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

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86-11A
Sec.

Eugene C. Pridgen, Esq.
Kennedy Covington Lobdell & Hickman
3300 NCNB Plaza
Charlotte, NC 28280

Re: Identification Number F-3070A

Dear Mr. Pridgen:

This is in response to your request for an advisory opinion that certain real estate transactions do not constitute prohibited transactions under section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) and that Mr. Robert L. Jones (Mr. Jones) is not a fiduciary within the meaning of section 3(21)(A) of ERISA with respect to either the United System Employee Retirement Plan (the Plan) or the Real Estate Fund (the Fund) of NCNB National Bank of North Carolina (NCNB).

You represent that the Plan was adopted by United Telecommunications, Inc. (the Employer) and certain of its subsidiaries. NCNB was appointed as an investment manager, as defined in section 3(38) of ERISA, for a portion of the Plan's assets under an investment management agreement which requires NCNB to comply with policies and guidelines issued by the Pension Trust Committee of the Employer. Those policies and guidelines authorize NCNB to invest plan assets in "high quality Real Estate investments with … emphasis on Purchase and Leaseback arrangements on a Net, Net, Net, basis."

During 1980-1981, NCNB invested Plan assets in four real estate projects (the Projects) located in the Highwoods Office Park in Raleigh, North Carolina. In each individual transaction, NCNB, acting on behalf of the Plan, purchased an unimproved tract of land from either the Ironwood Company (Ironwood) or the Highwoods Company, parties having no relationship to the Plan at the time of the transactions. Immediately following each purchase, the Plan leased that tract to Ironwood under a long-term triple net ground lease (the Ground Lease) which obligated Ironwood to construct an office building within a specified period of time. Each lease expressly reserved title to the improvements in Ironwood.

Each Ground Lease provides the parties with a right of first refusal to purchase each other's interest in the Projects at the same price and terms as offered by a third party. In the event that Ironwood is the selling party and the Plan does not exercise its right of first refusal, each Ground Lease requires Ironwood to purchase the Plan's interest for cash according to a fixed formula under the Ground Lease. In addition, one of the Ground Leases requires the Plan to purchase Ironwood's interest in the Project according to a fixed formula where the Plan is the selling party and Ironwood does not exercise its right of first refusal. After a fixed number of years, either party has the option under the Ground Leases to purchase the other party's interest for cash according to a fixed formula. Further, each Ground Lease grants the Plan the right of first refusal with respect to the purchase from, or co-development with, Ironwood (or any party related to Ironwood) of additional property located in the Highwoods Office Park.

As part of each overall transaction, the Plan made a permanent mortgage loan to Ironwood. If, at any time during the term of a Ground Lease, Ironwood is allowed to prepay the permanent loan (and such prepayment is not in connection with the sale of the Project to a third party) or in the event that Ironwood fully amortizes the loan at its maturity, Ironwood is required to purchase the Plan's interest for cash according to a fixed formula.

In addition to the above described transactions, your advisory opinion request describes certain transactions undertaken by the Fund, a collective investment fund for real estate and real estate related investments maintained by NCNB. You represent that, on May 16, 1980 and February 1, 1982, the Fund entered into property management and leasing agreements (the Agreements) with Highwoods Properties (the Management Company). Each Agreement covers a specific property owned by the Fund and provides for an initial one year term with subsequent year to year renewals unless either party notifies the other of its intention to terminate the Agreement.

With respect to the above described transactions, you represent that Mr. Jones and his father each own 20% of the partnership interests in Ironwood and 15.75% of the partnership interests in the Management Company. You state that the remaining partnership interests in Ironwood and the Management Company are owned by persons unrelated to Mr. Jones. You further state that Mr. Jones is not an employee, officer, director or shareholder of the Plan sponsor nor of any employer which sponsors a plan participating in the Fund. Mr. Jones became a member of the NCNB Board of Directors several years after each of the above described transactions was entered into.

You have requested the following advisory opinions:

(1) That Mr. Jones is not a fiduciary under section 3(21)(A) of ERISA with respect to either the Plan or the Fund;

(2) That Ironwood is not a party in interest under section 3(14) of ERISA with respect to the Plan, and that, therefore, the transactions involving the Projects do not constitute prohibited transactions within the meaning of section 406 of ERISA;

(3) That the Management Company is not a party in interest with respect to the Fund within the meaning of section 3(14) of ERISA, or, alternatively, that the Agreements qualify for the exemption under section 408(b)(2) of ERISA and the regulations thereunder; and

(4) That the Projects and the Agreements are legally permissible under ERISA assuming compliance with section 404(a)(1) of ERISA.

Issue 1

Section 3(21)(A) of ERISA provides, in relevant part, that a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or control respecting management of the plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary responsibility in the administration of the plan.

You represent that NCNB is a fiduciary of both the Plan and the Fund under section 3(21) of ERISA. However, you further represent that Mr. Jones is not a fiduciary of either the Plan or the Fund. Whether a person is a fiduciary requires an analysis of the nature of the services rendered and the circumstances under which the services are performed for the particular plan or common or collective trust fund. Thus, whether Mr. Jones' membership on the Board of Directors of NCNB renders him a fiduciary with respect to either the Plan or the Fund within the meaning of section 3(21)(A) of ERISA will depend on the facts and circumstances involved in each particular transaction.[1] Section 5.01 of ERISA Advisory Opinion Procedure 76-1 states that the Department generally will not issue opinions on such questions.

Issue 2

Section 406(a) of ERISA provides, in pertinent part, that a fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that the transaction constitutes a direct or indirect (1) sale or exchange, or leasing, of any property between the plan and a party in interest; (2) lending of money or other extension of credit between the plan and a party in interest; (3) furnishing of goods, services, or facilities between the plan and a party in interest; or (4) transfer to, or use by or for the benefit of, a party in interest, of any assets of the

[1] See D-4 of Interpretive Bulletin, 29 CFR §2509.75-8. (Addresses issue of when a member of the board of directors of an employer/plan sponsor becomes a fiduciary.)

plan. Section 406(b)(1) and (b)(2) of ERISA further provide that a fiduciary with respect to a plan shall not deal with the assets of the plan in his own interest or for his own account, or act, in his 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" to include, among others, a fiduciary of the plan, a partnership of which 50 percent or more of the capital interest or profits interest of such partnership is owned directly or indirectly by a fiduciary or a service provider to the plan, and a 10 percent or more partner of a service provider to the plan. 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 section 3(14) are found to exist, an entity would not be a party in interest with respect to a plan. You represent that Ironwood is not a party in interest with respect to the Plan under section 3(14)(A), (B), (C), (D), (E), (F), (H) or (I) of ERISA. You further represent that Mr. Jones and his father together own 40% of the partnership interests in Ironwood with the remaining 60% owned by unrelated parties.

Based solely on the facts and representations contained in your submission, the Department has concluded that Ironwood is not a party in interest with respect to the Plan under section 3(14) of ERISA. Accordingly, based on your representations and in the absence of additional facts which would suggest an indirect prohibited transaction, it is the Department's view that the transactions involving the Projects described above do not constitute prohibited transactions under section 406(a) of ERISA.

Issue 3

You represent that the Fund entered into the Agreements in 1980 and 1982 with the Management Company for the provision of management and leasing services with respect to certain properties owned by the Fund. Section 3(14) of ERISA defines the term "party in interest" to include a person providing services to such plan. Based solely on the facts and representations contained in your submission, the Department has concluded that the Management Company is a party in interest with respect to the Fund under section 3(14) of ERISA by virtue of providing services to the Fund under the Agreements. Accordingly, the provision of services by the Management Company would be prohibited under section 406(a)(1)(C) in the absence of a statutory or administrative exemption.

Subject to the limitations of section 408(d), section 408(b)(2) of ERISA exempts from the prohibitions of section 406(a) contracting (or making reasonable arrangements) for services (or a combination of services) with a party in interest, including a fiduciary, if: (1) the service is

necessary for the establishment or operation of the plan; (2) the service is furnished under a contract or arrangement which is reasonable; and (3) no more than reasonable compensation is paid for the service. 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)) as used in section 408(b)(2) of ERISA.

Accordingly, the provision of property management and leasing services by the Management Company would be exempt from the prohibitions of section 406(a) if 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. The appropriate plan or Fund 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) even if such act occurs in connection with a provision of services which is exempt under section 408(b)(2). As explained in 29 CFR 2550.408b-2(e)(1), if a fiduciary uses the authority, control or responsibility which makes him 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 best judgment 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). However, regulation section 29 CFR 2550.408b-2(e)(2) provides that a fiduciary does not engage in an act described in section 406(b)(1) of ERISA if the fiduciary does not use any of the authority, control or responsibility which makes such person a fiduciary to cause a plan to pay a fee for a service furnished by a person in which such fiduciary has an interest which may affect the exercise of such fiduciary's best judgment as a fiduciary.

To the extent that Mr. Jones is a fiduciary of the Fund (see discussion under issue 1) and absent any arrangement, agreement or understanding with respect to who will ultimately provide the services in question, Mr. Jones may avoid engaging in an act described in section 406(b)(1) and (b)(2) by removing himself from all consideration by the NCNB Board of Directors of whether or not to engage in any transactions involving the Agreements, and by not otherwise exercising, with respect to any such transaction, any of the authority, control or responsibility which makes Mr. Jones a fiduciary. See Advisory Opinion 79-72A (copy enclosed) and 29 CFR §2550.408b-2(e).

Similarly, to the extent that Mr. Jones is a fiduciary of the Plan, violations of section 406(b)(1) and (b)(2) of ERISA similar to those discussed above may arise in connection with any decisions to be made by the NCNB Board of Directors with respect to the Plan's investments in the

Projects or with respect to participation or non-participation by the Plan in future projects with Ironwood. As discussed above, Mr. Jones may avoid engaging in such violations if, absent any arrangement, agreement or understanding, he removes himself from all consideration by the NCNB Board of Directors of whether or not to engage in any transactions with Ironwood, and by not otherwise exercising, with respect to the transactions, any of the authority, control or responsibility which makes him a fiduciary.[2]

Issue 4

With respect to your request for an advisory opinion that, assuming compliance with section 404(a)(1) of ERISA, the Projects and the Agreements are legally permissible, the Department notes that, beyond the general rules discussed above, the issue of whether a particular transaction is "legally permissible" raises factual questions upon which the Department will not issue an opinion (see section 5.01 of the ERISA Advisory Opinion Procedure 76-1).

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

Sincerely,

Elliot I. Daniel
Assistant Administrator for Regulations and Interpretations

Enclosure

[2] However, depending on the surrounding facts and circumstances, NCNB itself could have an interest in the Management Company or Ironwood that might affect its best judgment as a fiduciary, and in such circumstances violations of section 406(b)(1) could occur.