authorize the investment of up to 10% of the fair market value of each Plan's assets in qualifying employer securities as defined by section 407 of ERISA. You represent that pursuant to this authorization the Plans intend to acquire shares of common stock of the Company. Following the investment of 10% of the fair market value of Plan assets in Company common stock, the Plans would own approximately 3.1% of all shares issued and outstanding of the Company, based on your representations regarding the fair market value of Plan assets and Company common stock, and the number of shares outstanding.

According to the information provided in your submission, the common stock of the Company is traded on the New York Stock Exchange, there were approximately 4.7 million shares of common stock issued and outstanding, and of the approximately 2,000 shareholders the only persons who directly owned more than 5% of the Company's outstanding shares of common stock were GRM Industries Inc. (47.4%); FMR Corporation (10.5%); and Prudential Insurance Company of America (9.9%).

The officers, directors and employees of the Company and their families own less than 5% of the common stock of the Company. The officers, directors and employees hold options pursuant to which they can acquire up to an additional 5% of the common stock of the Company.

The officers, directors and employees may also acquire an additional 3% of the Company's common stock pursuant to an employee stock purchase plan. You represent that if all outstanding options held by such persons were exercised, the percentage of shares owned by officers, directors and employees would not exceed 13% of shares issued and outstanding.

The Company is part of a group of companies that share significant ownership interests. Of the Company's issued and outstanding common stock, 47.4% is owned by GRM Industries, Inc. (GRM). GRM, in turn, is a wholly-owned subsidiary of Redlaw Industries, Inc. (Redlaw). By virtue of a 50.6% ownership interest, Redlaw is controlled by Galtaco, Inc. (Galtaco). Mr. Chandler, who serves as Chairman of the Board, President and Chief Executive Officer of the Company, directly owns 49.7% of all stock issued and outstanding of Galtaco. [1]

This group of companies also has significant overlapping membership on their respective Boards of Directors. The Boards of Directors of Galtaco and Redlaw are comprised of the same seven individuals.[2] Of these seven Directors, five also serve on the seven member Board of GRM.[3] Additionally, of the members on the Board of Directors of the Company, two, Messrs. Chandler and Bosselman, are concurrently serving on the Boards of Galtaco, Redlaw, and GRM.[4] Mr. Chandler also serves as Chairman of the Board of the Company and Redlaw. One other Director, Mr. Black, serves on both the Boards of GRM and the Company.

You have requested an advisory opinion from the Department of Labor (the Department) concerning the requirements of section 407(f)(1)(B) of ERISA. In effect, you seek a determination that immediately following the proposed purchase of the Company's common stock by the Plans at least 50 percent of the aggregate amount of issued and outstanding common stock will be held by persons independent of the issuer.

Section 406(a)(1)(E) of ERISA prohibits a fiduciary with respect to a plan from causing the plan to engage in a transaction if he or she knows or should know that such transaction constitutes a direct or indirect acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 407(a). Section 406(a)(2) provides that no fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer real property if the fiduciary knows or should know that holding such security or real property violates section 407(a).

Section 407(a) of ERISA specifically precludes a plan from acquiring or holding any employer security which is not a qualifying employer security. Section 407(d)(1) defines the term "employer security" to mean a security issued by an employer of employees covered by the plan, or by an affiliate of such employer. Under section 407(d)(5), an employer security which is stock meets the definition of "qualified employer security" only if it satisfies the requirements of section 407(f)(1).

Section 407(0(1) of ERISA provides that stock satisfies the requirements of this paragraph if, immediately following the acquisition of such stock:

(A) no more than 25 percent of the aggregate amount of

stock of the same class issued and outstanding at the time of acquisition is held by the plan, and

(B) at least 50 percent of the aggregate amount referred to in subparagraph (A) is held by persons independent of the issuer.

The fiduciary responsibility provisions of Title I of ERISA do not specifically define the phrase "independent of the issuer." Whether a particular person is independent of the issuer for the purposes of section 407(f)(1)(B) of ERISA is, in most instances, a factual question requiring examination of all surrounding facts and circumstances.[5] As a general practice, the Department will not issue opinions on such questions. See section 5.01 of ERISA Procedure 76-1 (41 Fed. Reg. 36281, August 27, 1976). However, the Department has determined, based on the representations contained in your request, that the issue raised therein is sufficiently clear to be the appropriate subject of an advisory opinion.

Specifically, you have represented that Mr. Chandler owns 49.7% of Galtaco; Galtaco owns 50.6% of Redlaw; Redlaw owns 100% of GRM; and GRM owns 47.4% of the Company. Mr. Chandler is the Chairman of the Board, President, and Chief Executive Officer of the Company as well as being a member of the Boards of Directors of all these corporations. Mr. Chandler owns or has options to purchase over 150,000 shares of Company stock. Mr. Chandler's daughter also serves on the Board of Directors of three out of four of these corporations. Mr. Bosselman serves on the Boards of Directors of all these corporations. Mr. Bosselman owns or has options to purchase over 50,000 shares of Company stock. Mr. Bosselman also serves as a trustee to the Plans.

Under the facts presented, GRM and the Company are component members of a group of corporations which share significant ownership interests, have overlapping board memberships and are connected by familial ties. Therefore, it is the view of the Department that, given the substantial commonality of interest between the corporations presented by the facts, GRM cannot be a person independent of the issuer for purposes of section 407(0(1)(B) of ERISA. Consequently, when GRM's holdings are combined with those of other non-independent persons, more than 50% of the common stock of the Company is held by persons not independent of the issuer. Therefore, the employer stock fails to meet the requirements of section 407(0(1) and is not a qualifying employer security as defined in section 407(d)(5).

In the view of the Department, this position is not inconsistent with the Treasury regulation cited in your letter (26 C.F.R. 1.503(e)-1(b)(3)(i)). The regulation provides that "person independent of the issuer" means a person who is not related to the issuer by blood, marriage, or by reason of any substantial business interest. The examples described in the regulation, and which you cite, are expressly meant not to be exclusive.

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

Sincerely,

ROBERT J. DOYLE
Director of Regulations
and Interpretations

[1] Additionally, you represent that Mr. Chandler directly owns 100,800 shares of Company stock and stock options amounting to 57,500 shares. R.H. Bosselman directly owns 1500 shares of Company stock and stock options amounting to 48,750 shares.

[2] These members are Mr. Chandler; Allyn Chandler (daughter); R.H. Bosselman; F. Simpson; J.M. Tory; J.R. Bingham; and T.W. Cook.

[3] Messrs. Chandler, Bosselman, Bingham and Cook and Ms. Chandler serve on the Board of Directors of GRM.

[4]Mr. Bosselman is also one of three trustees administering the Plans.

[5] However, some individuals and entities by the very nature of their relationship to the issuer are persons who are not independent of the issuer. For example, any officer, director or employee of the issuer would not be independent; nor would any person be independent who directly or indirectly through one or more intermediaries is controlling, controlled by or under common control with the issuer.