U.S. Department of Labor Office of Pension and Welfare Benefit Programs
Washington, D.C. 20210

JUN 14 1985

85-24A
Sec. 406(a)(1)(A), (C), (D)

Kenneth R. Hoffman, Esq.
Venable, Baetjer and Howard
1800 Mercantile Bank & Trust Building
2 Hopkins Plaza
Baltimore, Maryland 21201

Re: Federal Leasing, Inc. Profit Sharing Trust
Identification Number: F-2838A

Dear Mr. Hoffman:

This is in response to your letters of February 8, and October 31, 1984, requesting an advisory opinion on behalf of Federal Leasing, Inc. Profit Sharing Trust (the Plan) under section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975 of the Internal Revenue Code (the Code).

You represent that the Plan is sponsored by Fedleasco, Inc. (Fedleasco) and its subsidiaries, Federal Leasing, Inc. (Federal Leasing) and EMA, Inc. (EMA). The Trustees and Plan Administrators (Trustees) of the Plan are William T. Evans, Daniel C. Morley and Dorsey P. Wittig, all of whom are officers and full-time employees of Fedleasco and Federal Leasing. Messrs. Evans and Morley are the sole stockholders of Fedleasco which owns 90 percent of the capital stock of Federal Leasing.

Federal Leasing purchases conditional sales contracts or leases which provide financing for various types of equipment and then sells these financing contracts to financial institutions such as banks and insurance companies and, in some cases, to qualified retirement trusts. In many instances, purchasers that are agencies of the Federal government (Government Users) desire to "finance" the purchase of equipment. Typically, the manufacturer will enter into a lease or conditional sales contract with the prospective Government User and then sell the contract to Federal Leasing. Federal Leasing, in turn, finds a financial institution or qualified retirement trust interested in purchasing the contract. Federal Leasing earns a fee on the difference between the amount it pays the manufacturer for the contract and the amount it receives from the financial institution or qualified retirement trust.

Most of the financing transactions entered into by Federal Leasing involve equipment having a stated purchase price between $100,000 and $5,000,000. Although Federal Leasing occasionally handles transactions involving equipment of $100,000 or less, the volume of transactions processed by Federal Leasing at this level is insignificant, constituting less than 3 percent of Federal Leasing's total business during the fiscal year ended March 31, 1983. Federal Leasing stresses larger transactions because the documentation for any transaction is basically the same, regardless of its size. Accordingly, Federal Leasing realizes a greater profit on transactions involving larger equipment purchases in proportion to the effort actually expended. In recent years, these contracts almost exclusively involve the financing of equipment purchased by the Federal government.

The Trustees propose that the Plan enter into a master purchase agreement with Rolm Corporation (ROLM), a corporation which designs, manufacturers and installs a variety of telecommunications equipment. ROLM is a publicly owned corporation whose stock is traded on the New York Stock Exchange. Neither Federal Leasing, Fedleasco, EMA nor Messrs. Evans, Morley nor Wittig own any stock or have any proprietary interest in ROLM.

During a telephone conversation with a member of my staff on April 3, 1985, you represented that ROLM presently does no business with Fedleasco or its affiliates.[1] The only business relationship between ROLM and Fedleasco and its affiliates relates to the processing of purchase contracts which are the subject of the aforementioned master purchase agreement between ROLM and the Plan.

Under the master purchase agreement, ROLM may request that the Plan provide financing for contracts with Government Users. The master purchase agreement does not obligate the Plan to purchase contracts, rather, it simply establishes the basic terms and conditions of any purchase by the Plan. The Trustees will decide, on a case by case basis, whether to purchase a particular contract. The stated price of the contracts purchased by the Plan will generally be between $20,000 and $30,000. In no event will an individual financing transaction exceed the lesser of 8 percent of the Plan's assets or $100,000. Although the Plan will purchase ROLM's interest in the contract and equipment, ROLM will remain responsible for performance under the contract and servicing the equipment. ROLM also agrees to accept all risks of loss or damage during the terms of the contract.

You also indicate that purchase contracts executed by Government Users typically include a provision allowing the agency to terminate the agreement for lack of fiscal funding and may also

[1] By letter dated April 9, 1985, you indicate that Fedleasco may engage in business transactions with ROLM at some future date. This advisory opinion does not address the application of section 406 of ERISA to situations which might arise in the future where Federal Leasing or any of its affiliates also purchases contracts from ROLM.

allow the agency to terminate the agreement upon 30 to 60 days notice by simply returning the equipment. In the event of such a termination, title to the equipment will revert to the Plan, and the master purchase agreement provides that ROLM will have the right to repurchase the equipment at a mutually agreeable price. If a price cannot be agreed upon, ROLM must use its best efforts to sell the equipment on behalf of the Plan. In the event the Government User terminates the purchase contract due to a default on the part of ROLM, or ROLM replaces the equipment with other equipment which it markets, ROLM must repurchase the equipment from the Plan for the full balance due under the terms of the purchase contract.

Federal Leasing represents that it will not acquire a purchase contract after the Plan has declined to purchase that contract. It also points out that its functions with respect to purchase contracts are different from the functions of the Plan. Federal Leasing serves as a "broker" of purchase contracts, reselling them to financial institutions or qualified retirement trusts which hold the contracts for investment. Only on rare occasions will Federal Leasing acquire a purchase contract for its own account. On the other hand, the Plan will acquire the purchase contracts for investment.

In actual practice, if the Trustees determine that the Plan will purchase a contract, an employee of Federal Leasing (Account Executive) will process the transaction on behalf of the Plan. Federal Leasing (not the Plan) intends to pay the Account Executive a bonus of $200 to $500 for his or her services in connection with the transaction. The Plan will not make any payments to employees of Federal Leasing, nor will the Plan reimburse Federal Leasing for any bonus paid to an Account Executive who handles the paperwork on a Plan transaction. Once a transaction has been consummated, employees of Federal Leasing will bill and collect payments due under the contract. These services, which are ministerial in nature, will be performed for the Plan without charge.

The following advisory opinions have been requested:

(1) The execution of the master purchase agreement and the buying of the purchase contracts from ROLM will not constitute prohibited transactions under section 406 of ERISA or section 4975 of the Code.

(2) The services performed by Account Executives of Federal Leasing in the processing of purchase contracts from ROLM, and the use of Federal Leasing employees to handle the billing and collection of payments on contracts purchased by the Plan do not constitute prohibited transactions under section 406 of ERISA and section 4975 of the Code by reason of section 408(b)(2) of ERISA and section 4975(d)(2) of the Code.

Under Reorganization Plan No. 4 of 1978 (43 FR 47713, October 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 not here relevant, to the Secretary of Labor. Therefore, the references in this letter to specific sections of ERISA also refer to the corresponding sections of the Code.

Sections 406(a)(1)(A) and (C) of ERISA provide that a fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he or she knows or should know that such transaction constitutes a direct or indirect sale or exchange, or leasing, of any property between the plan and a party in interest, or the furnishing of goods, services or facilities between the plan and a party in interest. Section 406(a)(1)(D) further prohibits the transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan. Section 406(b)(1) and (b)(2) of ERISA provide that a fiduciary with respect to a plan shall not deal with plan assets in his or her own interest or for his or her own account or act in his or her individual or in any other capacity in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries.

Section 3(14) of ERISA defines the term "party in interest" with respect to a plan to include, among others, a fiduciary, a person providing services to the plan, an employer any of whose employees are covered by the plan, and employees of such employer. In order for a prohibited transaction to occur, there must be a transaction involving a party in interest with respect to an employee benefit plan. Where none of the relationships described in ERISA section 3(14) are found to exist, an entity would not be a party in interest with respect to a plan.

You represent that ROLM is not a party in interest with respect to the Plan under section 3(14) of ERISA. Based solely on the facts and representations contained in your submission, it is the Department's view that the execution of the master purchase agreement and the buying of purchase contracts pursuant to such agreement with ROLM will not constitute prohibited transactions under sections 406(a)(1)(A) and (C) of ERISA.

With respect to section 406(a)(1)(D), you have represented that the volume of transactions processed by Federal Leasing involving equipment with a value of $100,000 or less is insignificant and Federal Leasing will not acquire a purchase contract from ROLM after the Plan has declined to purchase that contract. On the basis of the facts and representations contained in your submission, it does not appear to the Department that the execution of the purchase contracts by the Plan pursuant to the master purchase agreement constitutes a direct or indirect transfer to, or use by or for the benefit of, a party in interest of any assets of the Plan in violation of section 406(a)(1)(D) of ERISA.[2]

[2] This conclusion, however, does not preclude an examination of the facts and circumstances surrounding the transaction to determine whether it is part of an agreement, arrangement or

With respect to section 406(b)(1) and (b)(2), Department regulations under section 408(b)(2) of ERISA (29 CFR 2550.408b-2(e)) provide that the prohibitions of section 406(b) are imposed on fiduciaries to deter them from exercising the authority, control or responsibility which makes them fiduciaries when they have interests which may conflict with the interests of the plans for which they act. In such cases, the regulation states that the fiduciaries have interests in the transactions which may affect the exercise of their best judgement as fiduciaries. It is the Department's view, however, that a fiduciary does not violate section 406(b)(1) with respect to a transaction involving the assets of a plan if he or she does not have an interest in the transaction that may affect his or her best judgement as a fiduciary.

Based on the facts and representations contained in your submission, it is the Department's view that the mere investment of Plan assets in ROLM purchase contracts pursuant to the master purchase agreement would not, in itself, cause the Trustees to have an interest in the transactions that may affect their best judgement as fiduciaries. Therefore, such an investment would not, in itself, constitute a violation of section 406(b)(1) of ERISA. In addition, it does not appear that there would be an adversity of interests involved in the Trustees' decision to invest Plan assets in ROLM purchase contracts as contemplated by section 406(b)(2) of ERISA. However, because of the inherently factual nature of the questions presented, the Department is unable to rule that the transactions would, in no case, violate section 406(b)(1) or (b)(2) of ERISA.

With respect to the second opinion you request, section 408(b)(2) of ERISA exempts from the prohibitions of section 406(a) any contract or reasonable arrangement with a party in interest, including a fiduciary, 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 therefor. Regulations issued by the Department clarify the terms "necessary service" (29 CFR 2550.408b-2(b)), "reasonable contract or arrangement" (29 CFR 2550.408b-2(c)) and "reasonable compensation" (29 CFR 2550.408b-2(d) and 2550.408c-2) as used in sections 408(b)(2) and 408(c)(2) of ERISA.

The provision of services by the Account Executives in connection with processing purchase contracts and the provision of billing and collection services by employees of Federal Leasing on contracts purchased by the Plan would be exempt from the prohibitions of section 406(a) of ERISA provided the conditions of section 408(b)(2) are met. We note, however, that the question of what constitutes a necessary service, a reasonable contract or arrangement and reasonable compensation are inherently factual in nature. Section 5.01 of ERISA Advisory Opinion Procedure 76-1 (ERISA Proc. 76-1, 41 FR 36281, August 27, 1976) states that the Department

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understanding designed to benefit a party in interest prohibited by section 406(a)(1)(D) of ERISA as interpreted by 29 CFR §2509.75-2.

generally will not issue opinions on such questions. The appropriate plan fiduciaries must determine, based on all of the relevant facts and circumstances, whether the conditions of section 408(b)(2) are satisfied.

With respect to the prohibitions in section 406(b), regulation 29 CFR 2550.408b-2(a) states that section 408(b)(2) of ERISA does not contain an exemption for an act described in section 406(b) of ERISA even if such act occurs in connection with a provision of services which is exempt under section 408(b)(2). As explained in regulation 29 CFR 2550.408b-2(e)(1), if a fiduciary uses the authority, control or responsibility which makes him or her a fiduciary to cause the plan to enter into a transaction involving the provision of services when such fiduciary has an interest in the transaction which may affect the exercise of his or her best judgement as a fiduciary, a transaction described in section 406(b) of ERISA would occur, and that transaction would be deemed to be a separate transaction from the transaction involving the provision of services and would not be exempted by section 408(b)(2) of ERISA. However, regulation section 29 CFR 2550.408b-2(e)(3) provides that if a fiduciary furnishes services to a plan without the receipt of compensation or other consideration (other than reimbursement of direct expenses properly and actually incurred in the performance of such services within the meaning of 29 CFR 2550.408c-2(b)(3)), the provision of such services does not, in and of itself, constitute an act described in section 406(b) of ERISA.

If Federal Leasing agrees to pay its Account Executives' fees, and the Plan is not under any circumstances obligated to pay such fees (either directly or indirectly), then the provision of services by Federal Leasing Account Executives would not, in itself, constitute a violation of section 406(b)(1) because the Trustees would not be using any of the authority, control or responsibility that makes them fiduciaries to cause the Plan to pay an additional fee to Federal Leasing or its Account Executives for the provision of such services. In addition, it is also the Department's view that, generally, the provision of services by employees of a plan sponsor whose fees will be paid by the plan sponsor will not involve an adversity of interests as contemplated by section 406(b)(2) of ERISA. Furthermore, the provision of services by employees of Federal Leasing in connection with contracts purchased by the Plan without the receipt of compensation or other consideration would not, in and of itself, constitute a violation of section 406(b) of ERISA. However, because a violation of section 406(b) could occur in the course of the provision of the above described services, the Department is unable to rule that the provision of those services would, in no case, violate section 406(b) of ERISA.

With respect to section 406(b)(3) of ERISA it does not appear that Federal Leasing would be dealing with the Plan in connection with transactions entered into pursuant to the purchase agreement and therefore such payments would not appear to violate section 406(b)(3) of ERISA.

This letter is an advisory opinion under ERISA advisory opinion procedure 76-1. Section 10 of the procedure explains the effect of advisory opinions. This opinion relates only to sections 3(14), 406 and 408 of ERISA and not to any other provision of the statute. For example, we are making no comment with respect to the general fiduciary responsibility provisions of section 404 of ERISA which, among other things, requires a fiduciary to discharge his or her duties respecting the plan solely in the interest of the plan's participants and beneficiaries and in a prudent fashion.

Sincerely,

Elliot I. Daniel
Assistant Administrator for Regulations and Interpretations