

SEP 9 1977

Paul S. Berger, Esq.
Arnold & Porter
1229 Nineteenth Street, N.W.
Washington, D.C. 20036

OPINION 77-66/67 A

404 (a)
408 (c) (2)
410

Dear Mr. Berger:

In response to your letter of July 29, 1977,
and the exhibit attached thereto, we have written
our answer on the enclosed photocopy of your letter.
By doing this we are able to avoid having to recite
or summarize the facts you have set forth in your
letter.

In future correspondence please refer to our
Reference No. C-3588A.

Sincerely,

Fred W. Stuckwisch
Director, Office of Regulatory
Standards and Exceptions

SEP 9 1977

OPINION 77-66/67 A

Theodore R. Groom, Esq.
Groom and Nordberg
1775 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

404(a)
408(c)(2)
410

Dear Mr. Groom:

In response to your letter of July 31, 1977,
and the exhibits attached thereto, we have written
our answer on the enclosed photocopy of your letter.
By doing this we are able to avoid having to recite
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In future correspondence please refer to our
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Fred W. Stuckwisch
Director, Office of Regulatory
Standards and Exceptions

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JULY 29, 1977

Advisory Opinion
Office of Regulatory Standards
and Exceptions
U.S. Department of Labor
Washington, D.C. 20216

Commissioner of Internal Revenue
Attention: E:EP:T
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Request for Advisory Opinion and Ruling
Submitted by Victor Palmieri and Company
Incorporated and The Equitable Life
Assurance Society of the United States --
Indemnification Provisions

Gentlemen:

Enclosed is a request for an advisory opinion or ruling that the indemnification provisions of certain contracts dated June 30, 1977 between the Equitable Life Assurance Society of the United States ("Equitable"), Victor Palmieri and Company Incorporated ("VPCO") and the Central States, Southeast and Southwest Areas Pension Fund ("Fund") are not contrary to the provisions of section 410 of the Employee Retirement Income Security Act ("ERISA"), and that payment under such provisions is exempt from ERISA section 406 and section 4975(c) of the Internal Revenue Code ("Code") by virtue of ERISA section 408(c)(2) and Code section 4975(d)(10), and is not violative of ERISA section 404(a).

ARNOLD & PORTER

Office of Regulatory Standards
and Exceptions
Commissioner of Internal Revenue
July 29, 1977
Page Two

This request is part of the series of ruling, advisory opinion and exemption requests that VPCO and Equitable are submitting in connection with the new arrangements for independent management of the assets of the Fund. These new arrangements, which are generally believed to be an integral part of the government's efforts to reform the management of the Fund's assets, are scheduled to go into effect on September 1, 1977. Accordingly, it is absolutely essential that favorable action be taken on this request by that date. In order to expedite the processing of this request, we are prepared to meet with representatives of the agencies at any time to discuss it and to cooperate with and assist the agencies to the fullest extent possible.

If there are any questions with respect to the enclosed requests, please be in touch with the undersigned (872-6784), Peter Schmidt (872-6834), or Lauralee Matthews (872-6791) of this firm.

Respectfully submitted,

(

Paul S. Berger
Attorney for
Victor Palmieri and Company
Incorporated

Enclosures

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August 3, 1977

Advisory Opinion
Office of Regulatory Standards
and Exceptions
U.S. Department of Labor
Washington, D.C. 20216

Commissioner of Internal Revenue
Attention: E:EP:T
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Request for Advisory Opinion and Ruling
Submitted by The Equitable Life Assurance
Society of the United States and Victor
Palmieri and Company Incorporated --
Indemnification Provisions

Gentlemen:

Enclosed is a request for an advisory opinion or ruling that the indemnification provisions of certain contracts dated June 30, 1977 between The Equitable Life Assurance Society of the United States ("Equitable"), Victor Palmieri and Company Incorporated ("VPCO") and the Central States, Southeast and Southwest Areas Pension Fund ("Fund") are not contrary to the provisions of section 410 of the Employee Retirement Income Security Act of 1974 ("ERISA"), and that payment under such provisions is exempt from ERISA section 406 and section 4975(c) of the Internal Revenue Code ("Code") by virtue of ERISA section 408(c)(2) and Code section 4975(d)(10), and is not violative of ERISA section 404(a).

This request is part of the series of ruling, advisory opinion and exemption requests that VPCO and Equitable are

August 3, 1977

Page Two

submitting in connection with the new arrangements for independent management of the assets of the Fund. These new arrangements, which are generally believed to be an integral part of the government's efforts to reform the management of the Fund's assets, are scheduled to go into effect on September 1, 1977. Accordingly, it is absolutely essential that favorable action be taken on this request by that date. In order to expedite the processing of this request, we are prepared to meet with representatives of the agencies at any time to discuss it and to cooperate with and assist the agencies to the fullest extent possible.

If there are any questions with respect to the enclosed request, please contact the undersigned or Lawrence J. Haas of this firm.

Respectfully submitted,

Theodore R. Groom
Attorney for
The Equitable Life Assurance Society
of the United States

Enclosures

Request for Advisory Opinion and Ruling
Submitted by
The Equitable Life Assurance Society of the
United States and Victor Palmieri and Company
Incorporated -- Indemnification Provisions --

It is respectfully requested that the Department of Labor and the Internal Revenue Service issue an advisory opinion or ruling that (1) the indemnification provisions of certain contracts dated June 30, 1977 between The Equitable Life Assurance Society of the United States ("Equitable"), Victor Palmieri and Company Incorporated ("VPCO") and the Central States, Southeast and Southwest Areas Pension Fund ("Fund") are not contrary to the provisions of section 410 of the Employee Retirement Income Security Act of 1974 ("ERISA"); (2) that payment under such provisions is exempt from the prohibited transaction restrictions and excise taxes of ERISA section 406 and section 4975(c) of the Internal Revenue Code of 1954 ("Code") by virtue of ERISA section 408(c)(2) and Code section 4975(d)(10); and (3) that payments made under the indemnification provisions would not be violative of ERISA section 404(a). This request

is submitted on behalf of Equitable and VPCO pursuant to ERISA Procedure 76-1 (41 F.R. 36281, August 27, 1976) and Treasury Regulation section 601.201.

Effective on the closing date of agreements hereinafter described, Equitable will be the named fiduciary of the Fund with specified overall responsibilities for investment of the assets of the Fund. Equitable, VPCO and other organizations will be the investment managers for specific blocks of Fund assets with responsibility for the daily investment management decisions relating thereto. In order for the new fiduciaries to properly undertake these functions and to achieve the best investment results consistent with prudent management, it is necessary to obtain certain exemptions from, and interpretations with respect to, provisions of ERISA and the Code.

In this connection we describe and identify

- (a) the general structure of the Central States Plan;
- (b) the general background of the contractual arrangements -- i.e., those events and circumstances

leading to the appointment of Equitable as named fiduciary and to the appointment of Equitable, VPCO and other independent organizations as investment managers; (c) Equitable, VPCO, and those other organizations designated as investment managers of Fund assets and their agreements with the Fund; and (d) the specific transactions here involved.

(a) The Central States, Southeast and
Southwest Areas Pension Fund

The Central States, Southeast and Southwest Areas Pension Fund is an employee pension benefit plan established and maintained pursuant to collective bargaining agreements between employers and certain affiliated unions of the International Brotherhood of Teamsters.*/ It was originally established in 1955 by trust agreement, amended from time to time thereafter, by and between Central Conference of Teamsters, Central States Drivers Council, Southern Conference of Teamsters,

*/ The Fund's Employer I.D. No. is 36-6044243; its Fiduciary No. is 36-6514764.

and their affiliated local unions, and the Southeastern Area Motor Carriers Labor Relations Association; Southwest Operators Association; National Automobile Transporters Labor Council; Motor Carriers Employers Conference -- Central States; Cartage Employers Management Associations; Cleveland Draymen Association, Inc., and Northern Ohio Motor Truck Association, Inc.*/ In accordance with Section 302(c)(5) of the Labor Management Relations Act, 1947 (29 U.S.C. § 186(c)(5)), the Fund is jointly administered by ten trustees, consisting of an equal number of employee and employer representatives. Until now, the Trustees have had exclusive authority and responsibility for the management of the Fund's assets.

More than 16,000 employers make contributions to the plan pursuant to approximately 30,000 separate collective bargaining agreements involving over 300

*/ Central States, Southeast and Southwest Areas Pension Plan, Effective January 1, 1976, Art. I. Sec. 2.

local union organizations.* / For the Fund's plan year ending January 31, 1976, the Fund received in excess of \$300 million in employer contributions. The number of active and retired participants of the Fund as of January 31, 1976, was estimated to be in excess of 450,000, and for the plan year ending on that date, the Fund paid benefits in excess of \$210 million.

The Fund generally covers Teamster employment in 33 states located, as the name of the plan indicates, in the Central, Southeast and Southwest areas of the United States. As of January 31, 1976, the book value of all assets of the Fund was stated to be \$1,438,230,551.** / The Fund is believed to be the second

*/ We understand that negotiations between the Teamsters and employer associations which result in the National Master Freight Agreement effectively establish or set the pattern for the applicable contribution rate in most cases.

**/ The information in the noted and immediately preceding paragraph is extracted from the Annual Report (Form 5500) of the Central States Plan filed by the Plan Administrator with the Internal Revenue Service and Department of Labor.

largest multiemployer plan in the United States today.

(b) Background of the Contractual Arrangements

The Teamsters Central States Fund has been the subject of investigation by the Labor Department, the Justice Department, the Internal Revenue Service, the Securities and Exchange Commission and other government agencies for a period of years. It has also been the subject of numerous Congressional inquiries and hearings. In published statements of government agencies, Congressional Committees, and the Fund's staff, and in other publicly-available information, there has been widespread criticism and allegation of civil and criminal abuse in connection with the management of the Fund's assets.

During the last year, the following governmental actions, among others, have been announced:

By letter dated June 25, 1976, the District Director of the Internal Revenue Service for Chicago revoked the Fund's tax exempt status.

Between the date of the initial revocation letter and March 14, 1977, the Internal Revenue Service delayed the application of the revocation four times while government attorneys and attorneys for the Fund engaged in a series of negotiations on problem areas.*/

On March 14, 1977, IRS and DOL issued a joint release (USDL 77-232, IR-1775) announcing the resolution of certain issues respecting asset management of the Fund "in a manner that meets the government's objectives." Among other matters the release stated:

The trustees of the fund have resolved to delegate to one or more investment managers (as defined in section 3(38) of ERISA) the control of all investments of the fund.

Based on this and other matters announced, and subject to the engagement of professional investment managers and other conditions, IRS said that it would

*/ See IR-1637 (July 8, 1976); IR-1664 (August 30, 1976); IR-1699 (November 26, 1976); IR-1763 (February 25, 1977). See also statement of Daniel Shannon, Executive Director, Central States Pension Fund, Before the House Ways and Means Oversight Subcommittee committee (March 21, 1977).

issue a determination letter requalifying the Fund and DOL said that it would terminate that portion of its investigation relating to procedures of the Fund respecting asset management.

Subsequently, on April 26, 1977, the IRS issued a determination letter announcing the qualification of the Plan and Fund for tax years beginning after December 31, 1976. This determination letter was subject to a number of conditions which included the following:

8. The Trustees placing all Fund assets and receipts, including funds derived from liquidation of existing investments (except funds reasonably retained by the Fund for (a) payment of plan benefits and (b) payment of administrative expenses), under direct continuing control of independent professional investment managers as defined by Section 3(38) of ERISA. The Trustees will adopt appropriate amendments to the trust agreement to accomplish this condition and will expeditiously transfer the assets to the investment managers. Recognizing the complexities of the large investment portfolio, the completion data for accomplishing delivery of the investment assets will be no later than December 31, 1977. However, the securities-related assets and the majority of

the real estate-related assets will be made available to the investment managers for inspection, documentation and evaluation no later than June 30, 1977.

During this same period of time, representatives of the Fund were actively discussing arrangements with potential investment managers including Equitable and VPCO and on Friday, June 17, 1977, the trustees of the Fund announced their decisions to select Equitable as managing fiduciary with primary responsibility for the investment and management of all fund assets and to select Equitable, VPCO and others as investment managers.*/
The contractual arrangements, described in greater detail in the following paragraphs, were executed by the Trustees on July 7, 1977, effective as of June 30, 1977.

*/ Initially the Fund undertook negotiations with Crocker National Corporation, or an affiliate thereof, to be overall fiduciary of the Fund; when these negotiations could not be completed to the satisfaction of both parties, the negotiations with Equitable commenced.

The selection of independent investment managers for the Fund was clearly regarded by the government as a crucial objective of governmental demands upon representatives of the Fund. This fact was attested to in testimony of Secretary of Labor Marshall before a subcommittee of the Senate Committee on Government Operations on July 18, 1977, in which he indicated that the "primary goal had to be the preservation of the Fund assets," and in which he also stated:

"In many ways, the second objective (that day-to-day asset management be taken out of the hands of the Fund's trustees) was the most important. It was imperative that those who contributed to the Fund should not see their assets dwindle because of mismanagement.

* * *

At a meeting on March 11, the trustees decided to comply with the Government's demand. On March 12, we met with their representatives. On March 14, the Labor Department and the IRS issued identical news releases announcing the terms of an agreement. The critical points were as follows: (1) that the trustees would reach agreement in principle as soon as possible with one or more independent investment managers.

* * *

We believe that the contractual structure [between the Fund and Equitable, VPCO and other independent managers] provides a sound basis for proper future management of the Central States Fund's giant portfolio. It removes entirely asset management control from the trustees, yet retains their authority and power to monitor performance. It provides sufficient security for the independent professional fiduciary and the investment managers to insure that they cannot be dismissed at the whim of the trustees, yet permits the trustees to dismiss them for cause. It leaves the affairs of a private sector fund in private sector hands, yet provides for lawfully authorized government assistance. It also contains a triggering device to insure government oversight in the event the trustees, Equitable or the investment managers need advice or help in matters relating to Fund management. And it contains great promise of ending, once and for all, the years of suspicion, allegations and demonstrable wrongdoing that have surrounded asset management of the Fund and the people associated with it."

- (c) Description of Equitable, the Investment Managers, and the Contractual Arrangements With the Fund for the Management of Assets.

The Equitable Life Assurance Society of the United States ("Equitable") is a mutual life insurance

company whose principal office is located at 1285 Avenue of the Americas, New York, New York 10019. Its Employer I.D. No. is 13-5570651. It is a New York corporation subject to the insurance laws of New York, and it is registered as an investment adviser under the Investment Advisers Act of 1940. Equitable is the third largest life insurance company in the United States; as of December 31, 1976, its assets were a total of \$22,430,472,618. Prior to its execution of the June 30, 1977 contracts, with a minor exception described below, it had no affiliation or relationship with the Central States Fund.*'

Victor Palmieri and Company Incorporated ("VPCO") is a corporation which has provided executive management services to various businesses and whose application for registration as an investment advisor under the

*' The minor exception involves a ground lease between the Fund and Equitable which arose because of a mortgage foreclosure between Equitable and an unrelated third party.

Investment Advisers Act of 1940 is currently pending. It is presently managing assets and operating companies valued at more than \$1,500,000,000, including all the non-rail assets and operating companies of the Penn Central Transportation Company and those of Levitt and Sons, Inc. It has a principal office at 2021 K Street, N.W., Washington, D.C. 20036; its Employer I.D. No. is 95-2644662. It has had no prior affiliation with the Fund.

Lazard Freres and Co. ("Lazard") is an investment banking firm registered as an investment advisor under the Investment Advisers Act of 1940 with its principal office located at One Rockefeller Plaza, New York, New York 10020.

Mercantile National Bank at Dallas ("Mercantile") is a national banking association which is a wholly-owned subsidiary of Mercantile Texas Corporation. Its address is P. O. Box 5415, Dallas, Texas 75222.

Crocker Investment Management Corp. ("CIMCO") is a corporation registered as an investment adviser under the Investment Advisers Act of 1940 and is a wholly-owned subsidiary of Crocker National Corporation, and its principal office is located in San Francisco, California.

In order to carry out that part of their agreement with the Department and the Service of March 14, 1977, and the condition of the Fund's requalification letter requiring independent investment managers for the assets of the Fund, the Trustees of the Fund have entered into a series of agreements dated June 30, 1977 with Equitable, VPCO, Lazard, Mercantile, and CIMCO.*/

*/ It might be noted that the Labor Department had an interest in the quality of the investment managers chosen. In the Senate testimony cited at page 10, Secretary Marshall set forth several criteria which the government required be met in the contractual arrangement divesting the Trustees of management responsibility. He stated one criterion as follows: "The arrangement also had to involve managers who were competent and who could withstand public scrutiny." Later in the same prepared statement, Secretary Marshall listed the investment managers which have been appointed, and stated, "These institutions and their management assignments were fully satisfactory to the Labor Department."

These agreements (attached as Exhibits A through G) establish the following arrangements for the management of the assets of the Fund:

The securities-related assets of the Fund (corporate stocks and debt securities, U.S. government securities, etc.) will be allocated for investment management initially to four investment managers: Equitable, Lazard, Mercantile and CIMCO. Each investment manager will be allocated 25 percent of the total market value of the securities-related assets.

The real estate-related assets of the Fund (mortgages and properties), which comprise approximately 70 percent of the value of the assets of the Fund, will be allocated to Equitable and VPCO for investment management. Equitable will generally be responsible for the management of the assets located east of the Mississippi River (approximately one-third of the total value of the real estate-related assets), and VPCO will manage the assets located west of the Mississippi River (the remaining two-thirds of the Fund's real estate-related assets). VPCO will also be responsible for

preparing a study evaluating the Fund's asset management staff.

Equitable will also assume the role of Fiduciary for the Fund, which will require Equitable to fulfill a number of functions in addition to serving as investment manager. Equitable will have exclusive authority and responsibility to monitor the performance of the other securities investment managers, to appoint and remove any or all of such managers, and to increase or decrease the portion of the securities-related assets allocated to such managers. Equitable cannot, however, allocate assets to itself for management if such allocation would increase the percentage of the securities-related assets under its management to above 25 percent. Equitable also cannot decrease its allocation below 25 percent. Further, when additional funds become available for investment in securities-related assets, it is Equitable's responsibility to allocate such additional assets to investment managers. Under the agreement, however, Equitable will receive one-fourth of such additional funds as may become

available for new investment in securities-related assets.

Equitable, together with the Trustees, is also responsible for monitoring VPCO's real estate investment management performance. However, within the initial five-year period of the investment management arrangements, VPCO can only be removed (by the Trustees) for cause and with the approval of the Secretary of Labor.

The investment objectives and policies to be followed by all of the Fund's investment managers are to be developed by Equitable. Equitable can also give specific guidelines to any of the securities investment managers with respect to the management of a particular portion of the Fund's assets.

While the other investment managers will be subject, for the most part, to Equitable's oversight, Equitable's performance as fiduciary and investment manager will be monitored by the Trustees. As in the

case of VPCO, however, Equitable can be removed by the Trustees within the initial five-year period of the new arrangements, only for cause and with the approval of the Secretary of Labor.

At the present time, it is uncertain whether there will be any other Fund assets besides securities-related or real estate-related assets when Equitable and the other investment managers assume their responsibilities for the Fund. If there are "other assets" at that time, Equitable is empowered to appoint an investment manager (including itself) to manage such assets. In such a case, it is Equitable's intention to either appoint someone other than Equitable to manage the assets, manage the assets itself at no charge to the Fund, or manage the assets itself for compensation upon the approval of the Fund's Trustees.

These investment management arrangements encompass all of the assets of the Fund, except those assets held in the Fund's Benefits and Administration Account. The assets held in the Benefits and

Administration Account are those which, in the determination of the Trustees, are needed by the Fund for payment of pension benefits, Fund administrative expenses, and an appropriate reserve therefor. The Benefits and Administration Account is managed by the Executive Director of the Fund under the supervision of the Trustees. Under the agreements, neither Equitable nor any of the investment managers have any responsibility with respect to the assets held in the Account.*/

These investment management arrangements are scheduled to go into effect on the Closing Date of the agreements, September 1, 1977. This date can be extended by Equitable or VPCO if either determines that it has not received all necessary rulings, exemptions and opinions of governmental authorities. However, if the Closing Date does not occur on or before November 1,

*/ Subsequent references in this submission to asset managers, investment managers, independent investment managers, etc. are not intended to include the manager of the Benefits and Administration Account.

1977, the Trustees of the Fund can elect to rescind the agreements.

Equitable and VPCO believe that the granting of the determinations requested herein and in separate submissions are essential if Equitable and VPCO are to assume their responsibilities for the Fund.

(d) Specific Transaction Involved

Article XI of the Master Agreement (Exhibit A) between Equitable, VPCO and the Fund provides the following indemnification provisions:

"To the fullest extent permitted by law, the Trustees acting on behalf of the Fund agree to indemnify and hold harmless Equitable, each investment manager and the custodian (severally sometimes referred to hereinafter as a person or such person) from and against any losses, claims, damages or liabilities, joint or several, to which such person may be subject insofar as such losses, claims, damages or liabilities or actions in respect thereof arise by virtue of this Agreement, or the fiduciary duties and responsibilities undertaken pursuant to this Agreement, and will reimburse each such person for any legal or other

expenses reasonably incurred by such person in connection with investigating, defending or preparing to defend any such loss, claim, damage, liability or action; provided, however, that the Fund shall not be liable in any such case to the extent that in the final judgment of a court of competent jurisdiction such person is found to have breached this Agreement or breached any duties or responsibilities undertaken pursuant to this Agreement. Expenses incurred in defending a civil or criminal action, suit or proceeding, if requested by such person, shall be paid by the Trustees in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by such person to repay such amount plus reasonable interest in the event that in the final judgment of a court of competent jurisdiction such person is found to have breached this Agreement or any duties or responsibilities undertaken pursuant to this Agreement, and proof satisfactory to the Trustees that such person is financially capable of repaying such amount in the event it is found liable for the amount alleged as damages in the action."

Similar provisions are contained in the Investment Management Agreements. See, e.g., Article XI of the Investment Management Agreements for Real Estate-Related Assets, (Exhibit B and C.)

ERISA Section 410*

ERISA section 410(a) provides that, with limited exception,

"any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part [i.e., Part 4 ('Fiduciary Responsibility') of Title I of ERISA] shall be void as against public policy."

The statutory provision cited above is meant to prevent plan fiduciaries from avoiding the duties and responsibilities imposed by ERISA by avoiding the consequences of breaching such duties and responsibilities. If plans were permitted to make good the personal fiduciary liabilities imposed by ERISA for such breaches, imposition of personal liability

*/ The indemnification provisions in question also apply to litigation not alleging or involving a breach of fiduciary duties. Since ERISA section 410 has applicability only in fiduciary breach contexts, situations not involving a fiduciary breach are not discussed in this section of the memorandum.

on fiduciaries would have little deterrent effect with respect to the commission of such breaches. Moreover, an arrangement such as that described in the preceeding sentence would prevent a plan from making itself whole for losses suffered as a result of a fiduciary's breach. An obligation of a fiduciary to make good plan losses is of no benefit to a plan which has an obligation to make good the fiduciary's resulting losses.

As the Labor Department has itself made clear, however, ERISA section 410 does not operate to void all indemnification agreements:

"The Department of Labor interprets this section to permit indemnification agreements which do not relieve a fiduciary of responsibility or liability under Part 4 of Title I." 29 C.F.R. 2509.75-4.

The indemnification provisions in question here do not purport to relieve Equitable or VPCO of responsibility or liability under Part 4 of Title I, and thus are proper and valid under the Labor Department interpretation cited above. The June 30 contracts specifically state

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that the Fund shall not be liable where a court's final judgment determines that there has been a breach of the contract or of any "responsibilities undertaken pursuant to" the contract. A breach of a fiduciary duty imposed by Part 4, Title I of ERISA would not be indemnifiable under Article XI of the Master Agreement and Article IX of the Investment Management Agreements for Real Estate - Related Assets. Where a final judgment determines a breach of contract responsibilities, not only is the Fund not liable for reimbursing the fiduciary, but the fiduciary must repay with interest any payments or reimbursements previously made by the Fund in connection with such litigation.

As stated earlier, representatives of the government have indicated that putting the responsibility for management of Fund assets into the hands of independent, professional managers was the central goal in negotiations leading to the requalification of the plan by the Internal Revenue Service and the decision

by the Labor Department not to bring suit to force the removal of certain Trustees.

Because of the unique history of the Fund, however, it would not have been possible to retain highly-qualified, independent, professional managers without indemnification provisions similar to those contained in the June 30 contracts. The Fund and its Trustees have been the subjects of intensive government investigations and numerous lawsuits. There are various lawsuits currently pending which relate to Fund assets and are in various stages of litigation. Notwithstanding the fact that Equitable and VPCO are stable, independent entities with outstanding records of managing assets similar to those owned by the Fund, the history of litigation surrounding the Fund indicates that Equitable and VPCO may well be drawn into litigation concerning Fund assets at some time in the future. Such litigation could involve a number of lawsuits and considerable expenditure. As the Labor Department undoubtedly realized at the time the original contracts in this

matter were drafted,*[/] the indemnification provisions contained in these contracts are essential if Equitable and VPCO are to assume their responsibilities for the Fund.

Law in several closely analogous areas indicates the general propriety of indemnification provisions such as those at issue here. Many states, for example, have corporation statutes regulating indemnification arrangements between corporations and corporate officers. The language of the indemnification provisions in issue here closely parallels the language permitted by these statutes. The Delaware statute, for example, permits indemnification against expenses incurred in connection with the defense or settlement of threatened, pending or completed litigation, where such litigation would be brought "by or in the right of the corporation." Del. Code tit. 8, § 145(b). The policy considerations

*[/] See the discussion earlier of the Labor Department's role in overseeing formulation of the contractual arrangements between the Fund and Equitable, VPCO, the other managers, and the custodian.

involved where a corporation indemnifies a corporate officer for expenses incurred in defending a derivative suit are quite similar to those involved where a pension plan indemnifies a fiduciary for expenses incurred in defending an action alleging a breach of fiduciary duty. Presumably, the rationale for allowing such indemnification in the corporate context is that, in the absence of a judicial finding of culpability, an innocent officer should not have to bear what may be substantial litigation expenses every time an allegation is made about the performance of his duties. The same reasoning applies to the present indemnification arrangements involving Equitable, VPCO and the Fund.

As in the contracts between Equitable, VPCO and the Fund, state corporation statutes often disallow indemnification where there is a judicial finding of a breach of duty by the corporate officer. The Delaware statute states:

" . . . no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable for

negligence or misconduct in the
performance of his duty to the
corporation,"*/

Similarly, the contracts between Equitable, VPCO and the Fund provide that the Fund shall not be liable where the fiduciary is found by court judgment to have breached the contract or any duties or responsibilities undertaken pursuant to the contract. To the extent there is any such judicial finding where the Fund has already paid expenses, the fiduciary would be required to reimburse the Fund in the amount of such payments together with "reasonable interest." Moreover, no payments by the Fund in advance of a judicial determination are permitted unless the fiduciary submits satisfactory proof that it is financially capable of making any reimbursement ultimately required.

A related but somewhat different question is

*/ Del. Code tit. 8, § 145(b). This section does allow indemnification even after a judgment adverse to the officer where the court itself deems such indemnification proper. Id.

posed with respect to amounts paid in settlement of pending or threatened litigation involving allegations of a breach of fiduciary duty. An investment manager could well find itself, for example, as the defendant in a clearly spurious lawsuit alleging a breach of fiduciary duty. The litigation expenses in defending such a suit to judgment could be substantial, say \$100,000, but because of the weakness of the plaintiff's case, it might be possible to settle the suit for \$25,000. If instead of being settled, the litigation proceeds to a judgment which exonerates the fiduciary, the Fund would be liable for the fiduciary's expenses of \$100,000. (If the Fund had been paying these expenses currently, there would be no obligation on the fiduciary to repay the Fund.) In these circumstances, the Fund's liability would be \$100,000 instead of the \$25,000 it could have settled for at an earlier date.*

*/ Sections 17(h) and (i) of the Investment Company Act of 1940 also impose limitations on the type of indemnification of investment advisers, officers and directors permitted with respect to registered investment companies. Guidelines issued by the Securities and Exchange Commission state the following with respect to indemnification in settlement contexts:

In cases such as that described above, it is clearly in the interest of the participants and beneficiaries of the Fund to have the litigation settled rather than carried through to judgment.*/ It may be

[Footnote continued]

" . . . It is the staff's position that in order to comply with Section 17(h), any indemnification provision must provide that if there is neither a court determination on the merits that the defendant is not liable nor a court determination that the defendant was not guilty of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office, no indemnification will be permitted unless an independent legal counsel (not including a counsel who does work for either the investment company, its adviser or principal underwriter, or persons affiliated with these persons) determines, based on a review of the facts, that the persons in question was [sic] not guilty of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office." SEC Release No. 7221, BNA Sec. L. Rep. F-1, et sec. (June 14, 1972).

*/ In this connection, the S.E.C Guidelines in the previous footnote cite 7 SEC Annual Report 16 (1942) where the Commission stated:

argued, however, that any reimbursement by the Fund of amounts paid in settlement of pending or threatened litigation alleging a breach of fiduciary duty would not be permitted under section 410 and other provisions of ERISA. If this interpretation were adopted here, plan fiduciaries would be extremely reluctant to settle any such litigation. If the claims were clearly spurious, the fiduciary would obviously prefer to be exonerated by a final judgment, since the Fund would then be liable for the fiduciary's expenses.

Statutory considerations aside, the practical problem with allowing reimbursement for amounts paid in settlement is illustrated most easily by the cases at the other end of the factual continuum, i.e., those

[Footnote continued]

"Where suits are settled, indemnity may be offered only where the reasonable expenses of prosecuting a case to judgment could exceed the amount paid in settlement. Without such limitations, the officers and directors of investment companies would be in a position to shift from themselves to the security holders whose investments had been impaired the liability for any loss caused by their misconduct."

where the claims of a breach of fiduciary duty are clearly meritorious. Any interpretation which would allow reimbursement of amounts paid in settlement here, say for 90 cents on a dollar, would create a giant loophole in ERISA section 410.

From a statutory point of view, an agreement permitting indemnification in the first instance discussed above (where the claim was clearly spurious) would not be void because of ERISA section 410. The indemnification would not be on account of the breach of any fiduciary duty imposed by ERISA. In the second instance (involving a clearly meritorious claim), an agreement allowing indemnification would most likely be void by operation of law.^{*/} As with nearly every continuum, the cases at either end are easily distinguishable, but it is difficult to visualize any "bright line" distinguishing cases that lie in gray areas of the continuum.

^{*/} Not only would ERISA section 410 be applicable here, but ERISA section 404(a) would likely render payment in such circumstances a breach of fiduciary duty.

In order to resolve the dilemma outlined above, Equitable and VPCO hereby represent that they will neither request nor accept indemnification for amounts paid in settlement of claims alleging a breach of fiduciary duty without Labor Department approval of such settlement and reimbursement. This procedure should effectively insure that amounts paid, directly or indirectly, by the Fund in settlement of claims alleging fiduciary breaches are paid in the interests of plan participants and beneficiaries, and do not serve to relieve a fiduciary from liabilities or responsibilities imposed by ERISA.

ERISA Section 404(a)

Section 404(a) states that

"a fiduciary shall discharge his duties . . . solely in the interest of the participants and beneficiaries and . . . for the exclusive purpose of providing benefits . . . and defraying reasonable expenses of administering the plan. . . ." (Emphasis added.)

In our view, payments by the Fund pursuant to the indemnification provisions described above are "reasonable expenses of administering the plan." As indicated earlier, there is at present a good deal of litigation involving Fund assets. The unique history of this plan is strongly suggestive that litigation will continue. Defending such litigation (even in an individual fiduciary capacity where there is no ultimate determination of a fiduciary breach) is part of a Fund fiduciary's task, and the payment of litigation expenses in this circumstance is consequently a "reasonable expense of administering the plan." It is important here to note again that where there is a judicial determination of a breach of fiduciary duty, the Fund would not be liable for the litigation-related expenses of such a fiduciary, and the fiduciary would have to repay with interest any amounts already paid.

For the reasons stated in both the preceding section of this memorandum and in the preceding paragraph, we submit that payments or reimbursements

by the Fund, such as those described in the preceding section, are not prohibited by ERISA section 404(a).

ERISA Section 408(c)(2); Code Section 4975(d)(10)

ERISA Section 408(c)(2) provides in part:

"Nothing in section 406 shall be construed to prohibit any fiduciary from receiving . . . reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan. . . ."

The language of section 4975(d)(10) of the Internal Revenue Code ("Code") is nearly identical. In our view, reimbursements such as those referred to in the preceding sections of this memorandum are clearly covered by the language of ERISA section 408(c)(2) (and Code section 4975(d)(10)) quoted above. For the reasons put forth in such preceding sections, expenses incurred by a fiduciary, in the absence of a breach of his fiduciary duty, are expenses properly incurred in the performance of the fiduciary's duties with the plan.

Conclusion

Based on the facts and circumstances described above, it is requested that the Department and the Service issue an advisory opinion or ruling that the indemnification provisions in question are valid and are consistent with ERISA section 410, and that payments or reimbursements of a fiduciary by the Fund pursuant to such indemnification provisions is exempt, by virtue of ERISA section 408(c)(2) and Code section 4975(d)(10), from the prohibitions of ERISA section 406 and Code section 4975(c), and is not violative of ERISA section 404(a).

To the best knowledge of Equitable and VPCO, the requests set forth herein are not currently being considered by any field office of the Service in connection with an active examination or audit of a tax return of either Equitable or VPCO. If it is contemplated that the agencies will not issue the requested advisory opinion or ruling, a conference is hereby requested. If any further information is required

by the agencies in connection with this request, please contact one or both of the undersigned.

Sincerely,

Theodore R. Groom
Attorney for
The Equitable Life
Assurance Society
of the United States

Paul S. Berger
Attorney for
Victor Palmieri and Company
Incorporated

Enclosures: Exhibits A-G -- Agreements dated June 30, 1977
Exhibit H -- Statement required by
26 C.F.R. § 601.201(e) (1)
Exhibit I -- Statement required by
26 C.F.R. § 601.201(e) (5)
Exhibit J -- Power of Attorney

Response of the Director,
Office of Regulatory Standards
and Exceptions

8 Sep

1977

Based on the facts and representations stated in the foregoing letter and the exhibits attached thereto, and more particularly the facts and representations contained on pages 20 through 35 of your letter, and without necessarily agreeing

with the legal analysis set forth therein, it is the opinion of the Department of Labor (the Department) that (1) the indemnification provisions in question do not contravene the provisions of section 410(a) of the Employee Retirement Income Security Act of 1974 (ERISA), (2) payment by the Central States, Southeast and Southwest Areas Pension Fund (the Fund) pursuant to the indemnification provisions in settlement of pending or threatened litigation will not contravene the provisions of section 410(a) of ERISA if the Fund obtains a written opinion of independent legal counsel (not including a counsel who does work for The Equitable Life Assurance Society of the United States, Victor Palmieri and Company Incorporated, any other Fund investment manager, or the Fund) that, based on a review of the relevant facts, the acts of the fiduciary in question do not constitute a breach of a fiduciary obligation by such fiduciary, (3) reimbursement or payment by the Fund pursuant to the indemnification provisions of expenses properly and actually incurred (including reimbursement or payment of expenses properly and actually incurred in settlement of pending or threatened litigation) is not a prohibited transaction under section 406(a)(1)(B) and (D) of ERISA to the extent the reimbursement or payment does not exceed amounts allowed under section 408(c)(2) thereof, and (4) reimbursement or payment by the Fund pursuant to the indemnification provisions would

not be violative of section 404(a) of ERISA if, under the facts and circumstances of a particular case, the making of such payment would be a reasonable expense of administering the Fund and would be consistent with the other fiduciary duties contained in section 404(a).

Section 406(a)(1)(B) of ERISA prohibits any direct or indirect lending of money or other extension of credit between a plan and a party in interest and section 406(a)(1)(D) prohibits the transfer to, or use by or for the benefit of, a party in interest of any assets of a plan. Section 3(14)(A) defines the term party in interest to include a fiduciary. Accordingly, the extension of credit by a plan to a fiduciary, or the transfer of plan assets to a fiduciary, or the use of such assets by or for the benefit of a fiduciary, are prohibited transactions under section 406(a).

Section 408(c)(2) of ERISA and regulations thereunder (29 CFR 2550.408c-2) provide, in pertinent part, that nothing in section 406 shall be construed to prohibit any fiduciary from receiving advances for, reasonable compensation for, or reimbursement of expenses properly and actually incurred in the performance of his duties with the plan, provided that the provisions of 29 CFR 2550.408c-2 are satisfied.

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We have conferred with representatives of the Internal Revenue Service (the Service) and they have advised us that the Service concurs with the interpretation contained in this response insofar as it relates to sections 4975(c)(1)(B) and (D) and 4975(d)(10) of the Internal Revenue Code of 1954 and 26 CFR 54.4975-6 thereunder.

Fred W. Stuckwisch
Director, Office of Regulatory
Standards and Exceptions