

U.S. DEPARTMENT OF LABOR
Pension and Welfare Benefit Programs
Washington, D.C. 20216



OCT 3 1977

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

OPINION 77-79/80 A

404 (a) (1)
409 (b)

Dear Mr. Berger:

In response to your letter of September 21, 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 or summarize the facts you have set forth in your letter.

In future correspondence please refer to our Reference No. C-3589A.

Sincerely,

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

U.S. DEPARTMENT OF LABOR
Pension and Welfare Benefit Programs
Washington, D.C. 20216



OCT 3 1977

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

OPINION 77-79/80 A

404(a)(1)
409(b)

Dear Mr. Groom:

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Sincerely,

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Director, Office of Regulatory
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PAUL S. BERGER

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DIRECT LINE (202) 872-6784

September 21, 1977

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

Re: Request for Advisory Opinion Submitted
by Victor Palmieri and Company Incorporated and The Equitable Life Assurance
Society of the United States -- Co-
Fiduciary Liability for "Prior" Breaches

Gentlemen:

Enclosed is a request for an advisory opinion with respect to the obligations of The Equitable Life Assurance Society of the United States ("Equitable"), as the managing fiduciary and an investment manager of the Central States, Southeast and Southwest Areas Pension Fund ("Fund"), and Victor Palmieri and Company Incorporated ("VPCO"), as an investment manager of the Fund, under Sections 404(a)(1) and 405(a) of the Employee Retirement Income Security Act of 1974 ("ERISA"). The Advisory Opinion is requested on obligations of VPCO or Equitable when it comes into knowledge of events, circumstances or transactions occurring or commencing prior to the time that VPCO or Equitable became fiduciaries of the Fund. Specifically, VPCO and Equitable request an opinion that they will fully satisfy their responsibilities and duties under ERISA Section 404(a)(1) or 405(a), with respect to breaches of fiduciary responsibilities by other Fund fiduciaries occurring or commencing prior to the time that Equitable and VPCO

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Office of Regulatory Standards
and Exceptions, DOL
September 21, 1977
Page 2

become Fund fiduciaries, if, in accordance with their June 30, 1977 agreements with the Fund they keep their records open for inspection by representatives of the Labor and Treasury Departments; if they provide materials to the Fund Trustees in connection with the Trustees' legal audit of Fund transactions, also in accordance with the June 30, 1977 agreements; and if they respond to questions put to them by government representatives from time to time.

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 arrangements, which are an integral part of the Labor Department's efforts to safeguard the Fund's assets for the payment of pension benefits are scheduled to go into effect on October 3, 1977, but will be delayed if the issues raised in this and the other requests are not resolved by October 3, 1977.

Accordingly, we are prepared to meet with the Labor Department with respect to this request, and to cooperate and assist the Department to the fullest extent possible to expedite the resolution of this matter.

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,

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—
Paul S. Berger
Attorney for Victor Palmieri
and Company Incorporated

Enclosures

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September 21, 1977

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

Re: Request for Advisory Opinion Submitted
by The Equitable Life Assurance Society
of the United States and Victor Palmieri
and Company Incorporated -- Co-Fiduciary
Liabilitv for "Prior" Breaches

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September 21, 1977

Page Two

fiduciaries, if, in accordance with their June 30, 1977 agreements with the Fund they keep their records open for inspection by representatives of the Labor and Treasury Departments; if they provide materials to the Fund Trustees in connection with the Trustees' legal audit of Fund transactions, also in accordance with the June 30, 1977 agreements; and if they respond to questions put to them by government representatives from time to time.

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Accordingly, we are prepared to meet with the Labor Department with respect to this request, and to cooperate and assist the Department to the fullest extent possible to expedite the resolution of this matter.

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

Respectfully submitted,

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

Enclosures

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Request for Advisory Opinion
Submitted by
The Equitable Life Assurance Society of the United States
and Victor Palmieri and Company Incorporated
Cofiduciary Liability for "Prior" Breaches

It is respectfully requested that the Department of Labor issue an advisory opinion under sections 404(a)(1) and 405(a) of the Employee Retirement Income Security Act of 1974 ("ERISA") with respect to the obligations of The Equitable Life Assurance Society of the United States ("Equitable") and Victor Palmieri and Company Incorporated ("VPCO") when, in connection with services performed pursuant to their contracts with the Central States, Southeast and Southwest Areas Pension Fund ("Fund"), Equitable or VPCO comes into knowledge of events, circumstances, or transactions occurring or commencing prior to the time that Equitable and VPCO become fiduciaries of the Fund. Specifically, Equitable and VPCO request an opinion that they will fully satisfy their responsibilities and duties under ERISA sections 404(a)(1) or 405(a), with respect to breaches of fiduciary responsibility by other Fund fiduciaries occurring or commencing prior to the time that Equitable and VPCO become Fund fiduciaries, if, in accordance with their

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June 30, 1977 agreements with the Fund, they keep their records open for inspection by representatives of the Labor and Treasury Departments, if they provide materials to the Fund Trustees in connection with the Trustees' legal audit of Fund transactions, also in accordance with the June 30, 1977 agreements, and if they respond to questions put to them by government representatives from time to time. This request is submitted on behalf of Equitable and VPCO pursuant to ERISA Procedure 76-1 (41 F.R. 36281, August 27, 1976).

Effective on the closing date of agreements hereinafter described, The Equitable Life Assurance Society of the United States ("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,

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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, VPCO, and other independent organizations as investment managers; (c) Equitable, VPCO, 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.^{1/} 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, 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.^{2/} 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.

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

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

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More than 16,000 employers make contributions to the plan pursuant to approximately 30,000 separate collective bargaining agreements involving over 300 local union organizations.^{3/} 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.^{4/}

^{3/} 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.

^{4/} The information in the noted and immediately preceding paragraph is extracted from the Annual Report

The Fund is believed to be the second largest multi-employer 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:

[Footnote continued]
(Form 5500) of the Central States Plan filed by the Plan Administrator with the Internal Revenue Service and Department of Labor.

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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.^{5/}

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

^{5/} 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 Committee (March 21, 1977).

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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 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:

4. The Fund completing by May 1, 1978 an examination of all loans and related financial transactions entered into by the Fund from February 1, 1965 to April 30, 1977. The results of this examination, including all background information, conclusions and recommendations will be submitted to unrelated independent professionals to determine if the Fund has any enforceable causes of action or other recourse arising from the transactions. These independent professionals may require the Fund to produce, or may themselves otherwise obtain, such

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additional information concerning these transactions as they deem necessary to make their determinations. The completed reports and recommendations for each transaction will be available to the IRS no later than the 5th working day of each month summarizing progress on this activity.

* * *

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 date 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.

The Fund shall allow the IRS access to all reports, systems and analyses prepared for and by the Fund, and to all Fund records. The Fund shall direct

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all banks or other institutions handling, disbursing, receiving or investing Fund assets to permit IRS to examine their records of all Fund-related transactions. The Fund shall submit to IRS a monthly report summarizing the staff recommendations and trustee actions taken to accomplish the conditions contained in this letter.

During this same period of time, representatives of the fund were actively discussing arrangements with potential investment managers including VPCO, and on Friday, June 17, 1977, the trustees of the Fund announced their decision 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.

Under these agreements, the investment managers and custodian have no contractual duty to investigate circumstances or events occurring prior to the time they become plan fiduciaries. These contracts

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specifically provide that neither Equitable, the other investment managers nor the custodian shall "be called upon to perform any general or special investigative functions with respect to any prior Fund transactions or investments, except as may be required by applicable law in connection with then current management of an investment asset of the Fund." Master Agreement (Exhibit A) at § 8.06.

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 on 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) Equitable, VPCO, the Other 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.^{6/}

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 adviser under the 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 nonrail 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. With a minor exception described below, it has had no prior affiliation with the Fund.^{7/}

6/ 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.

7/ The minor exception involves a loan made by the Fund in 1963 (and refinanced in 1974) to an independent third party to finance a hotel, secured by the hotel property and by guarantees of the third party. In 1976, a limited partnership, in which two executives (one

Lazard Freres and Co. ("Lazard") is an investment banking firm registered as an investment adviser 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

[Footnote continued]
also a stockholder) of VPCO have interests, purchased the hotel, subject to the Fund mortgage on which the third party remains liable.

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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.^{8/} 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

^{8/} 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 11, 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."

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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.

These investment management arrangements are currently scheduled to go into effect on October 3, 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

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authorities. However, if the Closing Date does not occur on or before November 1, 1977, the Trustees of the Fund can elect to rescind the agreements.

Equitable and VPCO believe that the granting of the opinion or ruling applied for herein and the issuance of interpretations in response to various requests therefore are essential if Equitable and VPCO are to assume their responsibilities for the Fund.

(d) Specific Transactions Involved

Pursuant to the June 30 contracts described above, Equitable and VPCO are responsible for the management of all real estate-related assets of the Fund. While neither Equitable nor VPCO has yet been provided with a final, detailed inventory of such assets, the majority appear to be loans secured by real property. In connection with such loans, Equitable and VPCO are required to conduct a physical inspection of the asset, verify its existence and condition, and determine the need for additional documentation. Master Agreement (Exhibit A) at § 5.04.

Pursuant to the contractual obligation outlined above and other contract provisions, Equitable and VPCO will be coming into contact with countless pieces of paper relating to hundreds of transactions, some ongoing and others involving transactions long since complete. If the fears and allegations of Fund mismanagement which have been expressed in the public statements of various government agencies and elsewhere are well-founded, Equitable and VPCO will constantly be dealing with documentation which is puzzling, suspicious, incomplete or even nonexistent. The day-to-day tasks of asset management will undoubtedly bring countless instances to light where it might be argued or the facts might suggest the possibility that, prior to the time that Equitable and VPCO became fiduciaries of the Fund, other fiduciaries authorizing or otherwise participating in the transaction in question had breached their duty to act prudently, had not acted solely in the interests of plan beneficiaries, or had participated in a prohibited transaction.

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Because there will likely be many instances uncovered which could be considered a past breach of fiduciary duty, Equitable and VPCO believe it to be extremely important to define their obligations in such circumstances.

Statutory and Administrative Background

ERISA section 405(a) provides that a fiduciary:

". . . shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:

"(1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;

"(2) if, by his failure to comply with section 404(a)(1) in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach;
or

"(3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach."

Section 404(a)(1)(B) provides that,

" . . . a fiduciary shall discharge his duties with respect to a plan . . . with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

ERISA section 409(b), however, provides that no fiduciary:

" . . . shall be liable with respect to a breach of fiduciary duty under this title if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary."

Obviously neither Equitable nor VPCO will be "participating in" a past^{9/} breach within the meaning of ERISA section 405(a)(1) or "enabling" a past breach to occur within the meaning of ERISA section

9/ In the context of this submission, the words "past" and "prior" when used in relation to events, circumstances, transactions, or breaches, are generally referring to the time prior to such time as Equitable and VPCO become plan fiduciaries.

405(a)(2). Any "past" breaches will already have occurred or commenced when Equitable and VPCO become Fund fiduciaries. There are ways, however, in which Equitable or VPCO could be seen to have a statutory obligation to take action with respect to events and circumstances of which either is aware which by any ultimate determination constituted (or constitute) a breach of fiduciary duty by another fiduciary.

ERISA section 405(a)(1) imposes liability on a fiduciary which "knowingly undertakes to conceal" an act or omission of a cofiduciary which the fiduciary knows is a breach. ERISA section 405(a)(3) imposes liability for mere knowledge of a breach by a cofiduciary unless the fiduciary makes "reasonable efforts under the circumstances" to remedy the breach. Thus, concealment of a past breach, or knowledge of a past breach without appropriate action by Equitable or VPCO respectively, could arguably subject Equitable or VPCO to liability. A past breach may have ongoing consequences. For example, a party no longer a fiduciary to the plan may have engaged in prohibited self-dealing

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by accepting an illegal payment on a prior loan. Even where the loan has been repaid, and the transaction is over, the Fund may have a claim against the prior fiduciary. A failure, by a fiduciary with actual knowledge of such events and actual knowledge that the events constituted a breach, to take some action could arguably constitute a current breach of fiduciary duty.

ERISA section 409 provides that no fiduciary shall be liable with respect to a breach committed before he became a fiduciary, but the Labor Department has not interpreted this provision so as to exempt a fiduciary from all responsibility with respect to past transactions about which the fiduciary has knowledge:

"Section 409(b) of the Act provides that no fiduciary shall be liable with respect to a breach of fiduciary duty under Title I of the Act, if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary. Section 409(b) does not, however, exempt a fiduciary from carrying out his responsibilities to a plan imposed by various provisions of Part 4 of Title I of the Act. For example, although a fiduciary may not be liable under section 409 of the Act for the acts of predecessor

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fiduciaries, if he knows of a breach of fiduciary responsibility committed by a predecessor he would be obligated to take whatever action is reasonable and appropriate under the circumstances to remedy such breach. Failure to take such action would constitute a separate breach of fiduciary responsibility by the successor fiduciary." Labor Department Opinion Letter 76-95 (September 30, 1976).

The Labor Department has also offered some guidance on the steps to be taken by a fiduciary with actual knowledge of a breach by another fiduciary. In Question-and-Answer FR-10, set forth in ERISA Interpretive Bulletin 75-5 (29 C.F.R. § 2509.75-5), minority trustees were confronted with an action by the majority "which would clearly be contrary to the prudence requirement" of ERISA. According to the Bulletin, the minority trustees in such a case would be required:

"to take all reasonable and legal steps to prevent the action. Such steps might include preparations to obtain an injunction from a Federal District court under section 502(a)(3) of the Act, to notify the Labor Department, or to publicize the vote if the decision is to proceed as proposed."

The Conference Committee Report suggests similar actions with respect to a hypothetical discussed therein, and states:

"The proper remedy is to be determined by the facts and circumstances of the particular case, and it may be affected by the relationship of the fiduciary to the plan and to the co-fiduciary, the duties and responsibilities of the fiduciary in question, and the nature of the breach." H.R. Rep. No. 1280, 93d Cong., 2d Sess. 300 (1974). (Emphasis supplied.)

Discussion

Pursuant to sections 404(a)(1), 405(a)(1) and 405(a)(3) of ERISA, as well as Opinion Letter 76-95 and the Conference Report language quoted above, Equitable and VPCO, as fiduciaries of the Fund, have a responsibility to make "reasonable efforts" to remedy prior breaches by other fiduciaries of which they have actual knowledge. The extent of such responsibility is, however, based on the "facts and circumstances of the particular case."

The facts and circumstances of this particular case are somewhat unique. The Labor Department is continuing its investigation of the Fund^{10/} and the Justice Department has recently announced that it is conducting 12 separate investigations involving the Fund.^{11/}

Further, as a condition of the requalification of the Fund by the IRS, the Fund is required to complete (by May 1, 1978) a legal audit of each and every loan and related financial transaction entered into by the Fund from February 1, 1965 to April 30, 1977. The results of this examination, including all background information, conclusions and recommendations, are to be submitted to unrelated, independent professionals (not Equitable or VPCO) to determine if the Fund has any enforceable causes of action or other recourse arising from the transactions. The independent professionals may require the Fund to produce, or may

^{10/} In his statement cited earlier at page 11, Secretary Marshall said that "... part of the investigation continues."

^{11/} BNA Daily Tax Report (July 21, 1977).

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themselves otherwise obtain, any additional information they need to make their determinations. The IRS will be monitoring this legal audit on a regular basis.

In addition, the June 30, 1977 agreements require that Equitable and VPCO keep their records as fiduciary and investment managers open for inspection by Labor and Treasury Department representatives (Master Agreement (Exhibit A), at § 1.08, Investment Management Agreements (Real Estate-Related Assets) (Exhibits B and C) at § 7.02) and that Equitable and VPCO cooperate with the Fund with respect to its legal audit by furnishing all materials requested by the Trustees in connection with the audit which are in Equitable's or VPCO's possession (Master Agreement at § 8.06, Investment Management Agreements (Real Estate-Related Assets) at § 7.03). Equitable and VPCO represent that they intend to comply fully with these provisions of the June 30, 1977 agreements. Furthermore, and significantly, Equitable and VPCO will respond to any requests for information in their possession made by the government agencies in connection with the agencies' investigations.

An additional and significant circumstance is that the central goal of the contractual arrangements entered into between the Fund, Equitable and VPCO is to provide independent, professional management of Fund assets. This goal will best be served where the managers are free to devote their energies to the area in which they have their expertise, the actual management of assets. Drawing the asset managers into the boiling pot of controversy surrounding the past dealings of the Fund will only divert them from their central tasks.

In view of the host of investigations and audits being conducted by the Fund, independent professionals, the IRS, the Labor Department and the Justice Department, and the remedial role of the investment managers, it would be unnecessarily duplicative, burdensome, and costly for Equitable or VPCO to have to assume any responsibility to investigate or take steps to remedy prior breaches of fiduciary responsibility other than to carry out the requirement of the June 30, 1977 arrangements to keep their records open for inspection by Labor and Treasury Department representatives and

to provide information upon request as discussed above. Indeed, this seems to have been the clear intent of the parties to the June 30, 1977 agreements (which agreements were fully reviewed by the Labor Department prior to their execution). Under § 8.06 of the Master Agreement, Equitable and VPCO are in no event to be "called upon or requested to perform any general or special investigative functions with respect to any prior Fund transactions or investments, except as may be required by applicable law in connection with the then current management of an investment asset of the Fund."

In this regard, we note that in every complex real estate transaction, the borrower and the lender negotiate with respect to a wide range of items, including the rights of the lender to inspect the property and to obtain information about the borrower's ongoing operations, the nature and the extent of the underlying security and any additional guarantees provided by the borrower, the terms of the repayment, and the rights of the lender upon late payment or

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default. In addition, a lender may have followed a number of preliminary information-gathering procedures in granting the loan, including the obtaining of independent appraisals, market studies, engineering reports, financial analyses or legal reports with respect to the property involved. Here, the usual complexities are magnified severalfold.

Determining whether a given action or course of action by a lender in such negotiations or subsequent decisions or actions was "imprudent" or constituted some other possible breach of fiduciary duty would frequently involve a complicated factual review of the transaction, and a difficult legal judgment. Virtually every transaction will retrospectively reveal, under the circumstances at the time the transaction occurred, apparent oversights, omissions or failures of judgment that could raise a threshold question about the discharge of fiduciary duty. In many cases the possibility of a breach will exist. Where the information available is incomplete, any obligation to determine or evaluate whether a breach of fiduciary duty has occurred would necessarily require an in-depth investigation.

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Given the special circumstances of this situation, if the new asset managers were required to investigate, or to evaluate the legal significance of, past fiduciary conduct generally, they would be swept away from their primary duties -- to manage the assets of the Fund -- and into the investigation and evaluation of a controversy which they had no part in creating and which is already being investigated and evaluated by independent professionals and by numerous agencies of the government.

As discussed earlier, Equitable, VPCO, and the other new investment managers have been retained for essentially one purpose -- to place the responsibility for the management of Fund assets in the hands of independent, professional managers. Equitable and VPCO should not be required to be drawn away from their management responsibilities to become involved in the investigation and legal evaluation of circumstances which are already being investigated and evaluated by the government.

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CONCLUSION

Accordingly, because the government is conducting a full and complete investigation of the Fund, including a detailed examination of Fund records, because the paramount duty of Equitable and VPCO is to obtain optimum results in the future investment management of the Fund, and because of the other facts and circumstances set forth above, Equitable and VPCO request that the Labor Department issue an advisory opinion that Equitable and VPCO will fully satisfy their responsibilities and duties under ERISA sections 404(a)(1) or 405(a) with respect to breaches of fiduciary responsibility by other Fund fiduciaries occurring or commencing prior to the time that Equitable and VPCO become Fund fiduciaries if they keep their records open for inspection by representatives of the Labor and Treasury Departments *in* accordance with the June 30, 1977 agreements, if they provide materials to the Fund Trustees in connection with the Trustees' legal audit of Fund transactions, also in accordance

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with the June 30, 1977 agreements, and if they respond to questions put to them by government representatives from time to time.

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

Response of the Director,
Office of Regulatory Standards
and Exceptions

The foregoing letter requests the Department of Labor (the Department) to rule that The Equitable Life Assurance Society of the United States (Equitable) and Victor Palmieri and Company Incorporated (VPCO), as investment managers for the real estate-related assets of the Central States, Southeast and Southwest Areas Pension Fund (the Fund), will satisfy their responsibilities and duties under the Employee Retirement Income Security Act of 1974 (ERISA) with respect to breaches of fiduciary responsibilities by Fund fiduciaries which occurred or

commenced prior to the time Equitable and VPCO became Fund fiduciaries if they keep their records open for inspection by representatives of the Department and the Internal Revenue Service, if they provide requested materials to the trustees of the Fund and if they respond to questions put to them by government representatives.

Based on the facts and representations stated in your letter and the exhibits attached thereto, and more particularly the facts and representations contained on pages 18 through 33, and without necessarily agreeing with the legal analysis set forth therein, the following is the opinion of the Department of Labor (the Department):

(1) Under section 409(b) of ERISA a fiduciary is not liable with respect to a breach of fiduciary duty under Part 4 of Title I if such breach was committed before he became a fiduciary. Section 409(b) does not, however, exempt a fiduciary from his responsibilities to a plan imposed by the various provisions of Part 4 of Title I of ERISA. As the Department has stated in Opinion Letter 76-95 (September 30, 1976):

. . . although a fiduciary may not be liable under section 409 of the Act for the acts of predecessor fiduciaries, if he knows of a breach of fiduciary responsibility committed by a predecessor fiduciary he would be obligated to take whatever action is reasonable and appropriate under the circumstances to remedy such breach. Failure to take such action would constitute a separate breach of fiduciary responsibility by the successor fiduciary.

What constitutes reasonable and appropriate action depends upon the facts and circumstances of each particular case.

(2) Equitable and VPCO will satisfy their responsibilities and duties under ERISA with respect to their knowledge of events, circumstances or transactions which occurred or commenced from February 1, 1965 to April 30, 1977 which indicate that a breach of fiduciary duty may have taken place prior to their becoming investment managers for the Fund's real estate-related assets if, pursuant to the provisions of the June 30, 1977 contracts, they keep their records open for inspection by representatives of the Department and the Internal Revenue Service, provide whatever materials are requested of them in connection

with the examination of Fund transactions for the period,^{1/} and respond to questions put to them by government representatives with respect to their knowledge of such events, circumstances or transactions. Under the special circumstances of this case, given the requirement of a legal action audit imposed on the Fund trustees with respect to every loan and related financial transaction entered into by the Fund from February 1, 1965 to April 30, 1977, and the government's investigation of such transactions and access to all of Equitable's and VPCO's records regarding such transactions, the above enumerated procedures constitute the appropriate action to be taken with respect to possible breaches of fiduciary duty by predecessor fiduciaries. If either Equitable or VPCO has actual knowledge of facts which would lead it, as an independent professional investment manager, reasonably to believe that there has been a breach of fiduciary duty committed by a predecessor fiduciary involving events, circumstances or transactions which occurred or commenced from February 1, 1965 to April 30, 1977, as opposed to knowledge which

^{1/} Pursuant to paragraph 4 of the April 26, 1977 IRS determination letter, the Fund is required to make an examination to determine if it has enforceable causes of action arising out of prior transactions occurring in the period February 1, 1965 through April 30, 1977. This examination is hereinafter referred to as the "legal action audit."

would indicate that a breach of fiduciary duty may have taken place, it is the opinion of the Department that Equitable or VPCO would fulfill its fiduciary duties by notifying the trustees of the Fund and the Department of the facts which lead it to conclude that a breach has occurred.

(3) With respect to events, circumstances or transactions which occurred or commenced prior to February 1, 1965 or subsequent to April 30, 1977, if Equitable or VPCO has actual knowledge of facts which would lead it, as an independent professional investment manager, reasonably to believe that there has been a breach of fiduciary duty committed by a predecessor fiduciary, it is the opinion of the Department that Equitable or VPCO would fulfill its fiduciary obligation to take whatever action is necessary or appropriate to remedy the breach if it notifies both the trustees of the Fund and the Department of the facts which lead it to conclude that a breach has occurred. If either Equitable or VPCO has information concerning any events, circumstances or transactions which occurred or commenced prior to the time it became an investment manager for the Fund which would lead it, as an independent professional investment

manager, reasonably to believe that a breach of fiduciary duty may have taken place, it does not have a duty to investigate further under ERISA, as that is not generally the duty of an independent investment manager of plan assets who is not a trustee of such assets, absent an explicit agreement to undertake such duties. However, with respect to events, circumstances or transactions which occurred or commenced prior to February 1, 1965 or subsequent to April 30, 1977, it would appear to be appropriate under the circumstances of this case for the investment managers to notify the Fund trustees and the Department of such information.

(4) Neither Equitable nor VPCO is required to implement special procedures to evaluate events, circumstances or transactions of which it is aware for the sole purpose of determining whether the particular events, circumstances or transactions constitute a breach of fiduciary duty or indicate that a breach of fiduciary duty may have taken place.

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