



| The ESOP Association

Fact Sheet

The ESOP Association petition to the U.S. Department of Labor under the Administrative Procedure Act

Summary

When the Employee Retirement Income Security Act of 1974 (“ERISA”) was enacted, Congress directed the U.S. Department of Labor (“Department”) to promulgate regulations interpreting the definition of “adequate consideration” (the “Adequate Consideration Exemption”), a key regulation related to employee stock ownership plans (“ESOPs”). Yet for nearly 50 years, the Department has refused to issue formal guidance. The Department has instead preferred to follow its policy of “regulation through litigation,” which has enabled it to avoid working with and learning from industry participants as required by the Administrative Procedure Act (“APA”), and to circumvent the necessary costs and difficulties of a formal notice-and-comment rulemaking process. The Department’s tactics have created an environment of profound regulatory uncertainty, which has frustrated Congress’s intent to expand employee ownership, ultimately harming employee owners.

What is an Employee Stock Ownership Plan (“ESOP”)?

ESOPs are a type of benefit plan that Congress designed to invest in the stock of a sponsoring employer company. ESOPs are regulated by the U.S. Department of Labor as a qualified employee benefit plan under the Employee Retirement Income Security Act of 1974 (“ERISA”). By establishing ESOPs and incentivizing their creation, Congress hoped to expand American workers’ equity ownership stake in American companies, which would allow workers to build wealth as their employers grow.

What is “Adequate Consideration”?

To encourage companies to establish ESOPs, Congress designed ERISA to allow ESOPs to buy employer stock so long as the ESOP pays no more than “adequate consideration,” which ERISA broadly defines as “the fair market value of the asset as determined in good faith” by the party representing the ESOP **“and in accordance with regulations promulgated by the Secretary.”** An ESOP stock purchase that occurs for more than adequate consideration is an ERISA violation that could make the parties to an ESOP transaction liable for the overpayment and subject to severe penalties. Because virtually the only way to establish an ESOP is via a stock purchase transaction to which this legal standard, known as the “Adequate Consideration Exemption,” applies, it is vital for the continued success and spread of ESOPs that parties to ESOP transactions have a clear understanding of what is required to satisfy ERISA’s requirements.

What is the Administrative Procedure Act (“APA”)?

The APA is a federal statute that governs the process by which federal agencies issue regulations. Congress passed the APA to ensure that federal agencies are accountable to the general public and act transparently when exercising their regulatory powers. Among its

rules is a requirement that federal agencies undertake the notice-and-comment rulemaking process when promulgating a regulation, which requires an agency to publish a proposed rule, receive feedback from industry stakeholders, and incorporate and/or respond to comments from the public.

What's the issue with the U.S. Department of Labor?

In the nearly half century since ERISA's passage, the Department has not issued any final regulations interpreting the Adequate Consideration Exemption despite Congress's clear directive. The Department's decades-long refusal to issue a prospective regulation does not appear to be the result of an inadvertent omission, the unhurried machinations of a large federal agency, or indifference, but instead a deliberate choice to circumvent Congress's directive and the APA's procedural safeguards. Rather than issue regulations, the Department has chosen to pursue a policy of "regulation by litigation" in which it opens an investigation into an ESOP fiduciary, alleges that the fiduciary violated the Adequate Consideration Exemption for reasons found nowhere in ERISA, and forces the fiduciary to sign a settlement agreement in which the fiduciary agrees to follow certain procedures in the future. The Department then publicizes this agreement as supposed guidance for other fiduciaries. In the past several years, this process has played out roughly every 18 months.

What's been the effect of the Department's failure to issue this regulation?

The Department's unchecked, *ex post facto* approach has been devastating: it has sown confusion, left a regulatory vacuum that has emboldened and expanded an opportunistic class action plaintiffs' bar, created unnecessary litigation risk that has driven up insurance costs, and pushed insurers out of the market. At bottom, the Department's policies have discouraged companies from establishing new ESOPs and, thus, kept innumerable American workers from building wealth through equity as Congress intended. Also, by failing to promulgate regulations on the Adequate Consideration Exemption—despite Congress's direction to do so—the Department has thwarted public participation in the regulatory process, thereby liberating the Department from the checks and balances that public input provides.

What is The ESOP Association seeking with this petition?

The ESOP Association is petitioning the Department under the APA to undertake a notice-and-comment rulemaking process and issue a final regulation interpreting the Adequate Consideration Exemption.

Where can I find out more about ESOPs and employee ownership?

In the simplest terms, an ESOP is a retirement plan, but an ESOP is really so much more. The ESOP Association's website, <https://esopassociation.org>, has information about ESOPs and their benefits to employee owners, their companies, and communities.

For more information, please contact Greg Facchiano, Vice President of Government Relations and Public Affairs at The ESOP Association, at 202-293-6268 or gfacchiano@esopassociation.org