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May a Fiduciary Accept Gifts and Gratuities From Service Providers?

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Background

It is common practice for service providers to provide modest gratuities, such as meals, tickets to a sporting event, or a round of golf, to employee benefit plan clients as token of goodwill or to aid in the development of the relationship.[1] For example, an investment fund manager may pitch services over a lunch, or counsel to a Taft-Hartley fund may pick up the tab for a meal with several trustees prior to a meeting discussing plan business. A law or accounting services firm may provide the fiduciary with a token gift, such as a hat or T-shirt with the firm's logo. Although small gifts and gratuities may be common, the Department of Labor has taken an increasingly negative stance toward these types of practices, highlighting the need for plan fiduciaries and service providers to reassess the legality of this type of conduct.

In March 2005, the DOL announced a new enforcement initiative related to the disclosure of certain conflict of interest transactions under the Labor Management Reporting and Disclosure Act of 1959 (LMRDA). The provisions of the LMRDA require union officers, employees, and representatives to file a Form LM-30 disclosing certain interests in or payments received from parties dealing with the union or an affiliated employee benefit plan.[2] Employers, including service providers to Taft-Hartley plans, must file a corresponding Form LM-10 disclosing any thing of value given to a labor organization, union official, employee, or labor relations consultant.[3]

Although Congress passed the LMRDA over 35 years ago, the DOL's enforcement of the reporting provisions is a relatively new phenomenon and may present risks to plan fiduciaries and service providers if not properly advised regarding the legality of payments reported on the LM-10 and LM-30. Even *de minimis* payments that are not reportable on the LM-10 and LM-30 are easily accessible in discovery or as part of a DOL investigation because of the LMRDA record-keeping requirements. Of course, the fact that a payment is reportable under the LMRDA does not mean that the payment is

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unlawful. However, by the same token, the fact that a payment is not reportable does not mean that it necessarily is lawful.

Aside from the obligation to report such transactions, the DOL may be using the information reported on the LM-10 and LM-30 to investigate possible violations of the fiduciary self-dealing provisions of ERISA and criminal violations of 18 U.S.C. §1954. The DOL's heightened interest in gratuity transactions may signal a renewed focus on the enforcement of § 406(b)(3) of ERISA,[4] which prohibits a plan fiduciary from receiving any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving assets of the plan.[5] Furthermore, recent guidance from the DOL and its new "Consultant Adviser Program" further illustrate the DOL's interest in the enforcement of the fiduciary self-dealing provisions of ERISA and other statutes criminalizing the receipt of certain gifts, gratuities, and illegal kickbacks by plan fiduciaries.

This report will first discuss the types of transactions that must be reported on the LM-10 and LM-30, and the *de minimis* exemption to the reporting requirements. Next the report will provide a brief description of the DOL's newest enforcement project, the Consultant Adviser Program, which focuses on the receipt of illegal fees and other compensation by investment managers. Although this program does not directly focus on the receipt of gratuities, the DOL has indicated that it plans to look for potential fiduciary and criminal violations associated with the selection of investment managers and other service providers. The report will then turn to an analysis of legal boundaries of ERISA §406(b)(3) and 18 U.S.C. §1954, with a particular emphasis on receipt of gifts and gratuities. Finally, taking these standards into account, we will provide some ideas for plan fiduciaries to consider if they want to formalize rules for their own conduct and the conduct of others regarding their plans.

Reporting under the LMRDA: Forms LM-10 and LM-30

Who must report?

The LMRDA requires individual union officers and employees (other than an employee performing exclusively clerical or custodial services) to file an LM-30 Report annually with the DOL.[6] "Employers" also have a corresponding obligation to report certain economic benefits paid to union officials, employees, or agents by filing the LM-10 Employer Report with the DOL each year.[7] The definition of employer under the LMRDA applies to virtually all private sector businesses or organizations with at least one employee.[8]

What must be reported?

Generally, any payment or loan, direct or indirect, of money or other things of value (including reimbursed expenses) given to any union, union official, agent or employee is reportable unless an exception applies.[9] The DOL issued guidance for the LM-10 in the form of questions and answers in late 2005, and has updated the Guidance as recently as September 19, 2006. The Guidance specifically explains that business development expenses and client relations expenditures by employers are not exempt from reporting under the LMRDA.[10] A great deal of the Guidance focuses on the receipt of gratuities by union officials and plan trustees from service providers. The following are examples of reportable transactions provided by the Guidance:

- An investment management firm provides the use of a vacation home or pays for travel and lodging in an effort to establish a business relationship.[11]

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• A vendor of legal or accounting services to a Taft-Hartley plan takes the union's officers on a "golf excursion."[12]

• A vendor of financial services to a union affiliated pension plan provides a gift worth more than $250 to a union trustee.[13]

• A vendor of printing and publishing services to a union sends a holiday gift basket worth more than $250 to the union's treasurer.[14]

• An investment fund adviser pays for a $300 golf outing for a union official who is also a plan trustee.[15]

• An investment fund adviser occasionally pays for dinners for plan trustees (both management and union) and the aggregate or individual amount exceeds $250.[16]

Although the reporting requirements of the LM-30 and LM-10 are generally parallel in most respects, there are several notable exceptions. First, the LM-30 must be filed by officers and employees of a union if they themselves *or their spouses or minor children* receive certain economic benefits, or hold certain financial interests. The LM-10 does not require employers to report economic benefits conferred upon spouses or minor children, unless the circumstances indicate that the gift is for the "indirect" benefit of the union official.[17] The *de minimis* requirements are generally the same under both forms, and any gratuity conferred directly to the plan trustee (e.g., golf game above the $250 amount) would have to be reported on both forms.

The *De Minimis* Exemption

The Form LM-10 and LM-30 informs filers that they may exclude from their reports "sporadic or occasional gifts, gratuities, or favors of insubstantial value, given under circumstances and terms unrelated to the recipient's status in a labor organization."[18]

Gifts and gratuities with an aggregate value of less than $250 will be considered "insubstantial" for purposes of the *de minimis* exemption.[19] The $250 was recently increased from $25 and refers to the aggregate amount of gifts given to a single union official or union during each year from a single employer.[20] Gifts given by multiple employees of an employer will be aggregated for the purposes of the *de minimis* rules.[21]

The *de minimis* exemption only applies to gifts that are unrelated to the recipient's status in a labor organization.[22] Therefore, even a gift under $250 must be reported if it is given because of the recipient's status as a union representative. The relevant inquiry is whether the employer routinely provides meals or other gifts to its clients under similar circumstances without regard to union status. For example, if a service provider to a Taft-Hartley plan provided a meal to both union and management trustees, and meals of this type are ordinarily offered to its clients under like circumstances, the meal would be deemed unrelated to the union's official's status for purposes of the *de minimis* test.[23]

The DOL has also created an exception for widely attended gatherings, such as receptions, educational conferences, and similar events offered by service providers.[24] The DOL considers a widely attended event to be one where the employer expects a large number of both union and nonunion persons to attend. Union officials must be treated the same as individuals with no connection to the union when the employer advertises or distributes invitations to the event. In calculating the cost of the event, the employer must include the cost of food, beverage, service, and entertainment, but not the

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cost of administration. The employer then should divide the total cost by the number of attendees to determine whether the amount conferred on each individual attendee. However, if the employer pays the cost of travel for a union official, the employer, instead, must report the costs of travel separately on the Form LM-10 subject to the *de minimis* exemption and any other exemption. If the employer sponsors a widely attended event and spends less than $20 per attendee, the employer has no Form LM-10 reporting obligations with regard to tracking or disclosing these costs, even if the employer is required to report the value of any other payment given to union officials during the same year.

The Guidance also contains an exemption for two widely attended events per year where the value conferred on each attendee at each event is less than $125. If the employer holds only one or two events during a fiscal year where the cost per attendee is greater than $20, but less than $125, the employer incurs no LM-10 reporting obligation. The DOL also notes that this exemption applies to the union official's reporting obligation on the Form LM-30. Accordingly, if a union official attends a widely attended gathering where the cost per attendee is less than $125, the official incurs no LM-30 reporting obligation.

The resurrection of the reporting requirements under the LMRDA—and particularly the DOL's focus on gratuities—evidences a considerable degree of interest by the DOL in reporting payments that service providers have traditionally considered marketing or business development expenses. Obviously, if the reported payments are illegal, this provides the DOL with direct information with which to bring a prosecution. In addition, the record-keeping and reporting requirements under the LMRDA also provide the DOL with an easy source of information regarding a possible fiduciary violation.

Consultant Adviser Program

On October 22, 2006, the DOL announced another new enforcement initiative called the Consultant Adviser Program. According to the DOL's Employee Benefits Security Administration (EBSA), the new project will address issues of whether plan service providers, particularly investment advisers, may have potential conflicts of interest that could affect the objectivity of the advice they provide to their pension plan clients.[25] DOL investigations will seek to determine whether the receipt of compensation violates ERISA because the adviser/consultant used its position with a benefit plan to generate additional fees for itself or its affiliates.[26]

Although the program focuses on the receipt of undisclosed compensation by investment fund advisers, the DOL will also "address such potential violations as failure to adhere to investment guidelines and improper selection or monitoring of the consultant or adviser."[27] In addition, the DOL will also seek to identify criminal violations such as fraud or kickbacks with respect to plan fiduciaries and even service providers who are not fiduciaries.[28]

The program's emphasis appears to be focused on the receipt of illegal fees by investment managers. As discussed below, the DOL has recently demonstrated an interest in bringing 18 U.S.C. §1954 criminal prosecutions against service providers who improperly confer gifts and gratuities upon fiduciaries in an effort to influence plan decisions. In conjunction with the LM-10 and LM-30 requirements, the Consultant Adviser Program puts the service provider relationship under the microscope, so plan fiduciaries should be careful not to receive any gifts and gratuities from investment fund managers that could be construed as a kickback given in exchange for plan business or for excessive or unreasonable service fees.

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Liability under §406(b)(3) of ERISA and 18 U.S.C. §1954

Both the LMRDA reporting initiative and the Consultant Adviser Program demonstrate the DOL's increasingly negative stance toward the receipt of gifts, gratuities, and other illegal compensation by plan trustees and fiduciaries. Although token gratuities of modest value are fairly commonplace, plan fiduciaries and service providers should reassess the legality of receiving any type of gift or gratuity to ensure that they are not subject to liability under ERISA and title 18 of the U.S. Code.

ERISA §406(b)(3)

The receipt of gratuities from service providers may run afoul of the prohibited transaction rules contained in § 406(b) of ERISA. Under §406(b), a fiduciary may not:

- deal with the assets of the plan in his own interest or for his own account;[29]
- act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries;[30] or
- receive any consideration for his own personal account from any party dealing with the plan in connection with a transaction involving the assets of the plan;[31]

Practice Tip: Receipt of gifts or gratuities in violation of §406(b) may also violate the general standards of fiduciary responsibility in §404 of ERISA, such as the duty of loyalty and the duty to act in a prudent manner.[32] In addition, although the language of §406(b)(3) makes it illegal for a fiduciary to receive certain payments, service providers can also be liable under this provision for knowingly participating in a breach of fiduciary duty. The DOL often alleges such violations against both the fiduciary and the service provider.

The simple receipt of a gift by a fiduciary may not trigger §406(b)(1) because payments from a service provider are not likely to be viewed as plan assets.[33] However, the receipt of gratuities can violate §406(b)(3) independently because, by its terms, the statute applies to payments received by a fiduciary from third parties. However, there are very few court decisions analyzing §406(b)(3), and only a handful have described the standard of conduct required with respect to commonplace gratuities in the service provider context.

Remedies for §406(b)(3) violations

Suits based on a breach of fiduciary duty can be brought by a participant, beneficiary, fiduciary, or the DOL.[34] As with any other breach of fiduciary duty under ERISA, a fiduciary who accepts an illegal gratuity from a service provider would be personally liable to the plan to make good any losses to the plan resulting from the transaction, and to restore any profits the fiduciary made through use of plan assets. In addition, the fiduciary may be subject to such other equitable or remedial relief as a court may deem appropriate, including removal.[35] Fiduciaries are also potentially liable for excise taxes and a mandatory civil penalty where the DOL is a party to the action. The penalty is 20 percent of the amount recovered pursuant to any settlement with the DOL or any court order in a judicial proceeding instituted by the DOL.[36]

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Legislative History and Interpretation by the Courts

The legislative history regarding §406(b)(3) is not very detailed, but it is clear that Congress intended §406(b)(3) to prevent "kickbacks" and transactions "...which offer a *high potential* for loss of plan assets or for insider abuse."[37] The statutory text and legislative history indicate that the receipt of any gratuity would have to be received "in connection" with a transaction involving the plan to violate ERISA. Therefore, the common practice of providing meals and entertainment of modest value to plan fiduciaries under circumstances where the payment is not provided in connection with a transaction involving the plan seemingly would not run afoul of ERISA. In addition, Congress' concern for payments that offer a "high potential" for loss would, in theory, place token gratuities of marginal value outside the reach of the statute.

Of course, receiving expensive gifts or lavish gratuities may amount to just the sort of violation envisioned by Congress when it enacted §406(b)(3). For example, *Donovan v. Tricario* provides a good example of the type of kickback scenario that §406(b)(3) was intended to prohibit.[38] In *Tricario*, several trustees entered into a tacit agreement to use their influence to make sure that an insurance company received continued business from the plan in exchange for under-the-table money payments and other substantial gifts. The court held that the receipt of monthly payments in the amount of $5,000 and use of a luxury boat (use valued at $16,500) violated section §406(b)(3).[39] Although the court's opinion does not include a detailed analysis of the statute, it clearly found that the trustees not only agreed to the kickback scheme, but that they were actually influenced by the payments when causing the plan to enter into contracts with the service provider.[40]

However, several decisions construe §406(b)(3) very broadly and highlight the need for a well-considered standard of conduct not only for fiduciaries, but also for service providers who may be considered to participate knowingly in a breach of §406(b)(3). In *Brink v. Da Lesio*,[41] a union filed suit against a trustee of the union's pension and welfare funds for a violation of his fiduciary duty under ERISA based on his receipt of free tax services and the use of a luxury condominium provided free of charge by a service provider.[42] The court held the plaintiff does not need to show that the receipt of gratuities actually influenced the fiduciary's decision involving a particular transaction, or that any harm to the plan was caused by the gift.[43] Citing prior decisions interpreting §406(b)(1), the court stated that a fiduciary who engages in a "prohibited transaction does not escape liability by showing the absence of bad faith, or...the presence of a fair and reasonable transaction...."[44] Furthermore, the court reasoned that requiring a plaintiff to prove a *quid pro quo* would be inconsistent with the common law rule that such a showing is not required. As a result, the court determined that §406(b)(3) "... is violated when a fiduciary receives gratuities from any party dealing with the fund."[45]

Although the *Brink* court held that §406(b)(3) does not require a showing of *quid pro quo* or harm to the plan, several aspects of the court's decision are noteworthy. First, although the court held that the plaintiff was not required to prove that the receipt of payments caused an injury to the plan, the court found that the receipt of free tax services actually did harm the plan because the accounting firm took the "free" services into account when billing the fund.[46] Similarly, although the court held that liability for the trustee's receipt of the rent-free condominium was not based on a finding that the gratuity influenced the trustee's decision, the court noted that "Da Lesio's conduct as a Fund trustee did not comport with fiduciary standards, and such an influence can be inferred."[47] As a result, although the court couched its finding of liability simply upon the receipt of the payment, it was careful to note that both gifts did in fact influence the

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trustee's decisions. In any event, the amount of the payments involved clearly exceeded the acceptable norms.

In a similar case, *Secretary of Labor v. Carell*,[48] the court held that fund trustees violated § 406(b)(3) by accepting payment of airfare, lodging, meals, refreshments, entertainment, and other items related to conferences in exotic cities.[49] The service provider also paid for the expenses of the trustees' spouses. Relying heavily on *Brink*, the court held that a violation of §406(b)(3) does not require proof of a *quid pro quo* or any resulting harm to the plan.[50] The court rejected the defendants' argument that the insubstantial value of the gifts undermined any finding that the payments were made "in connection" with a transaction involving plan assets, holding that "[d]efendants point to nothing in the statute or its legislative history hat supports their assertion that the courts must look to the amount in controversy when applying [§406(b)(3)]."[51] Once again, although the court noted that the statute does not contain a *de minimis* rule, the value of the gratuities conferred on the fund trustees was substantial.

Although no circuit court has considered the application of §406(b)(3) to gratuities received from service providers, the Second Circuit construed the language of the statute in *Lowen v. Tower Asset Management, Inc.*[52] In *Lowen*, an investment manager invested plan assets in several risky private equity ventures with companies linked to officers of the investment management firm.[53] The court held that such investments not only violated section §406(b)(1), but for purposes of section §406(b)(3) the receipt of fees, equity interests, and other compensation by Tower in exchange for the private equity contracts amounted to compensation received "in connection with" plan assets.[54]

The court's interpretation of the statute departs from the broad readings in prior §406(b)(3) cases. Unlike *Brink* and *Carell*, the court in *Lowen* held that "[t]he 'in connection with' requirement of §406(b)(3) moderates the strict common law rule that a trustee may not profit (other than from trust administration fees) from transactions involving plan assets."[55] Analyzing the burden of proof required, the court held that "a fiduciary charged with a violation of § 406(b)(3) either must prove by a preponderance of the evidence that the transaction in question fell within an exemption ... , or must prove by clear and convincing evidence that compensation it received was for services other than a transaction involving the assets of the plan."[56]

Practice Tip: Taken together, these decisions inject a considerable degree of uncertainty into any analysis of §406(b)(3). At worst, a fiduciary charged with a violation of §406(b)(3) for the receipt of gratuities from a service provider may not be able to avoid liability by showing:

- the absence of bad faith;
- the absence of a *quid pro quo* or that the gratuity was not given in exchange for a decision involving the assets of the plan;
- the absence of harm to the plan.

However, gifts and gratuities such as meals and entertainment of modest value are a common method of developing relationships between fiduciaries (or other customers) and service providers. And, in most instances, such payments are not intended to influence the fiduciary with respect to any specific decision and are not given "in connection with" a transaction involving the plan. As noted by the Second Circuit in *Lowen*, the "in connection with" requirement of §406(b)(3) should modify the common law rule that the receipt of any gratuity amounts to a breach of fiduciary duty.[57] Furthermore, even if such modest payments amount to "profit" under a strict reading of the statute, the

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remedy scheme provided by ERISA may practically put such payments outside of the reach of §406(b)(3). As explained by the Northern District of Illinois in *Ossey v. Marolda*: "... accepting a token gift from a broker may well constitute a prohibited transaction. Even if it does, however, the statute provides no remedy for it. ERISA requires fiduciaries who breach their obligations to "make good to such plan any losses ... resulting from" the breach and "to restore to such plan any profits" the fiduciary made from its use of plan assets.[58] It is difficult to imagine how a plan would lose money because a fiduciary attended a business development dinner with a broker. Moreover, assuming that a dinner or a round of golf even constitutes "profit" within the meaning of this section, it is impossible to imagine plan trustees suing a fiduciary to recover the value of a dinner for the plan."[59]

DOL's Position on §406(b)(3) Violations

When asked whether the receipt of modest gratuities violates §406(b)(3), Virginia Smith, Director of Enforcement for EBSA, told the authors "[t]he facts and circumstances of each situation must be evaluated in order to determine if a specific transaction is a violation of ERISA, but fiduciaries must be very careful about accepting any gift or gratuity from a service provider, even items of modest value."

The DOL has not issued regulations or formal guidance explaining in detail the types of transactions that may violate §406(b)(3). However, the resurrection of the LMRDA reporting requirements has generated a significant degree of interest in this area from both Taft-Hartley plan trustees and service providers. Although the DOL acknowledges that the law in this area remains uncertain and subject to a "facts and circumstances" analysis, regulations or guidance in this area remains unlikely in light of the resources required to interpret the Pension Protection Act of 2006.

February 23, 2005 Information Letter

The DOL's most recent guidance on this issue is a February 2005 Information Letter related to a possible violation of § 406(b)(3).[60] A union trustee requested guidance from the DOL after receiving contributions from several service providers toward his campaign for the state legislature. During the campaign, the fund was in the process of selecting a third-party administrator. A trustee subcommittee narrowed down the choices to two potential TPAs. The trustee in question did not participate on the subcommittee and did not have a vote in the selection of the two finalist TPAs.

After the two finalist TPAs were chosen, the trustee's campaign committee solicited the participation of over 600 donors, including the two TPAs, for a golf fundraiser without the trustee's knowledge. Representatives from both TPAs attended the golf event and contributed a total of $280 to the campaign fund. After the trustee discovered the contributions from the TPAs, he directed the campaign committee to return the amount of the contributions and recused himself from the final selection of the TPA.

In addition, prior to the trustee's election to the state legislature, a cocktail party was held in an effort to raise campaign funds. Although the trustee did not participate in the selection of the invitees, several service providers to the fund, including fund counsel, attended the event and made contributions to the campaign. The trustee also returned all contributions received from service providers at the cocktail party.

The letter explains that to avoid the possibility of a fiduciary violation, the trustee not only had to recuse himself from the decision, but he also had to inform all of the other trustees that he received the payments. Although the letter does not directly address the issue of whether the receipt of the contributions violated §406(b)(3), it suggests that the payments were made under circumstances that could potentially violate §406(b)(3) or lead to a

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prohibited transaction under §406(b)(1).

Relationship between the *De Minimis* Rule for LMRDA Reporting and Violations of §406(b)(3)

The guidance issued pursuant to the LMRDA acknowledges that although some gratuities may rise to the level of a conflict of interest, others, such as lunch or coffee, are so minuscule that they are not of interest to plan participants. For example, the DOL's Q&A Guidance for the LM-10 states:

> "Workers in their capacities as union members and participants in pension and welfare plans have a right to know whether insurance companies, banks, and credit institutions have provided their union's officials with expensive gifts, golf outings, entertainment, hunting trips, and other gratuities. In this way, they can gauge...whether pension and welfare plan business decisions are being made solely in the best interests of the plan, without regard to any personal benefits received by the union official. At the same time, the $250 *de minimis* threshold helps to ensure that employers are not burdened with reporting routine transactions of little interest to union members."[61]

The DOL's reasons for establishing a *de minimis* rule for purposes of the LMRDA, in theory, would apply to §406(b)(3) violations as well. It is extremely unlikely that a plan would suffer because a small or token gratuity is given from a service provider to a fiduciary. In addition, it is unlikely that a participant, fiduciary, or the DOL would file suit to recover the value of a dinner or a golf game that costs the service provider $50 or $100. However, the DOL offers no affirmative support for the position that the *de minimis* standard applicable to LMRDA reporting applies to a violation of §406(b)(3).

In fact, Virginia Smith, Director of Enforcement for EBSA, has carefully pointed out that "neither ERISA nor its implementing regulations have any *de minimis* amounts in connection with the application of the statute's standards of fiduciary conduct. In addition, the plan itself may have standards of fiduciary behavior which must be followed by plan fiduciaries."

Possible Criminal Violation: 18 U.S.C. §1954

In addition to the self-dealing provision in ERISA § 406(b)(3), the improper receipt of gifts and gratuities may also violate 18 U.S.C. §1954. With limited exceptions,[62] this criminal statute prohibits fiduciaries and union officials from "receiv[ing] or agree[ing] to receive or solicit[ing] any fee, kickback, commission, gift, loan, money or thing of value because of or with intent to be influenced..."[63] The definition of "thing of value" applies to virtually any payment or gratuity, including meals, lavish hunting trips, expensive sporting event tickets, personal loans, and even intangibles, such as legal services."[64] The statute also criminalizes the conduct of service providers who convey gratuities to fiduciaries and union officials with the intent of influencing the fiduciary's actions related to the benefit plan.

In a recent information letter,[65] the DOL acknowledged that the receipt of campaign contributions from service providers could not only violate the fiduciary standards in §406(a) and §406(b), but may amount to a criminal violation under §1954. This notation in the DOL's letter likely comes as a result of a high-profile investigation of Capital Consultants, LLC and subsequent settlements and lawsuits associated with over 30 trustees who received lavish gifts from Capital. With these violations fresh in the DOL's

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mind, the agency appears poised to bring §1954 violations in situations where gratuities are given under circumstances where the service provider intends to influence the trustee, or where the trustee receives the gift with the intent to be influenced.

Until recently, courts applied 18 U.S.C. §1954 very broadly and held that the government did not need to prove a *quid pro quo*, or that the gift or gratuity was actually intended to influence a specific plan decision.[66] Courts also held that the statute applied not only to fiduciaries, but to anyone that may only indirectly influence plan decisions, such a business agent of a labor union local, or counsel to a Taft-Hartley fund.[67]

In 1999, the Supreme Court decided *U.S. v. Sun-Diamond Growers of California*, which involved a claim brought under 18 U.S.C. 201(c)(1)(A), a gratuity statute that prohibits giving "anything of value" to a present, past, or future public official "for or because of any official act performed or to be performed by such public official."[68] In *Sun-Diamond*, the government took the position that any thing of value given to the official because of his official position constituted an illegal gratuity under §201(c)(1)(A).[69] However, the court held that "in order to establish a violation of 18 U.S.C. 201(c)(1)(A), the government must prove a link between a thing of value conferred upon a public official and a specific 'official act' for or because of which it was given."[70]

Although *Sun-Diamond* did not involve a violation of 18 U.S.C. §1954, the similarity of the language used in 18 U.S.C. §1954 and 18 U.S.C. §201(c) makes *Sun-Diamond* persuasive authority for any case dealing with 18 U.S.C. §1954. For example, in U.S. v. Kirkland,[71] the District of Oregon held that the government must prove that the intent to influence a plan decision was a "substantial motivating factor" for giving the gift or gratuity.[72] Applying the Supreme Court's reasoning in *Sun-Diamond*, the court held that the government could not prove a violation of 18 U.S.C. §1954 simply by proving that the trustee received something of value from a person doing business with the plan because of the trustee's general ability to decide matters involving the plan, or merely to "seek a reservoir of goodwill."[73] Although the service provider defendant was convicted, the individual trustees, who received lavish hunting trips valued at over $50,000, were not convicted because the court found that the government had not met the standard under *Sun-Diamond*.[74]

Kirkland is the most recent case brought by the DOL involving a violation of 18 U.S.C. §1954 for giving or receiving gifts and gratuities, and served as the capstone to the DOL's extensive investigation and prosecution of Capital Consultants, LLC.

Advising Clients on How to Avoid § 406(b)(3) and 18 U.S.C. §1954 Violations

The resurrection of the LMRDA reporting requirements and the Consultant Adviser Program demonstrate the DOL's increasingly negative stance toward gratuities received by fiduciaries from service providers. Although the DOL's guidance related to the LMRDA reporting requirements possibly could serve as a guide for the types of payments that may run afoul of ERISA, the absence of a *de minimis* standard or comprehensive guidance provides little solace to fund trustees and service providers searching for a bright-line rule with which to conform their conduct. However, informal conversations with national and regional DOL representatives along with the guidance issued pursuant to the LMRDA reporting requirements may serve as a principled basis for establishing an approach to proper fiduciary conduct and maintenance of service provider relationships.

First, most trustees and fund counsel know that substantial gifts or gratuities can give rise

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to a fiduciary violation. For example, a violation of §406(b)(3) is clear in a situation where the trustee is receiving an actual "kickback" from a service provider, e.g., direct cash payments or expensive gifts from a service provider under circumstances that indicate that the payment was given "in connection with" a transaction involving plan assets.

Practice Tip: Trustees clearly should not receive the following types of payments:

- **Cash payments.** Direct payments of cash, no matter what the amount and even if the payment is made for a cause unrelated to the plan.

- **Travel costs.** The cost of travel to any event that is not related to plan business is, under most circumstances, a violation of ERISA.

- **"Related" gratuities.** The DOL tends to view gratuitous services that correlate to the relationship between the trustee and the service provider (e.g., a free tax return provided to a trustee by an accounting services provider to the fund) in a negative manner, no matter how marginal the value of such services.

- **Gifts of unreasonable value.** The receipt of expensive gifts of substantial value that may give rise to an inference that the payment is made under circumstances that indicate the service provider intends to influence the fiduciary's decision. For example, a golf excursion hunting trip to an exotic location is likely to be viewed more unfavorably than a simple golf outing where a service provider pays for green fees or a hunting day-trip at a local hunting club where the service provider is a member. Similarly, season tickets amounting to over thousands of dollars in value are likely to be viewed differently than a $40 ticket to a baseball game.

- **Frequent gifts.** Gratuities of modest value which otherwise may be permissible but which are conferred on a frequent basis with a substantial aggregate value may run afoul of ERISA or trigger a DOL investigation.

Less clear under the court decisions and DOL guidance is whether the common practice of providing meals, entertainment, and token gifts of modest value to plan fiduciaries constitutes a violation of §406(b)(3).[75]

Practice Tip: First and foremost, the plan document should be the fiduciary's guide when considering whether a particular transaction or course of conduct violates fiduciary standards, assuming the plan's documents establish a standard that comports with ERISA. ERISA §404(a)(1)(D) requires plan fiduciaries to "act in accordance with the documents and instruments governing the plan." Therefore, if the plan document requires a fiduciary to refrain from receiving any and all gratuities from service providers, this standard should govern the individual's conduct.

However, assuming that the plan does not require complete abstinence from receiving even minimal gratuities, a fiduciary should carefully consider the circumstances surrounding the receipt of any thing of value. A conservative approach might lead a fiduciary, trustee, or board of trustees to completely abstain from the receipt of any and all gratuities. For example, the plan could send a letter to all potential and current service providers putting those parties on notice that the fiduciaries of the plan will not receive such gratuities in any amount. This may be the best approach for fiduciaries seeking a bright-line rule of conduct.

A second possible approach is for the plan to establish a *de minimis* standard of its own or to establish guidelines for the conduct of its fiduciaries. If a plan takes this approach, it could track the principles outlined in the LMRDA guidance because, at least in the context of the LMRDA, the DOL has indicated that token gratuities of marginal value

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provide little potential for a conflict of interest. However, the DOL may regard such a policy as being in technical non-compliance with ERISA.

In developing such a policy, a plan could deal specifically with:

- **Gifts of trivial or nominal value**. This would include sporadic gifts such as a Christmas basket, a reasonably priced meal, and token marketing gifts, such as a T-shirt or hat with the service provider's logo.

- **General attendance events**. This includes widely attended gatherings and receptions where a service provider invites all clients without regard to status as a plan representative, and where the amount conferred per attendee is reasonable.

- **Gratuities provided for an independent purpose**. This would include gratuities provided to a fiduciary of a plan for reasons independent of the individual's status as a plan representative. For example, if the service provider has a relationship with the fund representative independent of the client relationship and the gratuity is provided in with regard to that relationship, it is unlikely the gift will run afoul of ERISA.

- **Mixed-use or educational gratuities**. Meals or brief entertainment provided as part of or in conjunction with a program designed to educate fund representatives could be treated more favorably by the DOL.

Because of the high degree of uncertainty in this area, individual trustees, plan representatives, and service providers should consult counsel when developing policies to comply with ERISA or when confronted with a questionable gratuity.

Footnotes

[1] *See, e.g.*, U.S. v. Kirkland, 330 F. Supp.2d 1151, 1175 (2004) (noting that it was common practice for investment fund managers to take trustees to dinner, sporting events, or golf); Mader, Joyce A., *Trustee and Plan Expense Issues* (Nov. 2006), p. 32.

[2] Form LM-30 Instructions, *General Instructions* (2006).

[3] Form LM-10 Instructions, *General Instructions* (2006).

[4] "EBSA Seeks Fiduciary Self-Dealing, Using Labor Reports as Data Trove," *BNA Pension and Benefits Rep.* (153 PBD, 08/10/06; 33 BPR 1924, 8/15/06).

[5] ERISA §406(b) states:

(b) A fiduciary of with respect to a plan shall not –

(1) deal with the assets of the plan in his own interest for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) *receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.* (emphasis added).

[6] LMRDA §202.

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[7] LMRDA §203.

[8] Form LM-10 Q&A Guidance, A1 (Sept. 19, 2006). It still is uncertain, however, whether Taft-Hartley plans themselves will be categorized as employers for purposes of the LM-10.

[9] LMRDA §§202-203.

[10] LM-10 Guidance at Q&A 46.

[11] *Id.* at Q&A 2.

[12] *Id.* at Q&A 18.

[13] *Id.*

[14] *Id.*

[15] *Id.* at Q&A 22.

[16] *Id.* at Q&A 23.

[17] *Id.* at Q&A 40.

[18] Form LM-10 Instructions, Part A, Item 8a; LM-10 Guidance at Q&A 50; Form LM-30 Instructions, General Instructions for Reportable Transactions and Interests, Parts A, B, and C; Form LM-30 Advisory – De Minimis Exemption Increased (Nov. 7, 2005).

[19] Form LM-30 Advisory – De Minimis Exemption Increased (Nov. 7, 2005); LM-10 Guidance, at Q&A 50.

[20] LM-10 Guidance, Q&A 50; the DOL has suggested that the dollar amount applicable to the *de minimis* standard may be changed as applied to both the LM-30 and the LM-10.

[21] LM-10 Guidance, Q&A 50.

[22] *Id.*

[23] *Id.*

[24] *Id.* at Q&A 60-61.

[25] "Labor Department Adds Consultant Adviser Program to Its National Enforcement Projects," BNA Pension & Benefits Rep. (204 PBD, 10/24/06, 33 BPR 2565, 10/31/06).

[26] *Id.*

[27] *Id.*

[28] *Id.*

[29] ERISA§406(b)(1) .

[30] ERISA §406(b)(2).

[31] ERISA §406(b)(3).

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32 *See* DOL Adv. Op. 2003-09A (June 25, 2003) (discussing §406(b)(3) and the applicability of general fiduciary standards under §404(a)); DOL Adv. Op. 97-15A (May 22, 1997) (same).

33 Typically, violations of §406(b)(1) are brought where the fiduciary wrongfully causes a payment from the plan directly to himself or causes the plan to enter into a transaction that personally benefits the fiduciary. *See, e.g.*, Marshall v. Kelly, 465 F. Supp. 341 , 353 (W.D. Okla. 1978) (trustee caused the plan to make payments to himself for gratuitous services); Gilliam v. Edwards, 492 F. Supp. 1255, 1263 (D.N.J. 1980) (fiduciary authorized payment for his own services); PBGC v. Morin, 2000 WL 760737 (D. Me. 2000) (trustee transferred $141,760 from the plan to himself and $1,200 to a corporation controlled by the trustee); Conger v. Universal Marketing, Inc., 2000 WL 1818521 (D. Or. 2000) (fiduciary caused the plan to make loans to himself); *see also* Freund v. Marshall & Ilsely Bank, 485 F. Supp. 629, 637-38 (W.D. Wis. 1979) (trustees subordinated interests of the plan by causing the plant to enter into transaction through which many of them personally benefited); *Lowen*, 829 F.2d at 1214 (fiduciary investment manager invested plan assets in companies in which fiduciary owned substantial interest).

34 ERISA §502(a)(2).

35 ERISA §409(a).

36 ERISA §502(l).

37 H.R. Conf. Report No 93-1280, 1974 U.S. Code Cong. & Admin. News 5038, 5087 (emphasis added).

38 5 EBC 2057, 2065 (S.D. Fla. 1984).

39 *Id.*

40 *Id.*

41 496 F. Supp. 1350 (D. Md. 1980).

42 *Id.*

43 *Id.*

44 *Id.* (internal citations omitted).

45 *Id.* at 1368.

46 *Id.*at 1368-1369.

47 *Id.* at 1370-1371.

48 17 EBC 1159 (M.D. Tenn. 1993).

49 *Id.* at 1163.

50 *Id.* at 1164.

51 *Id.*

52 829 F.2d 1209 (2d Cir. 1987).

53 *Id.* at 1214.

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54 *Id.*

55 *Id.*

56 829 F.3d at 1215.

57 *Id.* at 1214.

58 1998 WL 67624, *5 (N.D. Ill. 1998); 29 U.S.C. §1109(a).

59 Ossey v. Marolda, 1998 WL 67624, *8 (N.D. Ill. 1998).

60 DOL Information Letter, William Lindsay, Feb. 23, 2005.

61 LM-10 Guidance, at Q&A 45 (answer portion).

62 The statute provides for an exception for any payment that qualifies as "bona fide salary, compensation, or other payments made for goods or facilities actually furnished or for services actually performed in the regular course of his duties." 18 U.S.C. §1954.

63 18 U.S.C. §1954 provides:

"Whoever being –

(1) an administrator, officer, trustee, custodian, counsel, agent, or employee of any employee welfare benefit plan or employee pension benefit plan; or ...

(3) an officer, counsel, agent, or employee of an employee organization any of whose members are covered by such plan...

receives or agrees to receive or solicits any fee, kickback, commission, gift, loan, money, or thing of value because of or with intent to be influenced with respect to, any of the actions, decisions, or other duties relating to any question or matter concerning such plan or any person who directly or indirectly gives or offers, or promises to give or offer, any fee, kickback, commission, gift, loan, money, or thing of value prohibited by this section, shall be fined under this title or imprisoned not more than three years, or both. . ."

64 *See e.g., Kirkland*, 330 F. Supp.2d at 1151 (hunting trips, meals, and sporting event tickets); U.S. v. Schwartz, 785 F.2d 673 (9th Cir. 1986) (service provider offered "assistance" with the merger of two labor union locals).

65 DOL Information Letter, February 23, 2005, at n. 3.

66 U.S. v. Friedland, 660 F.2d 919, 926-927 (3d Cir. 1981) (citing *Palmeri*, 630 F.2d 192, 199-200 (3d Cir. 1980) (holding that receipt of the gift with the intent to be influenced is enough to prove a violation of 18 U.S.C. §1954; proof of actual transaction influenced by the gift is not required); U.S. v. Romano, 684 F.2d 1057 (2d Cir. 1982) (statute encompasses any consideration received by the fiduciary because of a decision made with respect to plan assets regardless of intent).

67 U.S. v. Palmeri, 630 F.2d 192 (3d Cir. 1980), *cert. denied,* 450 U.S. 967 (1981) (union local business agent covered); U.S. v. Robilotto, 828 F.2d 940 (2d Cir. 1987) (same); U.S. v. Friedland, 660 F.2d 919 (3d Cir. 1981) (counsel to fund covered by statute).

68 526 U.S. 398, 404 (1999) (discussing 18 U.S.C. §201(c)(1)(A)).

69 *Id.* at 405.

70 *Id.*at 414.

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[71] 330 F. Supp. 2d at 1151.

[72] *Id.* at 1174.

[73] *Id.*

[74] *Id.* at 1194.

[75] Joyce A. Mader, *Trustee and Plan Expense Issues* (Nov. 2006), at p.32.

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