

**U.S. Department of Labor**

Pension and Welfare Benefits Administration  
Washington, D.C. 20210



June 26, 1996

96-08A  
ERISA SEC. 407(d)(5)

Mr. Ross W. Lillard  
Ms. Colleen E. Medill  
Stinson, Mag & Fizzell  
P.O. Box 419521  
Kansas City, Missouri 64141-6251

Dear Mr. Lillard and Ms. Medill:

This is in response to your letter on behalf of Ash Grove Cement Company (the Company) requesting an advisory opinion regarding the prohibited transaction provisions of the Internal Revenue Code (the Code). Specifically, you ask whether the definition of "qualifying employer security" in section 407(d)(5) of ERISA applies for purposes of the prohibited transaction exemption in Code section 4975(d)(13).

You represent that the Company Employee Stock Ownership Trust (the Plan) is an employee stock ownership plan and is an eligible individual account plan under section 407(d)(3) of ERISA. The Company has two classes of common stock, the Common Stock and the Class B Common Stock, both of which are held by the Plan. Neither the Common Stock nor the Class B Common Stock are traded through a national securities exchange. The stock is not considered to be "publicly traded" or "readily tradable" within the meaning of Internal Revenue Code Regulation §54.4975-7(b)(1)(iv) or Code section 409(l). Moreover, the stock is exempt from the Securities and Exchange Commission (SEC) registration requirements because the Company has fewer than 500 shareholders.

You further represent that both classes of common stock share equally in the equity of the Company. The characteristics of each class of stock are similar, except for voting rights and transferability. Holders of Common Stock are entitled to one vote per share, whereas holders of the Class B Common Stock are entitled to ten votes per share. The Common Stock is freely transferable, while the Class B Common Stock may be transferred only to a "permitted transferee." If the holder of the Class B Common Stock transfers the shares to someone other than a permitted transferee, each share of the Class B Common Stock is converted on a share-for-share basis into Common Stock. Further, Class B Common Stock is convertible to common stock on a share-for-share basis, at any time, at the option of the stockholders.

You represent that the Plan desires to purchase additional shares of Common Stock in the future from persons who are disqualified persons. The Plan is not leveraged and will not use loan proceeds to purchase the Common Stock. The Common Stock will be purchased using cash held by or contributed to the Plan. The purchases, you represent, will be for adequate consideration and no sales commission will be charged. The proposed purchases of Common Stock will also be monitored so that the value of the Class B Common Stock will exceed 50% of the total value of the assets held by the Plan.

You are concerned that because the conditions of the Common Stock and Class B Common Stock prevent the Common Stock from meeting the definition of "employer securities" under Code section 409(l),<sup>1</sup> the purchases

---

1. Section 409(l)(2) of the Code defines the term "employer securities" in part to mean, in cases where there is no readily tradable common stock, common stock issued by the employer (or by a corporation which is a member of the same controlled group) having a combination of voting power and dividend rights equal to or in excess of –

(A) that class of common stock of an employer having the greatest voting power, and

of the Common Stock from a disqualified person by the ESOP may not qualify for the exemption under section 4975(d)(13) of the Code. You have asked the Department to clarify that, for purposes of the exemption from the prohibited transaction provisions under section 4975(d)(13) of the Code, the term "qualifying employer security" will be defined as under section 407(d)(5) of ERISA.

Under Presidential Reorganization Plan No. 4 of 1978 (43 Fed. Reg. 47713, Oct. 17, 1978), the authority of the Secretary of the Treasury to issue rulings under section 4975 of the Code has been transferred, with certain exceptions here not relevant, to the Secretary of Labor. However, the Internal Revenue Service has exclusive jurisdiction with respect to questions involving section 409(l) of the Code. Accordingly, this advisory opinion will not address questions involving Code section 409(l).

Section 4975(c)(1)(A) of the Code prohibits any direct or indirect sale or exchange, or leasing, of any property between the plan and a disqualified person. Code section 4975(e)(2) defines the term "disqualified person" with respect to a plan to include a fiduciary; an employer any of whose employees are covered by such plan; a member of the family of either of these individuals; and an officer or director or 10 percent or more shareholder of an employer any of whose employees are covered by such plan. Code section 4975(c)(1)(E) prohibits a fiduciary with respect to a plan from dealing with the assets of the plan in his or her own interest or for his or her own account.

The prohibited transaction exemption in Code section 4975(d)(13) provides that the prohibitions provided in Code section 4975(c) shall not apply to any transaction which is exempt from section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) by reason of section 408(e) of such Act. Section 408(e) of ERISA provides, in part, that ERISA section 406 shall not apply to the acquisition or sale by a plan of qualifying employer securities (as defined in section 407(d)(5)), provided that: (1) the acquisition or sale is for adequate consideration; (2) no commission is charged with respect to the acquisition or sale; and (3) the plan is an eligible individual account plan (as defined in section 407(d)(3)).

Section 407(d)(1) of ERISA defines the term "employer security," in part, to mean a security issued by an employer of employees by the plan, or by an affiliate of such employer. Under section 407(d)(5) of ERISA, the term "qualifying employer security" includes an employer security which is stock. The term "stock" is not defined in Title I of ERISA.

As appears from the foregoing, section 4975(d)(13) of the Code specifically references section 408(e) of ERISA for purposes of meeting the exemption for purchases of stock by an ESOP from a disqualified party. ERISA section 408(e), in turn, specifically references the definition of qualifying employer securities in ERISA section 407(d)(5). It is the opinion of the Department that for purposes of meeting the exemption under section 4975(d)(13) of the Code, by way of section 408(e) of ERISA, the definition of "qualifying employer securities" in 407(d)(5) of ERISA controls. Provided that the conditions of ERISA sections 407(d)(5) and 408(e) are met, the purchase of Common Stock issued by the Company from disqualified persons with respect to the Plan would therefore come within the prohibited transaction exemption in Code section 4975(d)(13).

You have not requested an opinion that the common stock in question constitutes qualifying employer securities within the meaning of ERISA section 407(d)(5), or that the proposed purchase of such stock from disqualified persons meets the conditions of the exemption provided under ERISA section 408(e). As a general matter, whether the requirements of these sections are met involves questions which are inherently factual in nature and on which the Department ordinarily does not opine. See section 5.01 of ERISA Advisory Opinion Procedure 76-1, 41 Fed. Reg. 36281 (Aug. 27, 1976). It should be noted, however, that under section 408(e) of ERISA, the acquisition of qualifying employer securities must be for "adequate consideration." Accordingly,

---

(B) that class of common stock of the employer having the greatest dividend right.

the responsible Plan fiduciaries would have to determine, based on all the relevant facts and circumstances, that the proposed acquisition of the Common Stock is for adequate consideration.<sup>2</sup>

Finally, you should be aware that even if the conditions of ERISA section 408(e) are satisfied in regard to the proposed purchase, the statutory exemption provides no relief from ERISA's general fiduciary provisions. Section 404(a)(1) of ERISA requires, in part, that plan fiduciaries must act solely in the interest of participants and beneficiaries of a plan and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person 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. A plan may be permitted to acquire qualifying employer securities under section 408(e); however, if the acquisition is not prudent (because, for example, of the poor financial condition of the employer) or is not for the exclusive purpose of benefiting participants and beneficiaries (such as an acquisition which is made primarily to finance the employer), the responsible plan fiduciaries will remain liable for any loss resulting from a breach of fiduciary responsibility.

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

Sincerely,

Bette J. Briggs  
Chief, Division of Fiduciary Interpretations  
Office of Regulations and Interpretations

---

2. Section 3(18)(B) of ERISA defines the term "adequate consideration" to mean, 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 trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary. The Department proposed regulations under section 3(18)(B) on May 17, 1988 (53 Fed. Reg. 17632); no final regulation has been published to date.