

Client Alert

A report
for clients
and friends
of the firm July 2003

DOL Issues Proposed Class Exemption for Retirement Plans Sponsored by Trust REITs

The U.S. Department of Labor (the "DOL") has proposed a prohibited transaction class exemption that would allow an individual account plan (e.g., a 401(k) or profit sharing plan) sponsored by a real estate investment trust (a "REIT") to acquire, hold or sell publicly-traded shares of beneficial interests in the REIT. The National Association of Real Estate Investment Trusts ("NAREIT") requested the exemption on behalf of REITs structured under state law as business trusts ("Trust REITs") that are publicly traded on the New York Stock Exchange, American Stock Exchange or NASDAQ.

Because of certain state tax-related advantages, the use of a trust as a REIT business form has become common. Of 228 publicly-traded REITs, 52 are structured as Trust REITs. Generally, REITs structured as business trusts are virtually indistinguishable from REITs structured as corporations. Shareholders of Trust REITs have the same limited liability protection as do stockholders of corporate REITs, Trust REITs are managed by trustees in much the same way that corporations are managed by directors, and Trust REIT shareholders and corporate REIT stockholders receive the same type of disclosure documents required by the Securities and Exchange Commission.

Despite the similarities between Trust REITs and other REITs, 401(k) plans and other individual account plans maintained by a Trust REIT are prevented from offering interests in the employer as an investment option under the plan. While the Employee Retirement Income Security Act of 1974 ("ERISA") generally prohibits a retirement plan from acquiring any employer security, there is a limited exception for "qualifying employer securities" which are securities consisting of stock, marketable obligations (generally a bond, debenture, note or certificate), or interests in a publicly traded partnership. Currently, REITs that are organized as corpora-

tions are able to take advantage of this exception and their individual account plans may hold employer securities. However, since Trust REITs do not issue equity interests in the form of stock, it is unclear whether their interests can be held by their plans because the shares of beneficial interest issued by a Trust REIT may not technically constitute "stock" and, thus, satisfy ERISA's definition of a "qualifying employer security."

Proposed Exemption

The proposed exemption would allow employee benefit plans of Trust REITs the same opportunity to invest in employer securities as those plans maintained by other REITs. However, the exemption as proposed would not provide relief from ERISA's fiduciary duty provisions (e.g., the duties of prudence and diversification of plan investments).

If granted, the proposed class exemption would provide both retroactive and prospective relief from ERISA's prohibited transaction provisions for in-kind contributions, purchases, holdings or sales by defined contribution plans sponsored by a Trust REIT (and/or its affiliates) of shares of beneficial interest in a Trust REIT. The shares must be publicly-traded and have no trading restrictions other than those necessary to qualify for REIT status or to satisfy securities law or applicable exchange or market system trading rules.

In addition, the proposed exemption would apply to purchases and sales of qualifying REIT shares that occur between participants' accounts in a plan to avoid brokerage commissions and other transaction costs, provided that the transaction is executed at the closing price for the Trust REIT shares on the national exchange or market system the shares are traded on the date of the transaction. The required conditions of the proposed exemption depend on whether retroactive or prospective relief is sought.

Retroactive Relief

The exemption would provide retroactive relief to plans maintained by Trust REITs that have offered Trust REIT shares as an investment option during the six year period prior to the date of the final exemption.

Among the conditions required for the exemption to apply retroactively, participants must have had discretionary authority to sell the REIT shares no less fre-

quently than quarterly and to vote, tender and exercise similar rights with respect to those shares. Alternatively, an independent fiduciary must have had such discretionary authority.

This means that relief is not available with respect to Trust REIT shares that were subject to "lockup" provisions (*e.g.*, participants could not sell the shares contributed to their account for some period of time). The DOL is specifically seeking comments on whether the scope of this exemption should be modified to provide additional retroactive relief involving trust REIT shares that were subject to a "lockup."

If qualifying REIT shares were contributed in-kind to, or purchased by, a plan from a Trust REIT, the shares must have been conveyed to the plan:

- at or below the market price for the Trust REIT shares on the applicable national exchange or market system at the time of the transaction; and
- without the payment of any commission or other fee in connection with the transaction.

Prospective Relief

To qualify for the exemption prospectively, among the exemption's conditions, participants must have discretionary authority to direct the trustee to sell qualifying REIT shares purchased by, or contributed to, an account no less frequently than monthly and to vote, tender and exercise similar rights with respect to such shares in the account over which the participant has discretion. Alternatively, an independent fiduciary must have discretionary authority to exercise such rights.

Like ERISA's general exemption for qualifying employer securities, a person directing an investment in qualifying REIT shares (*i.e.*, the participant or the independent fiduciary) will need to be provided with financial information with respect to the Trust REIT (*e.g.*, the most recent prospectus, quarterly report and annual report for the Trust REIT) at the time of an initial investment in Trust REIT shares and thereafter as updated information becomes available.

The proposed exemption would also require plans to comply with certain confidentiality requirements that are not generally required of other plans. All information relating to the purchase, holding and sale of qualifying REIT shares, and the exercise of voting, tender and similar rights with respect to such shares by participants, would need to be maintained in accordance with procedures designed to safeguard the confidentiality of such information (except to the extent necessary to comply with Federal or state laws not preempted by ERISA).

In addition, before a plan participant, plan sponsor or independent fiduciary can engage in an initial transaction under the exemption, the Trust REIT (or an affiliate) must provide certain information to the participant or independent fiduciary. This information includes:

- the amount of any fees for brokerage services or transaction costs that will be incurred as a result of the transactions;
- the role of the Trust REIT, if any, as a principal in the transactions;
- the exchange or market system where the qualifying REIT shares are publicly traded; and
- a statement that a copy of the proposed and final exemption will be provided to participants and the independent fiduciary upon request.

A plan fiduciary will generally be required to maintain records for a period of six years so that the DOL, the Internal Revenue Service, plan fiduciaries and plan participants may determine if the conditions of the exemption are met.

Comments Requested

If you believe the relief provided by this proposed exemption could be useful to your employee benefit plans or if you have any comments as to how this exemption should be modified before it is finalized, please contact Proskauer Rose LLP.

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