



ESOP Sustainability: Fiduciary and Governance Issues

Ohio Employee
Ownership Center

April, 2009

Ben Wells

Dinsmore & Shohl LLP

1900 Chemed Center

225 East 5th Street

Cincinnati, OH 45202

513-977-8108

ben.wells@dinslaw.com



What are we going to cover?

- Legal decision making roles
 - In a corporation
 - In an ESOP
- Decision making confusion
- Fiduciary Rules



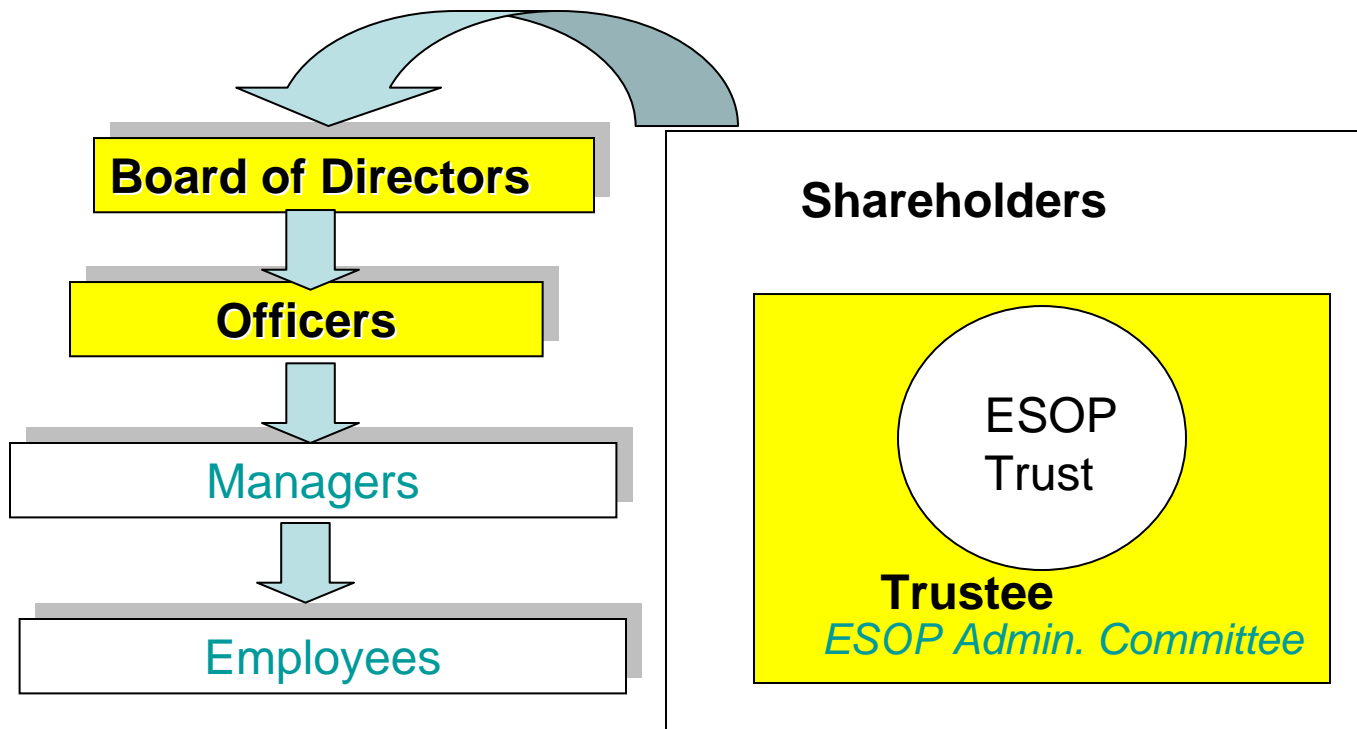
Who runs an ESOP-owned company?

No formal change in the way the company runs

- Shareholders elect the Board of Directors
 - Also vote on major corporate transactions
- Directors responsible for running the company
 - Can delegate authority to managers
- Officers/Managers appointed by Board
 - Have responsibility for day-to-day operations



Corporate Structure and Fiduciary Obligations





Who runs an ESOP?

- Trustee(s)
 - Legal owner of the ESOP shares
 - f/b/o ESOP participants
- Plan Administrator/Administrative Committee
 - Manages operation of the ESOP
 - May direct Trustee
- Company (Board)
 - Establishes ESOP
 - Chooses trustee and committee
 - May amend or terminate ESOP
- TPA/Consultants
 - Agent of Plan administrator



Duties – must guide decision making

■ Board

- Fiduciary Duties
- Must act:
 - With care
 - In good faith
 - In the interest of the corporation
- Protected by
 - Business Judgment Rule
 - State anti-takeover statutes
- Limited ERISA fiduciary duties



Duties – must guide decision making

■ Officers/Managers

- Duty of loyalty to corporation
- Must act only within scope of authority



Duties

ESOP Fiduciaries - ERISA fiduciary duties

- A fiduciary must comply with the requirements of ERISA:
 - Prudent person rule
 - Exclusive purpose rule
 - Plan Document Rule
 - Prohibited transaction rules (similar, but not identical, provisions in the Code)



What is a “prudent person”?

- ERISA Prudence requirements
 - Prudent person rule
 - Fiduciary must act with the “care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use”
 - “[ERISA’s] test of prudence...is one of conduct and not a test of the result of performance of the investment. The focus of the inquiry is how the fiduciary acted in his selection of the investment and not whether his investments succeeded or failed.” Donovan v. Cunningham, 716 F. 2d 1455, 1457 (5th Cir. 1983).



What is the “exclusive purpose rule”?

- Exclusive purpose rule
 - Fiduciary must discharge his duties for the exclusive purpose of providing benefits to participants and their beneficiaries
 - A fiduciary must act “with an eye single to the interests of the participants and beneficiaries.”



What is the “plan document rule”?

- Plan document rule
 - A fiduciary must follow the plan documents to the extent that they are consistent with ERISA
 - The overall rule of prudence prevails in that if it is imprudent to follow the plan documents, then the fiduciaries need not follow the plan document.



How can a fiduciary comply with all of these rules?

- The keys are prudent management, ongoing monitoring and documentation.
- Process is crucial



What is a “settlor” function?

- **Board/Company normally acts as “settlor” of the ESOP**
- Generally relates to formation rather than administration or management of a Plan.
- Generally settlor functions are not subject to ERISA’s fiduciary rules.
- Example: Establishment or termination of a Plan is a settlor function.
- Appointment of trustee, even by the settlor, is a fiduciary function.



Duties

- Shareholders
 - Few duties as such
 - Majority shareholder has duty of fairness to minority



ESOPs do not

- Change roles of shareholders, directors and officers
- Change state law duties and responsibilities



Where does “sustainability” fit in?

- Repurchase obligation
- Commitment to employee ownership
- Succession planning
- Potential sales/acquisitions
- Company growth
- Communication
- Tax planning



What are the roles of:

- **ESOP Trustees**
- **Other ESOP fiduciaries**
- **Directors**
- **Officers**
- **Employees/participants**



Dinsmore & Shohl Offices

CHARLESTON

900 Lee Street
Huntington Square, Suite 600
Charleston, WV 25301
Phone (304) 357-0900

CINCINNATI

255 East Fifth Street, Suite 1900
Cincinnati, OH 45202
Phone (513) 977-8200

COLUMBUS

191 West Nationwide Boulevard,
Suite 300
Columbus, OH 43215
Phone (614) 221-8448



DAYTON

One Dayton Centre
One South Main Street,
Suite 1300
Dayton, OH 45402
Phone (937) 449-6400

1100 Courthouse Plaza, SW
10 North Ludlow Street
Dayton, OH 45402
Phone (937) 449-2800

LEXINGTON

Lexington Financial Center
250 West Main Street,
Suite 1400
Lexington, KY 40507
Phone (859) 425-1000

LOUISVILLE

1400 PNC Plaza
500 West Jefferson Street
Louisville, KY 40202
Phone (502) 540-2300

MORGANTOWN

215 Don Knotts Boulevard,
Suite 310
Morgantown, WV 26501
Phone (304) 296-1100

PITTSBURGH

One Oxford Centre
301 Grant Street, Suite 2800
Pittsburgh, PA 15219
Phone (412) 281-5000

WHEELING

Bennett Square
2100 Market Street
Wheeling, WV 26003
Phone (304) 230-1700