U.S. Department of Labor

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

OCT 17 1995

95-26A

Mr. Ian D. Lanoff
Bredhoff & Kaiser
1000 Connecticut Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Lanoff:

This is in response to your request for an advisory opinion concerning the application of the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 (the Code) to a situation where certain employee benefit plans are deciding whether to participate in a proposed class action settlement.

Your submission contains the following facts and representations. On October 5, 1994, a consolidated class action complaint was filed in the United States District Court for the District of Minnesota (the "Court") against Piper Funds, Inc. and related defendants. The named plaintiffs were all investors in the Piper Institutional Government Income Portfolio Fund (the "Fund"), one of twelve separate series of capital stock issued by Piper Funds, Inc., an open-end management investment company organized under the laws of Minnesota in 1986. None of the named plaintiffs is an employee benefit plan within the meaning of section 3(3) of ERISA or a plan within the meaning of section 4975(e)(1) of the Code.

The named plaintiffs have sought to represent a class of plaintiffs that includes all persons who purchased shares of the Fund between July 1, 1991, and May 9, 1994. Of those investors, approximately 400 are employee benefit plans (the "Plan or Plans"). On March 3, 1995, the Court certified a conditional settlement class that the named plaintiffs sought to represent. This conditional class includes the Plans.

You have described three categories of relationships which existed between the Plans and the defendants before the current lawsuit.[1] First, with respect to the majority of the Plans, the only relationship that existed between the Plans and the defendants (other than the Plans' investment in the Fund) was that the Distributor, at the request of an unrelated fiduciary, purchased the shares of the Fund on behalf of the Plans and received a commission for that service. Second, with respect to some of the Plans, the Investment Advisor served as a paid consultant for rendering investment advice to those Plans at the same time that it was providing investment advice to the Fund. Third, in some instances Piper Trust, Inc., a corporation which provides trust and custodial services and is wholly owned by a named defendant, provided recordkeeping services to Plans. For purposes of your request, you have asked that the Department of Labor (the "Department") assume that all three categories of defendants described above are parties in interest under section 3(14)(B) of ERISA by virtue of providing services to the Plans.

You indicate that the complaint filed on behalf of the named plaintiffs involves allegations arising out of the services provided by the various defendants under contracts or other arrangements with the Plans. The named plaintiffs allege, among other things, that the Fund invested heavily in certain securities derived from bonds and that such

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[1] The defendants include the Fund; Piper Capital Management Incorporated, a corporation that provides customers -- including the Fund -- investment advice (the "Investment Advisor"); and Piper Jaffray, Inc. (the "Distributor"), a registered broker-dealer that distributes Fund shares.

investments were contrary to stated investment policies and took place without proper representations and disclosure to the Plans investing in the Fund. The defendants have filed an answer in which they deny each and all of the claims and contentions alleged by the named plaintiffs in their complaint and any wrongdoing or legal liability arising out of the conduct alleged in the lawsuit. Recently, a proposed settlement agreement was reached between the parties to the lawsuit pursuant to which the defendants will make certain periodic payments to conditional class members. In the proposed settlement agreement the defendants specifically repeat their denial of each and all claims and contentions alleged by the named plaintiffs and do not admit to any wrongdoing or liability.

The Plans, as conditional settlement class members, must decide whether to accept the proposed settlement or opt out of the conditional class and retain whatever rights and causes of actions they have against the defendants. Plans that choose to participate in the proposed settlement will have to release all claims against the defendants arising from the current action. No fiduciary of the Plans who will be making the decision as to whether to participate or accept the proposed settlement will be related to any of the defendants. You further represent that of the Plans included in the conditional class, approximately half have terminated their contractual relationship with the defendants.

You request clarification, based on the facts and representations described above, that the statutory exemption under section 408(b)(2) of ERISA or section 4975(d)(2) of the Code would be available where a plan and a party in interest enter into a settlement agreement which constitutes a prohibited exchange under section 406(a)(1)(A) of ERISA and section 4975(c)(1)(A) of the Code.

Under Presidential Reorganization 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 Internal Revenue Code has been, with certain exceptions not here relevant, transferred to the Secretary of Labor. Therefore, the references in this letter to specific sections of ERISA refer also to corresponding sections of the Code.

Section 406(a)(1)(A) of ERISA provides 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 a plan and a party in interest. Section 406(a)(1)(C) provides that the furnishing of goods, services, or facilities between a plan and a party in interest is likewise prohibited. Section 3(14) defines the term "party in interest" to include, among others, a fiduciary or a person who provides services to a plan.

Section 408(b)(2) of ERISA provides a statutory exemption from the prohibitions of section 406(a) for contracting or making reasonable arrangements 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 C.F.R. 2550.408b-2(b)), "reasonable contract or arrangement" (29 C.F.R. 2550.408b-2(c)), and "reasonable compensation" (29 C.F.R. 2550.408b-2(d) and 2250.408c-2) as used in section 408(b)(2).

With regard to your submission, the Department notes that where Plans have terminated their service arrangements with the defendants prior to the acceptance of a settlement agreement, the defendants may no longer be parties in interest with respect to those Plans. However, such a determination is factual and would be dependent on the nature of any ongoing relationship existing between the defendants and any Plan prior to the acceptance of a settlement agreement. In situations where any of the defendants are still parties in interest with respect to any of the Plans, the settlement of the lawsuit would be an exchange of property (a chose in action) between such Plans and parties in interest as described in section 406(a)(1)(A).

It is the view of the Department that with respect to any particular plan, the exemption provided in section 408(b)(2) may cover an exchange of property made solely to resolve claims arising out of the performance of an underlying

service arrangement. In this regard, however, the Department notes that the exemption provided in section 408(b)(2) would, with respect to any particular plan, apply only if: (1) the underlying service arrangement giving rise to the party in interest relationship is exempt under section 408(b)(2) and any other applicable exemption and the underlying arrangement continues to meet the requirements of section 408(b)(2) and any other applicable exemption, after taking into account -- (a) the settlement itself including any extension of credit incident thereto[2], (b) the alleged conduct of the service provider which gave rise to the claim, and (c) the following additional factors where the nature of the alleged conduct makes their consideration appropriate - (i) the service provider's ability to provide adequate assurances that the alleged conduct which gave raise to the claims and similar conduct will not occur in the future, including, where relevant, the service provider's willingness to acknowledge intentional wrongdoing or negligence, and (ii) the plan fiduciaries' ability to guard against the opportunities for any future abuse that may be inherent in the party in interest relationships between the settling parties and the plan; (2) the party in interest relationship arises solely from service arrangements that are exempt under section 408(b)(2); and (3) the settlement, including any extension of credit incident thereto, is a reasonable arrangement from the point of view of the plan in that the plan fiduciaries have prudently determined that the plan will receive payment in the settlement that is at least equal to the value of the plan's claims considering the risks of litigation and taking into account the creditworthiness of any party to whom credit is to be extended.

With regard to the foregoing, we note that whether the subject matter of a settlement is a claim that is incidental to the performance of an exempt service arrangement will depend on the facts and circumstances. Based on your representations, however, it appears that the Plans' claims at issue here are incidental to the service arrangements between the Plans and the defendants. However, the Department does not opine on the reasonableness of particular arrangements, and, in any event, the representations included in your request do not, in our view, permit a determination concerning the application of the above criteria.

Finally, we note that section 408(b)(2) does not contain an exemption for an act described in section 406(b) of ERISA. Accordingly, section 408(b)(2) would not exempt the settlement with respect to a given Plan if one of the defendants or its affiliates (or a person with an interest in one of the defendants or affiliates of the defendants which could affect such person's judgment) was a fiduciary with respect to such Plan (including as an investment advisor for a fee) and used its influence as a fiduciary to cause the Plan to enter into the settlement.

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

Sincerely,

ROBERT J. DOYLE
Director of Regulations and Interpretations

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[2] It is the view of the Department that the exemption provided in section 408(b)(2) would encompass an extension of credit only to the extent that such extension is incidental to an arms-length, negotiated settlement agreement between the parties (which settlement would otherwise be exempt); that the appropriate plan fiduciaries have determined such extension is necessary to the settlement and in the best interest of the plan participants and beneficiaries; and that such extension is not otherwise part of an arrangement to secure credit unrelated to the settlement. See, e.g., Advisory Opinion 87-06A (issued November 9, 1987).