

affects all employee benefit plans, the participants and beneficiaries of such plans, and parties in interest with respect to those plans engaging in the described transactions.

EFFECTIVE DATE: The exemption is effective January 1, 1975.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION: On February 11, 2003, the Department published a notice in the **Federal Register** (68 FR 6953) of the pendency of a proposed class exemption from the restrictions of section 406(a)(1)(A), (B) and (D) of the Act and from the sanctions resulting from the application of section 4975 of the Code, by reason of section 4975(c)(1)(A), (B) and (D) of the Code. The Department proposed the class exemption on its own motion, pursuant to section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in 29 CFR Part 2570 Subpart B (55 FR 32836, August 10, 1990).¹

The notice of pendency gave interested persons an opportunity to comment or request a public hearing on the proposal. The Department received five (5) public comments. Upon consideration of all the comments received, the Department has determined to grant the proposed class exemption, subject to certain modifications. These modifications and the major comments are discussed below.

Executive Order 12866

Under Executive Order 12866, the Department must determine whether a regulatory action is "significant" and therefore subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Under section 3(f), the order defines a "significant regulatory action" as an action that is likely to result in a rule (1) having an annual effect on the economy of \$100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or

State, local or tribal governments or communities (also referred to as "economically significant"); (2) creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order.

Pursuant to the terms of the Executive Order, it was determined that this action is "significant" under Section 3(f)(4) of the Executive Order. Accordingly, this action has been reviewed by OMB.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) (PRA 95), the Department submitted the information collection request (ICR) included in the Class Exemption For Release of Claims and Extensions of Credit in Connection With Litigation to the Office of Management and Budget (OMB) for review and clearance at the time the proposed class exemption was published in the **Federal Register** (February 11, 2003, 68 FR 6953). The ICR for the proposed class exemption was combined with the ICR in PTCE 94-71,² also approved under OMB control number 1210-0091, because of the similarity of subject matter between the two exemptions. No comments were received about the burden estimates and no substantial or material changes have been made in the grant of the exemption that would affect the burden estimates in the proposal. The approval for each of the ICRs included in the two exemptions will expire on April 30, 2006.

In order to grant an exemption pursuant to section 408(a) of the Act, the Department must, among other things, make a finding that the terms of the exemption are protective of the rights of participants and beneficiaries of a plan. To support making such a finding, the Department normally imposes certain conditions on fiduciaries and parties in interest that may make use of the exemption. The information collection provisions of the exemption are among these conditions. The information collection provisions are found in sections III(c), (e), (g), and

DEPARTMENT OF LABOR

Employee Benefits Security Administration

[Prohibited Transaction Exemption 2003-39; Application No. D-11100]

Class Exemption for the Release of Claims and Extensions of Credit in Connection With Litigation

AGENCY: Employee Benefits Security Administration, Department of Labor.

ACTION: Grant of class exemption.

SUMMARY: This document contains a final class exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974 (ERISA or the Act) and from certain taxes imposed by the Internal Revenue Code of 1986, as amended (the Code). The exemption permits transactions engaged in by a plan, in connection with the settlement of litigation. This exemption was proposed in response to concerns raised by the pension community regarding the impact of ERISA's prohibited transaction provisions on the settlement of litigation by employee benefit plans with parties in interest. The exemption

¹ Section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996), generally transferred the authority of the Secretary of the Treasury to issue exemptions under section 4975(c)(2) of the Code of the Secretary of Labor. For purposes of this exemption, references to specific provisions of Title I of the Act, unless otherwise specified, refer also to the corresponding provisions of the Code.

² PTCE 94-71, 59 FR 51216, October 7, 1994, as corrected, 59 FR 60837, November 28, 1994—Settlement Agreements Resulting From An Investigation, involving remedial settlements resulting from an investigation of an employee benefit plan conducted by the Department.

(h). These requirements are summarized as follows:

Written Agreement. The exemption requires that the terms of the settlement be specifically described in a written agreement or consent decree. In the exemption as granted, the Department has added that, with regard to transactions involving assets other than cash, the assets and their fair market value, including the date for such valuation, must be described in writing in the settlement agreement. Because a description and valuation of the assets involved in a settlement transaction are usually included in a settlement agreement, the requirement serves only as a clarification about assets that are not cash for the parties seeking to use the class exemption. In addition, because the Department believes that the ability to make changes with regard to a settlement allows more flexibility to the parties involved, it has also provided in the final exemption that certain adjustments, such as the right to amend the plan, are permissible if written into the agreement. These two new requirements are only operative for certain provisions and under certain conditions that may or may not be included in the settlement. Where appropriate, including the provisions in the agreement enables interested parties described in the exemption to verify that the conditions of the exemption have been met. However, neither requirement produces a measurable burden beyond that which would be considered usual business practice, and no additional burden has been accounted for in this ICR.

Acknowledgement by a Fiduciary. On a prospective basis, the exemption also requires that a fiduciary acting on behalf of the plan acknowledge in writing that it is a fiduciary with respect to the settlement of the litigation. Under the Act, a person that exercises "any authority or control respecting disposition of [the plan's] assets," is considered a fiduciary. It is anticipated that the applicable plan fiduciary will incorporate this acknowledgement in the written agreement outlining the terms and conditions of its retention as a plan service provider, and already in existence, as part of usual and customary business practice. As such, a written acknowledgement is not expected to impose any measurable additional burden.

Recordkeeping. Prospectively, the exemption requires a plan to maintain for a period of six years the records necessary to enable certain persons to determine whether the conditions of the exemption had been met. The six-year recordkeeping requirement is consistent

with the requirements in section 107 of the Act as well as general record-keeping requirements for tax information under the Code. As such, the Department has not accounted for a burden related to recordkeeping for this exemption.

The exemption may affect employee benefit plans, the participants and beneficiaries of those plans, and parties in interest to plans engaging in the specified transactions. It is not possible to estimate the number of respondents or frequency of response to the information collection requirements of the exemption due to the wide variety of litigation involving plans, parties to that litigation, and jurisdictions in which litigation occurs. However, the lack of an ascertainable number of settlements does not impact the hour or cost burden because no additional burden is associated with the information collection requirements of the exemption.

I. Discussion of Comments Received

The comments received by the Department were generally supportive of the issuance of a class exemption for the release of claims and extensions of credit in connection with litigation. However, commenters requested specific modifications to the proposal in the following areas:

A. Whether the settlement of litigation with a party in interest is a prohibited transaction. Several commenters argued that settling litigation is not a transaction, and, therefore, not prohibited under section 406 of the Act. Other commenters requested that the Department clarify that only a fiduciary, a participant or beneficiary, or the Secretary of Labor, may bring suit to enforce ERISA's fiduciary duties. These commenters asserted that, because the statute does not identify a plan as a party with standing to pursue ERISA litigation, an ERISA claim is not a plan asset and the release of such an asset, in exchange for consideration from a party in interest, would not be a prohibited sale or exchange of any property under section 406 of ERISA. Other commenters asserted that the settlement of litigation with a party in interest is a prohibited transaction and urged stricter conditions for the provision of retroactive relief because the Department's position on this issue was clearly articulated in its 1995 Opinion Letter, AO 95-26A (October 17, 1995).

As the Department noted in proposing this exemption, the fact that a transaction is subject to an administrative exemption is not dispositive of whether the transaction is, in fact, a prohibited transaction.

Rather, the exemption is being granted in response to uncertainty expressed on the part of plan fiduciaries charged with the responsibility under ERISA for determining whether it is in the interests of a plan's participants and beneficiaries to enter into a settlement agreement with a party in interest. The comments have confirmed the Department's earlier conclusion that there was considerable uncertainty surrounding this issue. After considering all of the comments, the Department has determined that the exemption, as revised, appropriately balances the concerns of these commenters while allowing plan fiduciaries to properly carry out their responsibilities under ERISA.

In response to the comments that ERISA civil actions for breach of fiduciary duty may only be brought by participants, beneficiaries, fiduciaries, and the Secretary of Labor, the Department has modified the final class exemption to include the release of claims by both the plan and a plan fiduciary. As the Department noted in the preamble to the proposed exemption, many situations in which a plan settles litigation may not give rise to a prohibited transaction or may be covered by an existing statutory or administrative exemption. For example, correction of a prohibited transaction that complies with section 4975(f)(5) of the Code³; reimbursement of a plan without a release of the plan's claim; settlement with a service provider of a dispute related to the provision of services or incidental goods to the plan that is otherwise exempt under ERISA 408(b)(2) (See, Opinion Letter, AO 95-26A); settlements authorized by the Department pursuant to PTE 94-71 (59 FR 51216, October 7, 1994, as corrected, 59 FR 60837, November 28, 1994); and judicially approved settlements where the Labor Department or the Internal Revenue Service is a party pursuant to PTE 79-15 (44 FR 26979, May 8, 1979).

In addition, the Department notes that this class exemption would be available for settlement agreements relating to an employer's failure to timely remit participant contributions to a plan, including a collectively bargained multiemployer or multiple employer plan, to the extent the conditions contained in this final exemption are

³ IRC Reg. sec. 141.4975-13 provides that for purposes of the excise taxes on prohibited transactions, the definition of the term "correction" under IRC Reg. sec. 53.4941(e)-1 (concerning excise taxes on self-dealing with foundations) is controlling.

met.⁴ In this regard, the Department notes that the relief provided by this exemption is limited to the prohibited transactions that arise where a plan trustee and an employer enter into a settlement involving the employer's failure to timely forward participant contributions to the plan as required under ERISA. Thus, nothing in this class exemption should be construed as exempting any of the prohibited transactions described in section 406(a) or 406(b) of ERISA that arise solely in connection with an employer's failure to timely forward participant contributions to a plan.⁵

This exemption does not, however, apply to transactions described in PTE 76-1, A.I. (41 FR 12740, March 26, 1976, as corrected, 41 FR 16620, April 20, 1976) relating to delinquent employer contributions to a collectively bargained multiemployer or multiple employer plan. Finally, PTE 76-1, A.I. does not extend relief to those settlement arrangements that arise from the failure of an employer to timely forward participant contributions to a multiemployer or multiple employer plan.

Section 502(d)(1) of the Act provides that "an employee benefit plan may sue or be sued under this title as an entity." This exemption covers settlement of any type of suit the plan has brought. However this exemption is not available for settlement of claims brought by a party in interest against a plan. This exemption does not cover a plan's payment of money or other things of value to a party in interest in exchange for the dropping of claims against the plan. As with exchanges made for the release of claims in favor of the plan, the Department's determination in this regard is not dispositive of whether such an exchange constitutes a prohibited transaction.

Finally, the Department notes that a settlement between a plan and a participant or beneficiary made solely to resolve claims against a plan for the recovery of benefits, by a participant or beneficiary, may not involve a prohibited transaction. If the plan makes payment to a participant who is a party in interest to settle a benefits dispute, such payment generally would be viewed by the Department as the

payment of a plan benefit that would not trigger the need for an exemption. As the Supreme Court noted in *Lockheed Corp. v. Spink*, 517 U.S. 882, 892-893 (1996), the payment of benefits is not a prohibited transaction.

B. The plan must obtain advice from an attorney representing the plan that a genuine controversy exists. Several commenters were concerned that imposing this requirement on past settlements would effectively limit the availability of the exemption. These commenters asserted that, prior to publication of the Department's proposed exemption, many fiduciaries were unaware that the settlement of litigation might be considered a prohibited transaction by the Department. Even if an attorney was retained in connection with the litigation, it is unlikely that the attorney would have opined as to whether or not there was a genuine controversy. Other commenters argued that: the filing of a lawsuit should be sufficient to find the existence of a genuine controversy; and class action settlements should not have to meet this requirement. Another commenter suggested retaining the requirement for a genuine controversy, but without requiring an attorney's determination. This commenter also suggested that the attorney review be permitted, but not required, as a safe harbor in certain situations. He explained that fiduciaries might find it prudent and in the interests of participants and beneficiaries to settle a frivolous case for a *de minimus* amount, rather than incur the cost of litigation. In this situation, such fiduciaries should be able to meet the condition of the class exemption by demonstrating that they sought and obtained advice of counsel before settling the case.

Several commenters asserted that the genuine controversy condition was unnecessary as the concern raised by the Department, the possibility of a collusive settlement, was addressed by the condition that the settlement is not an arrangement to benefit a party in interest. Another commenter suggested that independent legal advice and a written agreement or consent decree should be mandatory for all retroactive relief because, even if the fiduciary was unaware of the prohibited transaction issue, a prudent fiduciary would have obtained such written documentation before entering into a settlement.

On the basis of these comments, the Department has decided to amend the genuine controversy condition. No finding of genuine controversy will be required where the case has been certified as a class action by the court. In addition, for transactions entered into

prior to the publication of the final exemption, and the first 30 days thereafter, no attorney review will be required to determine whether the genuine controversy exists. On a prospective basis, attorney review will be required. In response to a question from one of the commenters, the Department confirms that the independent fiduciary's in-house attorneys, as well as its outside counsel, could provide the appropriate advice concerning the existence of a genuine controversy.

C. The decision-making fiduciary has no interest in any of the parties involved in the litigation that might affect the exercise of its best judgment as a fiduciary (independent fiduciary). Several commenters suggested that the Department eliminate the requirement for an independent fiduciary or, in the alternative, limit its application to prospective relief. Among the suggestions were: limit the requirement for an independent fiduciary to material claims where there are no alternative safeguards; and eliminate the independent fiduciary requirement where a judge reviews the fairness of a class action settlement. Other commenters expressed concern that the plan's directed trustee, even if not a defendant, should not be considered sufficiently independent to make decisions settling a case. They suggested that an entirely independent fiduciary be retained. Another commenter argued that relief in large cases should be conditioned upon the retention of an independent fiduciary with no prior relationship to the plan, or the defendants, and no future relationship with the plan for three years after the engagement.

Except as noted above in connection with the finding of genuine controversy, the Department does not believe that it would be appropriate to make a distinction between the requirements applicable to class action settlements and other settlements. However, in response to comments, the Department has decided to eliminate the requirement that the independent fiduciary "negotiate" the settlement. The Department realizes that many of the settlements to which this class exemption would apply are class action settlements. Where the plan is not a lead plaintiff, the plan fiduciary's role in negotiating the terms of the settlement may be limited. The Department recognizes, however, that even where negotiation does not take place between the plan and the defendant, a fiduciary will be compelled, consistent with ERISA's fiduciary responsibility provisions, to make a decision regarding

⁴ The Department notes that the relief provided by this exemption would be available for settlements involving participant or employer contributions to a single employer plan or to a non-collectively bargained multiple employer plan.

⁵ In this regard, the failure of an employer to timely remit contributions made to a plan by an employee of such employer violates ERISA sections 403(a), 403(c)(1), 404(a)(1)(A), 406(a)(1)(D), and 406(b)(1).

the settlement on behalf of the plan, even if that decision is merely to accept or reject a proposed settlement negotiated by other class members.

As modified, the final class exemption covers settlements authorized by a fiduciary that are reasonable, in light of the plan's likelihood of full recovery, the risks and costs of litigation, and the value of claims foregone. Such settlements must be no less favorable to the plan than comparable arm's-length terms and conditions that would have been agreed to by unrelated parties in similar circumstances. In addition, the transaction must not be part of an agreement, arrangement or understanding designed to benefit a party in interest. Thus, an independent fiduciary could satisfy the authorization requirements under the final exemption by deciding not to opt out of class action litigation if, after a review of the settlement, such fiduciary concludes that the chances of obtaining any further relief for the plan are not justified by the expense involved in pursuing such relief. Although the Department has determined to delete the requirement for negotiation as a specific condition of the class exemption, the Department notes that this modification does not diminish the fiduciary's responsibilities with respect to the settlement terms.

As noted above, several of the commenters expressed concern about the degree of independence of institutional fiduciaries, such as directed trustees, that may serve as the fiduciary contemplated by the class exemption. Without agreeing or disagreeing with this comment, the Department emphasizes that this class exemption does not provide relief from section 406(b) of the Act. In addition, the fiduciary's decisions in authorizing a settlement are subject to the fiduciary responsibility provisions of the Act.

D. Plans must select an independent fiduciary. Several commenters expressed concern about the additional cost of hiring independent fiduciaries in connection with settlements. The Department believes that plans often will not need to retain fiduciaries specifically to comply with this exemption. In most cases, the plan will be able to use a current fiduciary who is not a party to the action and who is not so closely allied with a party (other than the plan) as to create a conflict of interest. As with any other expense, the Department expects that fiduciaries will engage in prudent cost/benefit analysis to select the appropriate independent fiduciary in each case. In some cases, the cost of the independent fiduciary may be included in the damages

claimed by the plan and may be reimbursed by the defendant in settling the litigation.

One of the commenters suggested that to avoid duplication, the independent fiduciary should be permitted to rely on the opinion of plaintiffs' class counsel or experts hired to assist class counsel. The Department agrees that the fiduciary should not spend plan resources unnecessarily. Whether and to what extent a fiduciary should rely on a particular attorney or expert hired by one of the other parties are decisions that the fiduciary must make in accordance with its fiduciary responsibilities under ERISA.

In this regard, the Department notes that on occasion the independent fiduciary may wish to retain outside experts to assist the fiduciary in determining whether or not to settle litigation. The following are some of the factors that may assist the fiduciary in its determination: the size of the claim, the expertise of the fiduciary, and the subject matter of the litigation.

Several of the commenters asked the Department to clarify that the mere fact that a party in interest pays for an attorney, an independent fiduciary, or other expert hired by the plan, does not mean that these professionals are not independent for purposes of the exemption. The Department agrees with this assertion, assuming that the professional being paid by the party in interest understands that the plan is their client, not the party paying their bill. In addition, the amount of compensation paid to the professional by the party in interest constitutes no more than a small percentage of such professional's annual gross income.

E. What is the role of the independent fiduciary where there is judicial approval of a settlement? Several commenters recommended that judicial approval of a settlement should eliminate the need for an independent fiduciary. One of the commenters suggested that where the settlement is judicially approved, relief from section 406(b) of the Act should be available under the exemption for those fiduciaries that were defendants in the litigation. The Department has determined not to adopt these suggestions. The court, in reaching its conclusion that the settlement is fair, must balance the interests of all the litigants. ERISA, on the other hand, requires that a fiduciary make its decisions with an "eye single to the interests of the participants and beneficiaries." *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982), cert. denied, 459 U.S. 1069 (1982). In response to the request for relief from

section 406(b), the Department does not believe that a sufficient showing has been made that such relief would be appropriate under the circumstances.

F. Should there be special rules for settling class action litigation? Several of the commenters explained that, with respect to certain types of class actions, class members do not have the option of opting out of the class—all are bound by the decision. The commenters explained that ERISA class actions are often non-opt out cases. According to the commenters, this means that where class action litigation is brought by the participants, the plan fiduciary may, without taking any action, be bound by the class action settlement. In light of this, the commenters asked how such a fiduciary could cause a prohibited transaction where it took no action and yet was bound by the settlement. The Department does not regard this exemption proceeding to be the appropriate setting for resolving questions concerning what types of settlement are more or less likely to be prohibited transactions.

The Department notes, however, that the fiduciary is unlikely to remain uninvolved in the settlement of an ERISA lawsuit initiated by participants for two reasons. First, the fiduciary will, in all likelihood, be named as a party to the lawsuit and the court will almost certainly require the plan fiduciary's input on the settlement. Alternatively, the party in interest likely will seek the involvement of the fiduciary because the party in interest (disqualified person) may need to take advantage of the relief provided by the class exemption in order to avoid the possible imposition of excise taxes under section 4975 of the Code. Under the Code, such excise taxes are paid by the disqualified person who participates in the prohibited transaction, not the fiduciary who caused the plan to engage in the transaction.

In order to meet the conditions of the class exemption, the fiduciary faced with a non-opt out class action must take such actions as are appropriate under the particular circumstances. For example, before such a settlement is imposed on a non-opt out class, generally there is an opportunity to object to its terms. If the fiduciary does not believe that the proposed terms and conditions of the settlement are as favorable to the plan as comparable arm's-length terms and conditions that would have been agreed to by unrelated parties under similar circumstances, it should object to the settlement.

In securities fraud class action cases, there is often an option to opt out of the class. Where the plan or the plan

trustee, as the holder of record of the securities, is a class member, whatever action or inaction that fiduciary determines to undertake has consequences for the plan. If the fiduciary takes no action, and the case is settled for far less than the full value of the plan's losses, the burden will be on the fiduciary to justify its inaction. The fiduciary responsible for authorizing settlement of class action claims must decide, not only whether or not to opt out of the class action, but also whether to protest the proposed settlement during the fairness hearing.⁶

G. Only cash may be received in exchange for the release, unless the transaction at issue is being rescinded. The commenters were universal in their objection to this condition. They pointed out that frequently, in cases involving investment in employer securities, the settlement consists of additional employer securities. In addition, settlements with plan sponsors often include nonmonetary relief, such as a promise of future contributions and plan amendments improving participants' rights, for example, the right to diversify their investments.

In response to these comments, the Department notes that the conditions for retroactive relief do not specify the type of the consideration that may be provided in exchange for the release. On a prospective basis, the Department has decided to modify the final exemption to permit assets other than cash to be provided in exchange for the plan's or

the plan fiduciary's release of a claim. As modified, the final exemption permits contributions of qualifying employer securities, or other marketable securities, in certain instances. Any assets contributed to the plan, in connection with a settlement, must consist of securities that can be objectively valued to determine fair market value, in accordance with Section 5 of the Voluntary Fiduciary Correction (VFC) Program (67 FR 15062, March 28, 2002). The final exemption has also been modified to provide that plan amendments, additional employee benefits, and the promise of future contributions may be included as part of a settlement agreement covered by this exemption.

H. When is a settlement reasonable? One commenter urged the Department to apply this condition to all transactions and to include the costs of litigation among the factors to be considered in determining whether a settlement is reasonable. Another commenter asked to include the value of claims foregone. The Department has adopted these suggestions. The final exemption requires that the settlement must be reasonable in light of the plan's likelihood of full recovery, the risks and costs of litigation, and the value of claims foregone. How these factors are weighed by fiduciaries will differ, depending on the type of case, but will always involve a prudent decision-making process, given the facts and circumstances of the particular situation.

I. Should an interest rate be specified? Most of the commenters urged the Department to eliminate the requirement that a reasonable interest rate be charged for an extension of credit in connection with a settlement covered by the exemption. The commenters explained that often a settlement requires a payment of the promised sum over several years, without specifying an interest rate. In response to these comments, the Department has modified this condition to delete the reference to interest in connection with the loan or extension of credit. As modified, any extensions of credit must be made on terms that are reasonable. Although the final exemption provides more flexibility, fiduciaries that agree to an extension of credit with a party in interest nonetheless must consider that party's creditworthiness and the time value of money in evaluating the settlement.

As noted above, the settlement of litigation with a plan sponsor often involves the promise of future contributions. Another commenter requested that the Department clarify

that the promise of future contributions is not loan or other extension of credit. The Department agrees with the commenter.

The Department encountered a case where the trustees had agreed to accept payments over time in order to collect amounts misappropriated by a party in interest. In this case, the trustees extended credit to the party in interest, but did not release their cause of action against him. In such a case, the class exemption will apply if the extension of credit is being made in connection with a settlement and both the settlement and the extension of credit meet all of the conditions of this exemption.

Several commenters urged the Department to require that extensions of credit be secured by property or a letter of credit. Although the Department has decided not to adopt this suggestion as a condition of the final exemption, the Department encourages fiduciaries to seek security for an extension of credit, wherever feasible, to protect the plan against the risk of default.

J. Certain applicants request that the scope of AO 95-26A (October 17, 1995) be extended. In AO 95-26A, the Department opined that settlement of litigation with a service provider may be covered by the statutory exemption for service providers provided under section 408(b)(2) of the Act. Several commenters asked whether the same rationale extended to the settlement of cases where the transaction at issue in the litigation is of the type addressed by a statutory or administrative exemption. The Department notes that the issues raised by the commenters, with respect to the scope of AO 95-26A, are beyond the scope of this exemption proceeding.

K. Who bears the burden of proof? Several commenters expressed concern that, if the retroactive conditions of the exemption are too subjective or difficult to meet, fiduciaries who acted in good faith in settling cases, particularly complex securities fraud cases, may be subject to litigation. According to the commenters, most practitioners were unaware of the Department's position that settling litigation with a party in interest might result in a prohibited transaction until the Department published the proposal for this class exemption. These commenters argued that, without a broad retroactive exemption, frivolous litigation may ensue.

Other commenters asserted that whether or not the fiduciaries were aware of potential prohibited transactions, these fiduciaries knew they were making decisions involving plan assets. If they acted prudently and in the interests of participants and

⁶For example, in *Great Neck Capital Appreciation Investment Partnership v. PriceWaterhouseCoopers*, In re Harnischfeger Industries, Inc. Securities Litigation, 212 F.R.D. 400 (E.D. Wisc. 2002), the original securities law class action settlement proposal included release of ERISA claims against the fiduciaries of the Harnischfeger employee benefit plans, even though the lawsuit had not alleged ERISA claims. At the fairness hearing, a participant protested that the participants' ERISA claims might be extinguished if this release was approved as part of the settlement. After considering the parties positions, the judge, during a conference call, "advised the parties that [he] was inclined to view the proposed settlement as unfair if its effect would be to extinguish the Plan participants' ERISA claims without compensation and that it also appeared to be unfair to require Plan participants to give up their right to participate in the settlement as a condition of asserting ERISA claims." 212 F.R.D. at 406. The securities law parties took the judge's hint and voluntarily agreed to exclude the ERISA claims from the release. In re IKON Office Solutions, Inc. Securities Litigation, 194 F.R.D. 166 (E.D.Pa. 2000), on the other hand, involved a securities law release that arguably released at least some of the ERISA claims and participants protested this at the fairness hearing. The court held that it would be premature, in the context of a settlement, for the court to address such issues—participants could either opt out and not be bound by the settlement, or take their chances pursuing what was left of their ERISA claims after receiving their portion of the securities class action settlement.

beneficiaries in settling the litigation with the party in interest, these fiduciaries should have no trouble meeting the retroactive requirements of the exemption. These commenters argued that, given the Department's guidance on this issue in 1995, it is appropriate to shift the burden of proving substantive and procedural prudence from the person challenging the settlement to the fiduciary seeking the protection of the exemption.

In light of these comments, the Department confirms that the party seeking to take advantage of any administrative exemption granted by the Department has the burden of proving that it met each condition of the exemption. Nonetheless, the Department has been persuaded that many practitioners were unaware of the prohibited transaction issues involved in settlements. The Department is also aware that some attorneys may have advised their clients that the settlement of litigation with a party in interest is not the type of transaction intended to be covered by section 406 of the Act. After considering these comments, the Department believes that it is appropriate to modify the retroactive relief under the final exemption. Accordingly, for settlements entered into on or before 30 days after the date of publication of the final exemption, the determination that there was a genuine controversy need not have been made by an attorney.

L. Should notice be required? Several commenters urged the Department to require notice to all participants and beneficiaries in connection with the settlement of litigation. One commenter pointed out that the Department requires notice in connection with PTE 94-71 (59 FR 51216, October 7, 1994, as corrected, 59 FR 60837, November 28, 1994) (settlement agreements between the U.S. Department of Labor and plans) where the Department is a party to the settlement. This commenter argued that without the involvement of the Department, notice is even more important to the participants and beneficiaries because their rights to pursue their own ERISA litigation could be compromised or waived entirely by the plan fiduciary. The commenter recommended that notice to participants of the nature of the allegations leading to the settlement and the terms of the proposed settlement should be required. This commenter also urged that all settlements should take the form of a proposed consent decree filed after, or contemporaneous with, the Complaint. In addition, the analytical basis for the settlement should be open to inspection by participants for a stated period of

time. Another commenter explained that, in his experience, participants are not aware of litigation, or at least the plan's involvement, until after the settlement is final. Other commenters strongly oppose notice. These commenters asserted that such an undertaking could be very costly and disruptive, especially for minor litigation.

The Department has determined not to add a notice requirement as a condition of this class exemption. Requiring notice at the point where litigation is about to be settled could result in unnecessary delays and additional costs. The Department believes that the interests of the participants and beneficiaries will be sufficiently protected by the conditions of this class exemption, especially the requirement that the settlement is authorized by a fiduciary who is independent of the parties involved in the litigation.

M. Discussion of other comments. One of the commenters requested the Department's concurrence that, if ERISA claims are not covered by the release given by the plan or the plan fiduciary in settlement of litigation, the fiduciary need not obtain additional consideration to account for such claims. The Department agrees with this statement.

One commenter urged the Department to opine that, where a plan fiduciary causes a plan to release all the plan's non-ERISA claims arising out of a transaction, the fiduciary does not automatically release the fiduciary's own claims for breach of fiduciary duty arising out of the same transaction. The commenter explained that the proposed exemption did not distinguish between claims brought by the plan, *i.e.*, with the plan itself as a named party, and claims brought on behalf of the plan by a fiduciary. ERISA § 502(d)(1), 29 U.S.C. 1132(d)(1), provides that an employee benefit plan may sue and be sued as an entity. Claims for violations of title I of ERISA, however, may be brought by a fiduciary, participant or beneficiary of the plan or by the Secretary of Labor. ERISA §§ 502(a)(2), 502(a)(3), 502(a)(4), 502(a)(5), and 502(e)(1), 29 U.S.C. 1132(a)(2), 1132(a)(3), 1132(a)(4), 1132(a)(5) and 1132(e)(1). Some courts have concluded that plans may bring actions under other laws, but may not bring an action for a fiduciary breach under title I of ERISA. *E.g.*, *Pressroom Unions-Printers League Income Security Fund v. Continental Assurance Co.*, 700 F.2d 889, 893 (2nd Cir. 1983). Other courts have not adopted this distinction. *E.g.*, *Samarar Aluminum Co. v. Pension Plan for Employees of the Aluminum*

Indus. and Allied Indus., 782 F.2d 577, 581 (6th Cir. 1986). The commenter believes that a failure to distinguish between claims that a plan can make in its own name and those that must be made by a plan fiduciary, for example, could cause courts to conclude that releasing a plan's non-ERISA claims automatically releases a plan fiduciary's, or participant's or beneficiary's ERISA claims on behalf of the plan.

The Department amended the proposed exemption to clarify that it applies to releases by the plan or by a plan fiduciary. The issue of how a release of claims by a plan or plan fiduciary may affect ERISA claims that could otherwise be brought by a fiduciary, participant or beneficiary is beyond the scope of this exemption proceeding. In the Department's view, a fiduciary should understand, in advance of signing, the legal effect that a settlement agreement may have on all claims that might be brought by or on behalf of the plan or its participants and beneficiaries. Plan fiduciaries may need to obtain legal advice on the scope of claims affected by a proposed settlement agreement. The Department notes that it has long held the view that a fiduciary's release of ERISA claims does not bind the Secretary.

It is not uncommon for the same transactions to give rise to both ERISA and securities fraud claims. The plan, and by extension, the participants and beneficiaries of the plan, are entitled to the same recovery as other shareholders in the securities fraud settlement. However, the participants and beneficiaries may have another avenue of recovery not available to other shareholders. They are authorized, under ERISA, along with the plan fiduciary and the Secretary of Labor, to bring suit to make the plan whole for all losses caused by a breach of fiduciary duty. As noted above, the Department recognizes that, in a number of securities fraud class action settlements, the participants and/or plan fiduciaries have successfully objected to the original release and were able to modify the terms of the release to permit the plan to receive its share of the securities fraud settlement without releasing its ERISA claims against the parties in interest. In other instances, fiduciaries have successfully negotiated additional relief for the plan beyond that provided to shareholders who did not have ERISA claims against the defendants. The Department notes that plan fiduciaries should consider whether additional relief may be available for the ERISA claims before agreeing to a broad release.

In conclusion, the Department encourages participants, beneficiaries, fiduciaries, parties in interest and other interested persons to take advantage of the wide range of compliance assistance offered by the Department. Those with questions about their rights and responsibilities in particular situations should look first to our web site: <http://www.dol.gov/EBSA/>. You may also call, toll-free, the Employee & Employer Hotline 1-866-444-EBSA (3272). To discuss substantive ERISA issues in connection with particular cases, please contact your local EBSA field office. The EBSA web site mentioned above includes a state-by-state list of phone numbers and addresses for these offices. Click on "About EBSA/EBSA Offices."

II. Description of the Exemption

The exemption provides retroactive and prospective relief from the restrictions of section 406(a)(1)(A), (B) and (D) of the Act and from the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1)(A), (B) and (D) of the Code, for the following transactions, effective January 1, 1975:

(1) The release by the plan or by a plan fiduciary of a legal or equitable claim against a party in interest in exchange for consideration, given by, or on behalf of, a party in interest to the plan in partial or complete settlement of the plan's or the fiduciary's claim; and

(2) An extension of credit by a plan to a party in interest in connection with a settlement whereby the party in interest agrees to repay, over time, an amount owed to the plan in settlement of a legal or equitable claim by the plan or a plan fiduciary against the party in interest.

A. Conditions Applicable to All Transactions

The exemption is conditioned upon the existence of a genuine controversy involving the plan unless the case has been certified as a class action by the court. The Department believes that this condition is necessary to prevent the plan and parties in interest from engaging in a sham transaction purporting to fall within this class exemption, thus shielding a transaction, such as an extension of credit or other transaction with a party in interest, that would otherwise be prohibited.

The fiduciary that authorizes the settlement must have no relationship to, or interest in, any of the other parties involved in the litigation, other than the plan, that might affect its best judgment as a fiduciary. The Department intends a flexible standard for fiduciary independence, recognizing that the

exemption will encompass a wide range of situations, both in terms of the type of litigation and the cost of pursuing such litigation. For example, in some instances where there are complex issues and significant amounts of money involved, it may be appropriate to hire an independent fiduciary having no prior relationship to the plan, its trustee, any parties in interest, or any other parties to the litigation. In other instances, the plan's current trustee or investment manager, assuming that fiduciary's conduct is not at issue, may be an appropriate party to make the decision on behalf of the plan as to whether to settle the litigation.

In response to comments received by the Department regarding the settlement of class action litigation in which the ability to negotiate may be limited, the Department eliminated the requirement that the settlement be "negotiated" by the fiduciary. In lieu of this requirement, the exemption provides that the fiduciary may authorize a settlement if its terms and conditions are no less favorable to the plan than comparable arm's-length terms and conditions that would have been agreed to by unrelated parties under similar circumstances.

The exemption is conditioned upon the settlement being reasonable given the likelihood of full recovery, the costs and risks of litigation, and the value of claims foregone. The claims foregone may include additional causes of action not available to the other plaintiffs in the same case. For example, where shareholders have brought a class action securities fraud case against the Company and its officers, the Company's employee benefit plan or the trustee, as the holder of record, may be named as a member of the class because it holds employer securities. The plan or trustee may also have ERISA claims against the Company and some or all of its officers, as well as against other parties. Before entering into a settlement with any defendant, the plan fiduciary should consider the value of these additional claims against that defendant. The plan fiduciaries may also be able to pursue claims against defendants not named in the securities fraud case, including knowing participants in the breach. Under certain circumstances, the plan will have additional sources of recovery, including fiduciary liability insurance, the plan's fidelity bond, and the personal assets of the defendants, including their own employee benefit plan accounts.⁷

⁷ Section 206(d)(4) of the Act permits a plan to offset the benefits of a participant under an

The exemption also provides that the settlement must not be part of an agreement, arrangement, or understanding designed to benefit a party in interest. The intent of this condition is not to deny direct benefits to other parties to a transaction but, rather, to exclude transactions that are part of a broader overall agreement, arrangement or understanding designed to benefit parties in interest.

Where a settlement includes an extension of credit by a plan to a party in interest for purposes of repaying an amount owed in settlement of litigation, the exemption requires that the credit terms be reasonable. Fiduciaries must consider the creditworthiness of the party in interest and the time value of money in evaluating extensions of credit to settle litigation. The settling fiduciary should also consider security for such loans, such as a third party guarantee or letter of credit, to protect against default.

The Department has added a new condition which clarifies that this class exemption does not cover those transactions that are described in PTE 76-1, A.I. (41 FR 12740, March 26, 1976, as corrected, 41 FR 16620, April 20, 1976) (relating to delinquent employer contributions to multiemployer and multiple employer collectively bargained plans).

Finally, in response to a question received during the comment period, the Department has defined the terms "employee benefit plan" and "plan" to include an employee benefit plan described in section 3(3) of ERISA and/or plans as defined in section 4975(e)(1) of the Code.

B. Conditions Applicable to Prospective Transactions

On a prospective basis, the existence of a genuine controversy must be determined by an attorney retained to advise the plan unless the case has been certified as a class action by the court. That attorney must be independent of the other parties to the litigation. All terms of the settlement must be specifically described in a written agreement or consent decree and the fiduciary authorizing the settlement must acknowledge its fiduciary status in writing.

The exemption provides that in certain instances assets, other than cash,

employee pension plan against an amount that the participant is ordered or required to pay, if the order or requirement to pay arises under a judgment of conviction of a crime involving the plan, a civil judgment, including a consent order or decree, entered into by a court, or where there is a settlement agreement between the participant and the Secretary of Labor or the PBGC in connection with a violation of Part IV of ERISA.

may be received by the plan from a party in interest. Assets may be received by the plan if necessary to rescind transactions. The conditions for retroactive relief do not specify the nature of the consideration exchanged for the release. On a prospective basis, securities with a generally recognized market may be exchanged for the release, provided that such securities can be objectively valued. In addition, the contribution of additional qualifying employer securities is permitted in settlement of the dispute involving such qualifying employer securities. Where assets, other than cash, are provided to the plan in exchange for a release, such assets must be specifically described in the written settlement agreement and valued at their fair market value as determined in accordance with section 5 of the Voluntary Fiduciary Correction (VFC) Program (67 FR 15062 March 28, 2002). The final exemption also provides that the settlement may also include a written agreement to: make future contributions, adopt amendments to the plan, or provide additional employee benefits.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest or disqualified person from certain other provisions of the Act and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act which require, among other things, that a fiduciary discharge his duties with respect to the plan solely in the interests of the participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; nor does it affect the requirement of section 401(a) of the Code that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries;

(2) In accordance with section 408(a) of the Act and section 4975(c)(2) of the Code, and based upon the entire record, the Department finds that the exemption is administratively feasible, in the interests of the plans and their participants and beneficiaries, and protective of the rights of participants and beneficiaries of such plans;

(3) The exemption is applicable to a particular transaction only if the conditions specified in the class exemption are met; and

(4) The exemption is supplemental to, and not in derogation of, any other provisions of the Code and the Act, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

Exemption

Accordingly, the following exemption is granted under the authority of section 408(a) of the Act and section 4975(c)(2) of the Code, and in accordance with the procedures set forth in 29 CFR part 2570, subpart B (55 FR 32836, 32847, August 10, 1990.)

Section I. Covered Transactions

Effective January 1, 1975, the restrictions of section 406(a)(1)(A), (B) and (D) of the Act, and the taxes imposed by section 4975(a) and (b) of the Code, by reason of section 4975(c)(1)(A), (B) and (D) of the Code, shall not apply to the following transactions, if the relevant conditions set forth in sections II through III below are met:

(a) The release by the plan or a plan fiduciary, of a legal or equitable claim against a party in interest in exchange for consideration, given by, or on behalf of, a party in interest to the plan in partial or complete settlement of the plan's or the fiduciary's claim.

(b) An extension of credit by a plan to a party in interest in connection with a settlement whereby the party in interest agrees to repay, over time, an amount owed to the plan in settlement of a legal or equitable claim by the plan or a plan fiduciary against the party in interest.

Section II. Conditions Applicable to All Transactions

(a) There is a genuine controversy involving the plan. A genuine controversy will be deemed to exist where the court has certified the case as a class-action.

(b) The fiduciary that authorizes the settlement has no relationship to, or interest in, any of the parties involved in the litigation, other than the plan, that might affect the exercise of such person's best judgment as a fiduciary.

(c) The settlement is reasonable in light of the plan's likelihood of full recovery, the risks and costs of litigation, and the value of claims foregone.

(d) The terms and conditions of the transaction are no less favorable to the plan than comparable arms-length terms and conditions that would have been

agreed to by unrelated parties under similar circumstances.

(e) The transaction is not part of an agreement, arrangement, or understanding designed to benefit a party in interest.

(f) Any extension of credit by the plan to a party in interest in connection with the settlement of a legal or equitable claim against the party in interest is on terms that are reasonable, taking into consideration the creditworthiness of the party in interest and the time value of money.

(g) The transaction is not described in Prohibited Transaction Exemption (PTE) 76-1, A.I. (41 FR 12740, March 26, 1976, as corrected, 41 FR 16620, April 20, 1976) (relating to delinquent employer contributions to multiemployer and multiple employer collectively bargained plans).

Section III. Prospective Conditions

In addition to the conditions described in section II, the following conditions apply to the transactions described in section I (a) and (b) entered into after January 30, 2004:

(a) Where the litigation has not been certified as a class action by the court, an attorney or attorneys retained to advise the plan on the claim, and having no relationship to any of the parties, other than the plan, determines that there is a genuine controversy involving the plan.

(b) All terms of the settlement are specifically described in a written settlement agreement or consent decree.

(c) Assets other than cash may be received by the plan from a party in interest in connection with a settlement only if:

(1) necessary to rescind a transaction that is the subject of the litigation; or

(2) such assets are securities for which there is a generally recognized market, as defined in ERISA section 3(18)(A), and which can be objectively valued. Notwithstanding the foregoing, a settlement will not fail to meet the requirements of this paragraph solely because it includes the contribution of additional qualifying employer securities in settlement of a dispute involving such qualifying employer securities.

(d) To the extent assets, other than cash, are received by the plan in exchange for the release of the plan's or the plan fiduciary's claims, such assets must be specifically described in the written settlement agreement and valued at their fair market value, as determined in accordance with section 5 of the Voluntary Fiduciary Correction (VFC) Program, 67 FR 15062 (March 28, 2002). The methodology for determining

fair market value, including the appropriate date for such determination, must be set forth in the written settlement agreement.

(e) Nothing in section III (c) shall be construed to preclude the exemption from applying to a settlement that includes a written agreement to: (1) Make future contributions; (2) adopt amendments to the plan; or (3) provide additional employee benefits.

(f) The fiduciary acting on behalf of the plan has acknowledged in writing that it is a fiduciary with respect to the settlement of the litigation on behalf the plan.

(g) The plan fiduciary maintains or causes to be maintained for a period of six years the records necessary to enable the persons described below in paragraph (h) to determine whether the conditions of this exemption have been met, including documents evidencing the steps taken to satisfy sections II (b), such as correspondence with attorneys or experts consulted in order to evaluate the plan's claims, except that:

(1) if the records necessary to enable the persons described in paragraph (h) to determine whether the conditions of the exemption have been met are lost or destroyed, due to circumstances beyond the control of the plan fiduciary, then no prohibited transaction will be considered to have occurred solely on the basis of the unavailability of those records; and

(2) No party in interest, other than the plan fiduciary responsible for record-keeping, shall be subject to the civil penalty that may be assessed under section 502(i) of the Act or to the taxes imposed by section 4975(a) and (b) of the Code if the records are not maintained or are not available for examination as required by paragraph (h) below;

(h)(1) Except as provided below in paragraph (h)(2) and notwithstanding any provisions of section 504(a)(2) and (b) of the Act, the records referred to in paragraph (g) are unconditionally available at their customary location for examination during normal business hours by—

(A) any duly authorized employee or representative of the Department or the Internal Revenue Service;

(B) any fiduciary of the plan or any duly authorized employee or representative of such fiduciary;

(C) any contributing employer and any employee organization whose members are covered by the plan, or any authorized employee or representative of these entities; or

(D) any participant or beneficiary of the plan or the duly authorized

employee or representative of such participant or beneficiary.

(2) None of the persons described in paragraph (h)(1)(B)–(D) shall be authorized to examine trade secrets or commercial or financial information which is privileged or confidential.

Section III. Definition

For purposes of this exemption, the terms “employee benefit plan” and “plan” refer to an employee benefit plan described in section 3(3) of ERISA and/or a plan described in section 4975(e)(1) of the Code.

Signed at Washington, DC this 24th of December, 2003.

Ivan L. Strasfeld,

*Director, Office of Exemption Determinations,
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U.S. Department of Labor.*

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