

ESOP | Report

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Culture, Great Food, Exciting Activities, and the National Conference: Washington Has All You Need for a Great Spring Trip.

You already know that the National Conference offers great content with more than 70 sessions, and a unique opportunity to visit your elected officials with your peers in the ESOP community. But you might be surprised by all the entertainment options that will be available to you when you come to our nation's capital in May.

Washington is an exciting city with a metropolitan population of more than six million people and a host of unique options to quench your thirst, sate your hunger, and satisfy your desire for an entertaining spring visit.

Look at some of the options below, and be sure to check out our [Going Out Guide](#) (on the National Conference page of our website) for additional information.

Start with the Classics

Visit the multitude of [DC museums](#), many of them a short trip from the conference hotel and most of them [absolutely free](#)! Or take a walk to the National Mall and get great views of the Washington Monument, Lincoln Memorial, Vietnam Veteran's Memorial, and the World War II Memorial.

Or you can save yourself the walk and sign up for our Night Tour of the Monuments when you [register](#) for the National Conference.

More Interested in DC's Night Life?

See a concert, belly laugh at a comedy club, see one of our resident spirits on a ghost tour, or find the kind of spirits that come in a bottle at one of the thousands of restaurants and bars in the city. DC is home to sidewalk cafes, rooftop bars, and even a [floating paddle bar on the Potomac River](#). If you can't find something great to do here, you just haven't tried.

Just want to hang out? Last year some attendees headed to [Buffalo Billiards](#) for daily food and drink specials and games like skeeball or pool. Another option: the thriving new waterfront area known as the [District Wharf](#).

Want a More Natural Experience?


Did you know if you want to see a Giant Panda in the flesh (and don't want to leave the country) you've got only four options, and D.C. is one of them? Preview the experience with the live, [Panda Cam](#). The national zoo has animals of all shapes and sizes—including the giant panda's less famous cousin, the Red Panda. Best of all, the price for admission is free.

While you are at the Zoo, consider taking a hike in Rock Creek Park or going for a relaxing drive through this oasis of green in the heart of DC.

Speaking of Capitol Hill...

After visiting your elected officials, stop by one of our favorite spots, the Library of Congress. This library is the largest in the world with more than 168 million items. It's also completely free to visit!

Want more options? Get the official Washington DC [Visitors Guide](#).

Whatever you decide to do, share your photos using our conference hashtag #ESOPDC, or show us how you're living the ESOP rock star lifestyle with #ESOPsRock. 

President's Corner

Something in the Air

James J. Bonham, President & CEO

If you haven't had the chance to attend a chapter meeting or other event with your employee owner peers this spring, I want to tell you something they know that you probably don't: There is definitely something going on in our community. There is an energy that seems to be building around employee ownership, and it isn't isolated to ESOPs.

Perhaps the single best barometer of enthusiasm and energy I have is the attendance level at The ESOP Association's 18 state and regional chapter conferences spread across the nation. As you know, these local, volunteer-driven events aren't just close to the grassroots, they *are* the grassroots. And somebody has been fertilizing the lawn.

I've now visited four chapters in five weeks, and I expect to visit at least two more before our National Conference next month. Every single event I've attended set a new record for attendance. And, while I would like to take credit for that statistic, it clearly isn't about me, because it is happening everywhere. Seven of our chapters have registered record attendances for any spring conference they've held, and several others have scored record

ESOP Report



The Voice of The ESOP Association

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attendance for the specific location they were at this year. The few chapters that are not setting records are reporting full houses and certainly well above-average participation.

We are seeing it at the national level too.

The ESOP Association's National Conference (now in its 42nd year!) has grown to a size where only four hotels in Washington, DC can even hold our attendees. This year, we sold out our block of 530 rooms at the JW Marriott a full two weeks before the early registration deadline! So our staff hit the street and negotiated new room blocks at adjacent hotels—and they are filling up fast, too. There is something going on.

Outside our association, the story is the same. Sen. Pat Roberts (R-KS) introduced pro-ESOP legislation so quickly at the beginning of the Congress that the bill received the lowest bill number of any ESOP bill in history: S-177. These low numbered bills, especially from a retiring Senator, indicate a very high interest in passing it into law. Think of it this way: Senators introduce their highest priority bills first. If each of the 100 Senators introduces two top priorities, that takes up the first 200 bill numbers. Ours is 177. Oh, and we already have two bills—HR 2022 and HR 2258—that have been introduced in the House. Pretty good start.

Last month one of our Mid-Atlantic Chapter members, Mid-South Building Supply in Virginia hosted a Small Business Administration outreach forum for potential new ESOPs in the suburbs of Washington, DC. They had around 30 local companies come and listen to the panel, with very

little promotion of the event—we know because we were there. We met later with the SBA and now plan to connect Chapters and host companies across the country to their effort to help grow the ESOP community while there is such enthusiasm on the street.

When you look around the states, you also see groups like the Employee Ownership Expansion Network (EoEx)



setting up to help identify and educate potential new ESOPs in several places through the state centers they are trying to form. These are important efforts for the entire community to identify potential ESOPs and incubate them.

This is all, of course, just anecdotal evidence. But I also know there are some exciting new studies coming out that may tell us the enthusiasm for employee ownership extends well beyond current ESOPs.

I believe we are at the start of an entirely new era for employee ownership. I think the evidence is mounting that our elected leaders and government officials are ready to embrace and support that future. What an incredibly exciting time to be part of this effort. €

Ownership Advantage

Explaining Distribution Delays to ESOP Participants

By Steven R. Lifson, Seyfarth Shaw LLP

At one of our annual ESOP conferences I participated on a panel to discuss the “ABC’s of Employee Communications.” In that panel, we discussed communicating basic administration information—such as participant eligibility, annual allocations, vesting, and distributions.

(Although these may appear to be mundane matters, a plan administrator is legally required to communicate them to participants in a written summary plan description. And many ESOP companies go well beyond what is legally required in an effort to effectively communicate to employee owners how the ESOP operates.)

During the panel, an audience member asked for ideas about communicating ESOP distribution rules—in particular, why a 401(k) plan allows for immediate distribution and the ESOP imposes a five or six year delay before a former employee may request a distribution.

The attendee mentioned that employees have expressed concern, confusion, and some distrust over the delay.

There are various reasons for a delay in distribution from an ESOP, and we discussed several of them.

For example, unlike a 401(k) plan—in which plan assets can be sold on a public market—the plan sponsor of an ESOP is responsible for either:

- Repurchasing shares of stock distributed by an ESOP, or
- Contributing cash to the ESOP, which is then paid to the former employee.

In either situation, the plan sponsor must divert cash from other business purposes to fund the distribution from an ESOP. This legal obligation often is referred to as the plan sponsor’s “repurchase liability.”

Many plan sponsors devote considerable time and effort to studying and managing this repurchase liability, and

these studies contain information that may be shared with employees to help them understand the rationale behind the delay.

Another reason for a distribution delay is that the bank or other lender in the transaction that created the ESOP (or a sale of additional shares) may request that distributions be delayed for a limited period of time to better ensure the company has sufficient cash to pay down its loan. The statutory rules permit an ESOP to delay distributions to a terminated employee for up to six years, and then to spread out payment of the participant's account over as many as five annual installments.

Furthermore, shares of stock acquired by an ESOP in a leveraged transaction may be delayed until the related ESOP loan is repaid, except in cases of death and normal retirement.

An ESOP company also may have its own unique reason for delaying distributions, consistent with the ESOP statutory distribution rules.

One of my early ESOP clients was a large, long-established company with an older employee population. The ESOP purchased 100 percent of the outstanding stock of the company in a single transaction, and the company took on significant debt to fund the purchase. As a result, company management and the bank felt it was prudent to delay distributions—including distributions to retirees—for at least five years.

To accomplish this delay, the ESOP defined the term “normal retirement age” to mean age 65, plus five years of participation in the ESOP. This meant that existing employees who were close to age 65 would not reach retirement age for at least five years.

I was asked to meet with older employees and explain to them the legal requirements and the rationale behind the delayed distribution. I realized that the best—and, perhaps, only—acceptable approach was to be honest, forthright, and direct.

I started with an explanation of the history of the ESOP and the stock transaction. I explained the rationale behind

deferring distributions to all employees, and how this delay would give the company time to pay down some of its debt.

I explained that the company, and all the ESOP's participants, needed the efforts of all employees to make the ESOP a success. I also explained that the bank involved in the transaction had negotiated hard so that distributions would be delayed until a certain portion of the bank debt had been repaid.

This situation helped me realize that often it is necessary to communicate negative news or unpopular information. Through the years I have been called on to address unfortunate events and convey negative information, such as significant drops in stock values during the stock market dips in the 1990s and in 2009. Another example is a freeze or reduction of the annual employer contribution to an ESOP or to a 401(k) plan.

I have found that bad news left unaddressed tends to produce greater anxiety and negativity than if the issue had been brought to light. I also have learned that people are willing to accept bad news if they understand the context.

Editor's Note: For information on the other side of this issue—when an ESOP company can make distributions without a participant's consent—see the Advisory Committee on Administration article below.

This article was reviewed and approved by the Chair of the Ownership Culture Committee, Jason Wellman, Senior Relationship Consultant, ESOP Partners. 

Calendar of Deadlines and Important Dates

May 22 ESOP Association National Awards Ceremony

May 23-24 [National Conference](#)

June 23-28 [Leading in an Ownership Setting](#)

Aug. 7-9 [Employee Owner Retreat](#)

Nov. 14-15 Las Vegas ESOP Conference & Trade Show

To see the full list of ESOP Association meetings, visit us online at: www.esopassociation.org.

Advisory Committee on Administration

When Can Distributions Be Paid Without Participant Consent?

By Carla Klingler, Blue Ridge ESOP Associates
Reviewed by Susan Petrirena, Swerdlin & Company

Despite best efforts, mistakes commonly occur in qualified plans. ESOPs are particularly complex, with special rules that may result in errors. The goal of this article is to explain several of the most common errors

that occur and to provide some guidelines for potential fixes.

For many years, this has been a common question: “How long can we wait to distribute vested ESOP account

balances?” Considerations included a company’s cash flow management, ESOP repurchase obligations, a carefully crafted Distribution Policy, and the company’s philosophical stance on dis-incentivizing employees to quit their jobs so they could access their retirement accounts.

However, over recent years with the growth of tax-efficient 100 percent ESOP owned S-corporations and the increase in consistent and targeted employee communications, many ESOP companies have experienced a steep rise in productivity, fair market value, and accumulated cash on hand.

With ESOP account balances rising and plenty of cash in the company, thoughts at some businesses have shifted from worrying about having enough cash to the question of *who* is benefiting from increases in stock value?

The simple answer is that ESOP participants are benefiting, and that is good news! But ESOP participants

Thoughts at some businesses have shifted from worrying about having enough cash to the question of who is benefiting from increases in stock value?

are made of up both *active* participants and *terminated* participants. And while it is the Trustee’s job to make decisions in the best interests of *all* ESOP participants, it is the Board of Directors’ responsibility to make decisions in the best interests of the shareholders.

In most companies, the bulk of increased productivity and value is the result of the continued efforts of *active* employees. Meanwhile, *terminated* participants with deferred distributions continue to reap the benefits of their ESOP account balance, sometimes long after their employment—and efforts on behalf of the company—have ended.

In fact, many terminated participants intentionally postpone distribution of their ESOP accounts because the account is inexpensive to them to maintain (the company normally pays the administration fees) and they don’t expect a better return on other investment options.

These experiences can persuade the Board that to sustain a comparable level of growth and to best serve the shareholders (including the ESOP), it is best to get the stock back into the accounts of active employees as soon as possible—both as an incentive and a reward for employees’ ever-increasing productivity.

This certainly is not the situation at every ESOP company, but for purposes of this article, it is true often enough to raise the question: When can distributions to ESOP participants be forced out of the hands of terminated participants and back into the accounts of active participants?

The answers to this question are found in the distribution provisions in the Plan Document and Distribution Policy, and in the “Participant Consent” requirements of Treasury Reg. 1.411(a)-11. It is important to understand the Consent

requirements and how they relate to plan provisions, distribution policies, and administration forms that are used for notifying participants of their distribution rights.

Notifying Participants

A primary fiduciary responsibility under ERISA is to timely pay plan participants the benefits due under a qualified retirement plan *and* to disclose the tax consequences and available benefit options before checks are cut.

There are specific steps the plan administrator must take to notify plan participants of their benefits—and their rights to postpone payment—before a distribution can be made. Participants must be given time to read and understand the distribution forms and the required tax notice (often referred to as the “402(f) tax notice”). The plan administrator must give the participant at least 30 days to review the distribution package and decide whether to “consent” to the plan distribution or not.

If the participant does not provide written consent, or does not return completed paperwork within the deadline outlined in the distribution forms package, a determination can then be made by the plan administrator to “force out” the distribution in accordance with the plan’s force out provisions. “Forced Out” distributions also are commonly referred to as “mandatory distributions.”

When Mandatory Distributions Are Allowed

Consent requirements do not apply to every payable situation, and the plan administrator generally can “force out” distributions (if the plan permits) under the following circumstances:

Vested Balances of \$1,000 or Less. The plan administrator can make direct payments to the participant, net of the required 20 percent federal withholding tax (and applicable required state tax). The plan document also can provide for the automatic rollover of these accounts (instead of cash outs to participants) if uncashed checks are anticipated to be an administration problem.

Vested Balances greater than \$1,000 but no more than \$5,000. The plan administrator can force out payment to an automatic IRA rollover account.

NOTE: In determining whether an account falls under the \$1,000 or \$5,000 threshold (“small amount”), the plan may stipulate that amounts rolled over from a prior plan or IRA—and earnings on those amounts—are not considered. If the account is determined to be a “small account” per these thresholds, distribution of the entire vested balance of the account can be forced out.

Vested Balances greater than \$5,000. The plan administrator can distribute, without consent, at the later of normal retirement age (as defined in section 411(a)(8)) or age 62 to an automatic IRA Rollover account. **Fiduciary alert:** There are different interpretations and plan document

Engineers of the Future?



In March, Mechanical Mayhem, a robotics team sponsored by ESOP Association member Cirtronics, won the FIRST Robotics Granite State District Event. The team also earned the Gracious Professionalism Award

for demonstrating the core values of working together respectfully and supporting the success of other teams. Those sound like core values for a lot of ESOP companies, too.

nuances surrounding the fiduciary ability to force out a distribution greater than \$5,000 before age 70½. The relative code section, 26 CFR 1.411(a)-11(c)(4) states:

Participant consent is required for any distribution while it is immediately distributable, i.e., prior to the later of the time a participant has attained normal retirement age (as defined in section 411(a)(8)) or age 62. Once a distribution is no longer immediately distributable, a plan may distribute the benefit in the form of a QJSA in the case of a benefit subject to section 417 or in the normal form in other cases without consent.

Being able to force out a retirement benefit at retirement age is a consistent interpretation with other qualified plan regulations, but best practice would dictate having your ERISA attorney weigh in on the decision and support this interpretation.

Death of a Participant. Consent requirements under section 411(a)(11) expire after the death of a participant.

Qualified Domestic Relations Order (QDRO).

Generally, distributions to an alternate payee under a QDRO under section 414(p)(8) are exempt from the consent requirements.

Required Minimum Distributions (RMD) at Age 70½ can be paid out without consent directly to the participant.

Since the RMD is not eligible for rollover, it is not subject to the 20 percent federal tax withholding rules. Federal withholding of 10 percent applies unless the participant opts out of it.

Plan Termination. Participants must be given the opportunity to elect direct payment or rollover of their benefit. If participants do not timely consent to the distribution, their distributions can be forced out and rolled over to another qualified plan of the employer, regardless of the amount of the distribution. If the employer has no other qualified plan, all undistributed accounts can be rolled over into an auto/mandatory IRA established under safe harbor provisions for auto-rollovers.

ERISA requires the plan sponsor to act prudently in choosing the IRA provider and the investment vehicle to use for the automatic rollovers. The Department of Labor (DOL) issued “safe harbor” guidance in Notice 2005-5. Most products on the market available to plan fiduciaries and branded for this purpose are structured to satisfy the DOL safe harbor requirements.

Once the fiduciary has made a choice regarding a safe harbor provider that offers a safe harbor investment vehicle, the fiduciary responsibilities shift away from the plan sponsor and onto the provider, as expressly provided in the DOL guidance.

Conclusion and Action Items

There are many reasons beyond fiduciary requirements that a plan sponsor may take a more proactive approach to mandatory distributions of terminated participant accounts. When handled properly, this approach generally will reduce plan expenses and administrative responsibilities, eliminate the plan fiduciaries' obligations for those forced out accounts, and get company stock reallocated back into the ESOP accounts of current employees.

There are four main areas of focus to make sure your plan documents and disclosures to participants are consistent and compliant with regulations and the terms of your plan:

1. Review the distribution provisions of your plan document and distribution policy, including force out provisions. Determine if changes should be considered.
2. Review your Plan Document (including trust agreement) and the Summary Plan Description

(SPD) to make sure that all of the language in these documents is consistent and reflects your operational intent. The SPD must include an explanation of their rights and what will happen if they do not return their distribution election forms consenting to a distribution. Be sure to ask your Third Party Administrator (TPA) or attorney for assistance, as needed.

3. Have your TPA (and possibly your ERISA attorney) review your administration forms and confirm these forms are consistent with your plan documents and your operational intent.
4. Choose an IRA provider that meets the DOL "safe harbor" requirements. [E](#)

This article was reviewed and approved by the Chair of the Administration Advisory Committee, Dolores Lawrence, Managing Director at Blue Ridge ESOP Associates.

Legal Update

Appellate Court Affirms Award in Favor of Constellis Group

By Stanley E. Bulua and Lawrence S. Hirsh, Robinson Brog

Edited by Julie Govreau, Senior Vice President and Chief Legal Counsel, Greatbanc Trust Company, Lisle, IL

On March 21, 2019, the Court of Appeals for the Fourth Circuit in Richmond, Virginia affirmed in all respects the 2017 decision in the closely-watched case of *Brundle et al. v. Wilmington Trust, N. A., No. 17 – 1873 (4th Cir. March 22, 2019)*. The lower court in the case had awarded \$29.7 million in damages against an ESOP trustee, plus attorneys' fees.

Background

Constellis Group, Inc., the parent company of a group of subsidiaries offering private security services, created an ESOP that purchased 100 percent of Constellis' voting stock in December 2013.

The sale amount of \$4,235 per share was based on what the court described as an estimated range of enterprise value of \$275 to \$325 million.

Less than a year after the ESOP was created, all its stock was sold to a major competitor, Academi LLC, for approximately \$281 million, a price within the same estimated range of value.

In 2015, Tim P. Brundle, a former employee who was a participant in the Constellis ESOP, sued. Brundle alleged that Wilmington Trust, N.A.:

- Breached its fiduciary duties as the trustee for the ESOP's 2013 purchase of Constellis's shares.

- The transaction was a prohibited transaction under ERISA.
- The share price paid by the ESOP exceeded the fair market value of the stock by more than \$103 million.

Following a multi-day bench trial, the district court issued detailed findings of fact, concluding that the trustee had indeed breached its fiduciary duties in several respects, causing the ESOP to overpay for Constellis's stock by \$29,773,250. The court entered judgment against Wilmington in that amount, and awarded attorney's fees totaling \$3.3 million—\$1.5 million of which was to come from the money awarded to the ESOP.

Wilmington appealed the judgment. Brundle also appealed, seeking more in attorney's fees. On appeal, the Fourth Circuit affirmed the district court's decision in all respects.

Analysis of the Trustee's Conduct

The Court of Appeals began its analysis with a discussion of the governing legal principles, which it described as undisputed by the parties. Noting that the exception to ERISA's ban on party-in-interest transactions requires that an ESOP pay no more than "adequate consideration" for an employer's stock, the court stated that "the focus of the adequate consideration inquiry rests on the *conduct* of a

fiduciary, as judged by ERISA’s ‘prudent man’ standard of care.”

The court noted that the fiduciary (in this case, the trustee for the ESOP) bears the burden of proving—by a preponderance of the evidence—that the employer’s stock was sold for adequate consideration. The court then turned to the facts of the case as had been set out in the district court’s opinion.

The Court of Appeals applied a very deferential standard of review to the trial court’s factual findings that Wilmington had not established the affirmative defense of adequate consideration under ERISA §1108(e).

On appeal, Wilmington emphasized there was no claim it had acted in bad faith. The court noted, however, that an ESOP participant seeking recovery from its fiduciary need not prove the fiduciary acted in bad faith but only that the fiduciary failed to act solely in the interest of the participants and failed to engage in a *reasoned decision making process*.

Thus, the court was not concerned with Wilmington’s motives, but rather with the process Wilmington engaged in when considering whether to approve the transaction.

Wilmington’s challenge to the trial court’s decision relied heavily on the valuation of Constellis stock submitted by its financial advisor, SRR. Upholding the trial court’s factual findings, the court discussed what it described as Wilmington’s four principal failures:

1. Failure to investigate SRR’s omission from its report of another, lower valuation of Constellis stock that had been done just months earlier by an investment bank.
2. Failure to adequately probe the reliability of financial projections prepared by Constellis management, particularly since a management bonus plan based on the purchase price provided management with a financial incentive to inflate the purchase price.
3. Failure to investigate the appropriateness of applying a 10 percent control premium to Constellis stock and not discounting the valuation for lack of control in light of the limited control rights provided to the ESOP.
4. Failure to probe why SRR consistently rounded the valuation of Constellis stock upwards throughout its report.

Regarding each of these areas, the court affirmed the findings of the district court under the deferential “clear error” standard of review, finding that the trial testimony adequately supported the lower court’s conclusions.

In its discussion of those four issues, the court upheld the district court’s overall criticism of Wilmington’s process, concluding the transaction was hurried so it would conclude before the end of 2013 and maximize the after-tax benefits to the sellers.

The court noted the entire ESOP transaction—from the trustee’s due diligence through the tender offer for the stock—was completed in less than two months. The court

found there was insufficient time allotted to review SRR’s valuation report, as Wilmington repeatedly violated its 48-hour rule for receipt of reports, and that the trustee’s meetings to discuss the transaction each lasted less than 90 minutes.

Importantly, the court also discussed Wilmington’s investigation of the appropriateness of including a 10 percent control premium to the value of stock. While Wilmington argued that control was evidenced by the ESOP’s ownership of 100 percent and other indices of control, the Court of Appeals upheld the district court’s finding that the structure of the deal—wherein the sellers retained the ability to appoint the majority of the Board, and Wilmington served as a directed trustee—meant the ESOP had “essentially no power to control Constellis.”

The court further rejected the so-called ERISA “out,” wherein a fiduciary could refuse to follow a direction if it violates the plan or ERISA, finding it was available to any shareholder, even a minority shareholder. The court’s analysis of control makes clear that a trustee must analyze what control in fact the ESOP is obtaining if a control premium is to be considered.

The court opined that ESOPs structured to maintain the sellers’ control over the company post-transaction required not only analysis of control, but consideration to apply a minority discount.

The court’s decision upholding the trustee’s liability thus focused on the lower court’s determination that the trustee’s conduct, particularly its process in evaluating the valuation conclusion of its financial advisor, was lacking. It should be noted that this transaction occurred in 2013 and that since that time, most trustees and their financial advisors have improved their processes, which may obviate many of the concerns identified by the court in *Constellis*.

Review of the Damages Awarded

Having rejected Wilmington’s challenges as to liability, the Court of Appeals turned to a discussion of damages. The court approved the district court’s analysis of the comprehensive damages estimate provided by Brundle’s expert, which was based on subtracting the stock’s fair market value as determined by the court from the price paid by the ESOP.

According to the court, because Wilmington did not offer an alternative damage calculation, it forfeited any objection to the damages methodology used by the district court. The appellate court also upheld the district court’s refusal to offset its damages calculation by the \$20 million in cash the ESOP received from the Academi sale.

In this regard, the opinion is consistent with the position taken in many ESOP cases by plaintiffs—including the Department of Labor—that subsequent gains involving the stock after the date of the ESOP transaction have no bearing on the loss incurred at the time of the ESOP’s purchase of the stock.

Educating New Potential ESOP Companies



In late March, ESOP Association member Mid South Building Supply hosted an educational event for companies interested in employee ownership. Attorney and ESOP Association member Christopher McLean of Kaufman and Canoles PC was one of four panelists who addressed the well attended session. Events like these are being conducted by the Small Business Administration, which has been directed by the 2018 Main Street Employee Ownership Act to provide employee ownership education. For more information, see the Washington Report on page 10.

Review of Attorneys Fees

The Court of Appeals awarded Brundle's counsel \$1,819,631 in fees based on ERISA's statutory fee shifting provision authorizing prevailing plaintiffs to recover reasonable attorneys' fees from defendants. The court also awarded an additional \$1.5 million in fees to be paid from the judgment awarded to the ESOP.

No party appealed the award of attorney's fees under the fee shifting statute.

Brundle challenged the \$1.5 million in additional fees, claiming the amount was too small. Brundle's claim was based primarily on the fact he had entered into a one-third contingency fee agreement with his counsel, which would have produced approximately \$9.9 million in attorneys' fees.

The district court determined that Brundle had no right to have the ESOP fund his own contingency agreement with his lawyers, a conclusion the Court of Appeals refused to disturb.

The court noted that because ERISA does not authorize a party suing on behalf of an ESOP to unilaterally bind the ESOP to a contract or fee agreement, most suits on behalf of ERISA plans take the form of class actions, in which counsel can seek fees after a class has been certified and

class members have been given the opportunity to object or opt out.

This case did not proceed as a class action because class certification was denied early in the proceedings. Brundle's attorneys nevertheless continued to pursue the case on his behalf, but as noted, their contingency fee arrangement was found to be not binding on the ESOP.

Wilmington and Constellis, as fiduciaries, objected to the \$1.5 million in attorneys' fees, arguing that ERISA's anti-alienation and exclusive benefit provisions precluded such an award. The court found that ERISA did not bar this aspect of the attorneys' fee award because the funds produced by the damages award had not yet been delivered to the ESOP and could not be considered plan assets.

The court's opinion upholds long-standing precedent that the process that is undertaken, rather than the final result, is important in ascertaining whether a fiduciary breached its duty to an ESOP.

While many of the criticisms concerning the trustee's probing of the financial analysis have already been addressed by trustees and financial advisors in the normal course, the decision is important in that it does lay a firmer framework around what is considered "control" of an ESOP company. €

Washington Report

Advocacy and Engagement Beyond the Halls of Congress

By James Bonham, President and CEO, The ESOP Association

Representing ESOPs in Congress will always be central to The ESOP Association's mission. TEA and our friends at the Employee Owned S-Corps of America (ESCA) are both structured as 501(c)6 not for profit organizations, a legal requirement to lobby any level of government. ESCA is an excellent partner with TEA, but their mission is focused only on S-corp ESOPs, leaving TEA as the only advocate working on behalf of all ESOPs.

But in an era when Congress is being less productive legislatively, to achieve our goal of making employee ownership available to every American, we need to expand our efforts beyond Capitol Hill. We can and will work through other channels to expand employee ownership—and along the way we will seek your help.

Some of these expanded efforts likely will follow the course of the budding efforts outlined below.

SBA

We are exploring new ways of working collaboratively with the Small Business Administration (SBA) to the benefit of both organizations. The Main Street Employee Ownership Act directs the SBA to educate small businesses on ESOPs and employee ownership. The SBA has a job to do, and they can use our help to do it well.

We have initiated conversations with SBA about helping both organizations achieve their shared objectives. We are offering our expertise and chapter network to interested SBA districts, and we are getting positive responses.

We hope you will help in these efforts too—by offering to host an SBA educational event at your offices, by helping to spread the word in your local business community when these events take place, and by sharing your expertise and experiences.

The legislation mandating these educational sessions was a great step forward, and we thank our supporters in the House and Senate for their efforts. By putting our collective shoulders to the wheel, we can help make this new initiative succeed at attracting new ESOP company formation.

This is a great example of how we can move beyond the narrow confines of federal legislation to grow ESOPs, when it makes sense to do so.

Department of Labor

The tension between the Department of Labor and the ESOP community is well known and long standing. And,

while we must remain firm, we need a new posture and a genuine dialogue that can help form a new relationship with the professionals at this important agency.

Our community urgently needs clear DOL guidance on issues such as adequate consideration. ESOP companies and potential ESOP companies simply want to set up reasonable plans and to follow the federal government's rules. For that to happen, they first need to know what the rules are.

Currently, there are no clearly defined rules, and the case law and DOL arguments in those cases are at times contradictory on key points in different cases. This creates more uncertainty and confusion. Neither of those things is conducive to helping businesses grow or share the rewards with their employees.

But beating up the DOL has not worked, and in my quarter century in Washington I have learned you need both a carrot and a stick to be successful. If DOL isn't giving clear guidance to our community, perhaps we need to take on that responsibility ourselves. We should look into ways to identify and articulate the best of what our community has learned in the last 45 years about adequate consideration.

It well may be time to develop our own best practices and guidance that ESOP companies and potential ESOP companies can follow—and use as an affirmative defense when accused of wrongdoing. Rather than working alone, it is far better if companies can take actions knowing that their decisions represent the collective wisdom of our most experienced corporate and professional members.

Let's move forward setting clear standards for how we believe ESOP companies should conduct their affairs. That will be far more productive than raising our fists at the DOL.

State Activities

While federal legislation affects the entire nation, state legislation is incredibly important too. Many issues have started as state level initiatives that bubbled up to inform the national consciousness.

Several state initiatives relating to ESOPs already are in motion this year.

In Texas, the legislature is considering a bill that would make it easier for ESOPs to form. The bill would:

- Allow professional corporations to organize as ESOPs if all of their voting trustees are licensed in that profession.

- Provide for meaningful contract preferences for employee owned firms for state, city, county, and special districts.
- Create an office to promote, encourage, and assist employee ownership in Texas.

We have been assisting our members in Texas, especially Mike Hart of EEA Consulting Engineers in Austin, to encourage passage of this bill.

Two bills in New York—NY A03514 and NY S02709—would make it possible for design professional corporations to form an ESOP.

A bill in California, CA SB553, would provide a three-percent preference for contract bids from qualified ESOPs.

In Indiana, SR0035 would establish a committee to examine:

- Efforts to promote ESOPs in the state.
- Offering a gross income tax exclusion to ESOPs with fewer than 500 employees.

In Colorado, Governor Jared Polis is working to establish a center that would reduce the costs and simplify the process of becoming employee owned. Gov. Polis previously served as a Representative in Congress, where he learned about and became an ESOP Champion.

These measures show a strong movement at the state level, one we can and will support. We already have federal legislation allowing ESOPs, but if we work at the state level too, we can expand ESOPs from two fronts.

HR 2258

Last, but certainly not least, let's celebrate [H.R. 2258](#). The bill was introduced by Representatives Ron Kind (D-WI-3) and Jason Smith (R-MO-8), and is the House companion to [S. 177](#), which was introduced in the Senate earlier this year by Sen. Pat Roberts (R-KS).

Representatives Kind and Smith were joined in sponsoring the bill by a bipartisan group of their peers on the influential Ways and Means Committee. Those co-sponsors include: Rep. Earl Blumenauer (D-OR-3), Rep. Mike Kelly (R-PA-16), Rep. Tom Reed (R-NY-23), and Rep. Bill Pascrell (D-NJ-9).

Having two bills in Congress means that no matter which of your elected officials you interact with, you can ask them to support a pro-ESOP measure. (For more information and tips on interacting with your representatives in the House and Senate, see our National Conference web page.)

More Work to Do

Working multiple channels to expand employee ownership will require greater attention, resources, and effort on our part. But the goal is worth it. If we can overcome some of the hurdles that prevent businesses from knowing about and adopting ESOPs, we can ensure that more Americans enjoy the benefits of being employee owners. [E](#)

Just Announced: Frank Luntz to Speak at National Conference in Washington, DC

Expert on Business Communication and Political Trends Will Address Attendees at a New Special Session Friday Morning.

The 42nd National Conference in May—the premiere event for information on advocacy and communicating about ESOPs and company culture—will now feature a keynote presentation by Frank Luntz, a nationally prominent speaker and expert on business communication and political trends. When it comes to understanding what people want and how best to communicate with them, Luntz is unrivaled.

Luntz's insights on corporate communication and political trends are legendary. He has become the go-to consultant for Fortune 100 companies that need guidance on communication and language. In a one-time-only appearance, Luntz will apply his expertise to communicating in the employee-owner environment.

The pioneer of the “instant response” focus group technique, Luntz has conducted more than 2,500 surveys,

focus groups, ad tests, and dial sessions in more than two dozen countries and six continents over the past 20 years.

Luntz's political knowledge and skills are recognized the world over. His polling on Brexit just days before the vote was the most accurate of any published poll. He won *The Washington Post's* coveted Crystal Ball award for being the most accurate pundit. His segments on MSNBC/CNBC, “100 Days, 1,000 Voices” won an Emmy Award in 2001.

He is a celebrated author, whose three books have become *New York Times* Best Sellers.

Words that Work: It's Not What You Say it's What People Hear, explores language creation. His second book, *What Americans Really Want...Really*, addresses the hopes, dreams, and fears of the American people. His most recent book, *WIN*, reached No. 3 on The *New York Times* Business Best Seller List in its first month in print. [E](#)



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Publication Highlight

ESOP Flag

This attractive flag is made of sturdy nylon and features The ESOP Association logo and white lettering on a blue background. It makes a great addition to any company. One Corporate Member added an extra flag pole so they could display this flag proudly in front of their ESOP company!



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