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## The Expenses Putting Your Apprenticeship Program at Risk

by | Jennifer E. Germaine

Failing to properly evaluate apprenticeship program expenses such as the purchase of real estate can cause programs to run afoul of Department of Labor and ERISA regulations.

benefits  
MAGAZINE

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# Common Sense:



Imagine this: An apprentice makes a complaint about a training program (operated by a local union through a joint board with local contractors) to an international union that sponsors the local union. Representatives from the international make an on-site visit to investigate the local and the apprenticeship program. From this investigation, the international union finds the apprenticeship fund conducted Department of Labor (DOL)-prohibited transactions, including renting property from the local union and sharing secretarial staff. The international union determines this is a major issue for the program and recommends hiring legal counsel to clean up the mess.

### The Path to Destruction

This might seem like an extreme example, but the situation described above happens over and over again. Trustees often fail to realize what expenses are allowed in their apprenticeship program and what type of expenses represent DOL-prohibited transactions that carry with them massive risk to the entire program. The previously mentioned example actually occurred, and the program had to request nearly \$90,000 back from the local union for payments made for the rent and shared secretarial staff. The program also incurred another \$50,000 in attorney fees. Insurance did not cover any of it.

Even worse, the trustees lost valuable time they could have spent working in their real jobs. The investigation into the prohibited transaction rule violations and the subsequent remedy took more than two years to complete. The board members each spent several hours a month looking into the issue and attending special board meetings. Other board members re-

signed, and no other union member or contractor was willing to serve on the apprenticeship board. In the end, the board felt it had no choice but to merge its local apprenticeship program with a larger regional program and, as a result, lost control of the local training.

All of this could have been avoided if the board of trustees would have taken the proper steps to evaluate these transactions before entering into the rent and secretarial-sharing relationships with the union.

Unlike health and welfare funds or retirement plans, an apprenticeship program operates the most like a normal business. However, unlike a normal business, the apprenticeship program is governed by DOL and the Employee Retirement Income Security Act (ERISA), which requires the apprenticeship program to abide by strict rules and regulations on the use of assets and payment of expenses. These rules and regulations don't always align with common sense and can put an apprenticeship program at risk. This article will describe the questions trustees should ask when evaluating expenses in their program and how ERISA applies to those questions.

### The Path to the Promised Land

Here's another example. An apprenticeship program is slowly growing and has had some success in recruiting good applicants. However, the program is feeling the pinch of the tight labor market and wants to attract top-level applicants to give member contractors the competitive edge they deserve in the market. The board starts identifying recruitment strategies and decides to purchase real estate to build a state-of-the-art training center, with the construction provided by one of the member contractors. The board selects a location, and the fund has enough money to purchase the property with the help of a loan from the local union. The local union also has agreed to use the building for its office and meeting space. This arrangement will benefit the program, a contributing contractor and the local union. It seems like a win for all.

Where should the fund start to evaluate whether this transaction is legal?

Apprenticeship boards get into difficult situations time and time again because they fail to speak to an attorney specializing in apprenticeship programs before they take any action or incur any expenses. Many of the ERISA regulations may seem contrary to common sense when considering the apparent benefits of the situation. Although the above example seems like a simple real estate transaction that benefits several related

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parties, the transaction carries several hidden risks that trigger ERISA issues and represent prohibited transactions. Discussing such plans with an ERISA apprenticeship attorney before acting will ensure apprenticeship funds know the proper steps to take so they will not get hit after the fact with thousands of dollars in penalties.

ERISA Section 404 sets forth the duties trustees have to their program. The trustees must act solely in the interest of the apprentices and trainees in the program for the exclusive purpose of providing training to apprentices and trainees and paying reasonable expense of running the training program. The following are questions and issues that apprenticeship trustees should consider when evaluating an expense under ERISA.

***Will This Expense Benefit Program Trainees?***

A board of trustees needs to answer this question for every expense in its program.

Perhaps upon discussing the transaction, the board determines that the real estate purchase and construction of the training center will directly benefit the apprentices and trainees in the program because the building will be larger and training capabilities will be improved. The new space will also be built in a highly visible area to help attract top-level applicants. After discussing the benefits, the board should document in the meeting minutes the reasons stated for how the transaction will benefit apprentices and trainees in the program.

If an expense will not benefit trainees, the board cannot pay for it through the apprenticeship program. Common examples of expenses that do not benefit trainees are gifts to long-time employees

**takeaways**

- The Employee Retirement Income Security Act (ERISA) contains regulations that govern the transactions that benefit funds, including apprenticeship funds, may engage in.
- Apprenticeship fund trustees often fail to realize what expenses are allowed in their apprenticeship programs and what type of expenses trigger transactions prohibited by Department of Labor (DOL) regulations.
- When evaluating an expense, trustees must determine whether it will benefit program trainees and whether the expense is necessary and reasonable.
- Apprenticeship boards should not conduct business with a contractor, union or other related party with whom a trustee is personally involved unless a specific prohibited transaction exemption applies and is followed.

who are retiring or excessive spending on graduation parties. The program may look to other sources to pay for the expenses. For instance, the trustees could personally pay the expense, or the contractor's association or union could pay for the expense instead of the apprenticeship program.

***Is the Expense Necessary?***

After determining that the expense will benefit the apprentices and trainees in the program, trustees must determine whether it is necessary.

Making that determination requires a board to look at its overall finances to verify that the program can afford the expense and whether it is actually necessary to move the program forward. The purchase of real estate and construction of a building is a significant expense that should be planned for several years. In addition to financing the initial costs, the program will need enough money to afford any increased utility, repair and maintenance expenses. Again, the board should discuss the effect of the expense on the plan and document the discussion and outcome in meeting minutes. Those minutes can be shown to DOL officials if the expense is questioned in the future.

***Is the Expense Reasonable?***

The reasonableness of an expense relates to whether the program is getting the best value. The program needs to research each expense to determine whether it is reasonable within the market. Boards should research prices of comparable providers of the service or product to determine a range of reasonable prices. Unfortunately, information about many expenses is not publicly available, such as the expenses for a loan for the purchase of real estate or the construction of a building. These types of expenses will require programs to request proposals or bids to determine the fair price within the market.

If a loan is required for the purchase of the real estate and construction or renovation of the building, boards should request quotes for loan terms from several banks or institutions to be able to compare terms, interest rates and the security requested from the program. Trustees should then document in the meeting minutes why they chose the loan and how it will impact the program.

In the case of a real estate purchase, it is recommended that funds use a real estate agent or appraiser to determine the fair market value of the property they want to purchase. Determining the

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fair market value will help determine whether the price for the property is reasonable. Boards should make sure to keep records of comparable real estate or the appraised value of the real estate showing the fair market value of the property.

If the project will require the construction or renovation of a building, boards should request bids from several contractors in order to compare costs. Trustees are not required to choose the lowest bidder. Instead, boards should analyze the contractors based on the services they provide and their fees. If the board decides to go with a contractor that does not have the lowest fees, the board should document in the meeting minutes the reasons behind its choice of contractor. All bids should be kept with the records of the apprenticeship program to document that this step was taken.

### ***Hidden Risk***

A massive hidden risk is lurking if a program purchases property or receives a loan from the union, contractor, another benefit fund or other service provider. It's also a risk to consider construction bids from contractors that contribute to the apprenticeship program. ERISA considers the union, contributing contractors, benefit funds and other service providers to be related parties, and related party transactions are automatically prohibited.

Funds that engage in prohibited transactions are required to pay significant penalties. Plus, the entire transaction is subject to being reversed, and the related-party must pay back the money plus interest from the time it received payment. Board members face personal liability for these penalties. In addition, the program's relationship with that related party will be stressed, if not ruined.

A program entering into any transactions with the union, contractor, another benefit fund or service provider should consult with an attorney specializing in ERISA apprenticeship programs. Exemptions are available and can be requested from DOL to provide programs with relief from the strict prohibited transaction rules.

A prohibited transaction is also triggered if a board does business with a contractor, union or other related party with whom a trustee is personally involved. For example, it is a conflict of interest for an owner of a contributing contractor who is also a trustee for the program to bid on construction for the building. The contractor may still bid on the project, but that trustee needs to be removed from all board discussions on the construction bids and the vote on construction bids. This is the only way to not trigger this type of prohibited transaction.

### ***Union Use of the Building***

If the purchase of real estate and construction of the building is contingent on the union having office and meeting space, the fund will trigger another prohibited transaction. The apprenticeship program should consider discussing with an attorney how to set up the relationship. Available options include dividing the building into condominium-style offices or renting directly to the union. Any situation will require certain specific steps to follow to avoid significant prohibited transaction penalties.

If a union officer is also a trustee on the board for the apprenticeship program, the apprenticeship program must remove that union officer from the board's discussion and vote on the relationship with the union. If all union/labor trustees for the program are also union officers, the board may need to appoint a neutral union trustee with authority to discuss and vote on the apprenticeship program's relationship with the union regarding the building.

### **Conclusion**

When evaluating program expenses, apprenticeship fund boards of trustees should ask "Will this expense benefit the apprentices and trainees in my program?" and "Is this expense reasonable and necessary?" Those that are purchasing property from or entering into a relationship with the union, a contributing contractor, benefit fund or other related entity should speak with an attorney specializing in apprenticeship program law about any potential prohibited transaction rules that may be violated and how to comply with the law. 🗨️