

# Publications

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## ESOP Transactions and the Duty to Monitor Revisited

### Key Takeaways:

1. **Board's Duty to Monitor the Trustee:** A company's board of directors has a fiduciary duty to monitor the ESOP trustee's actions in an ESOP transaction, ensuring that the trustee is acting in the exclusive interest of the ESOP participants and has sufficient information to make informed decisions with respect to the transaction.
2. **Trustee Certification and Fairness Opinion:** Historically, it has been standard practice for the ESOP trustee to provide a certification confirming several aspects of a transaction, including a financial advisor's opinion on the adequacy of the deal consideration and the fairness of the transaction's terms.
3. **Role of Special Meetings:** Based on recent caselaw, advisors have begun holding a special meeting with the board and trustee before the closing of the transaction to further support the position that the board has fulfilled its monitoring duty.

### ESOP Transactions and the Duty to Monitor Revisited

While the Department of Labor has provided little guidance on the scope of the duty to monitor in the context of an ESOP transaction, since *Bensen*<sup>1</sup> several practitioners have adopted the practice of having the ESOP sponsor convene a special meeting of the board of directors with the trustee shortly before the scheduled closing of the transaction. The purpose of the meeting is to aid the board in meeting its fiduciary duty to monitor the trustee. During the meeting, the board asks questions of the trustee regarding its due diligence process and ensures that the trustee has had access to and sufficient time to review the information that has been provided during such process to enable it and its advisors to analyze the financial condition of the company, determine its range of value and analyze other material terms of the proposed transaction.

### What is the Duty to Monitor in an ESOP Transaction?

With respect to a selling shareholder or board member acting in a fiduciary capacity under ERISA by virtue of appointing a trustee or other fiduciary, generally the duty to monitor requires a review, at reasonable intervals, of the performance of the appointee(s) in such a manner as may be reasonably expected to ensure that their performance satisfies the needs of the ESOP.<sup>2</sup> No single procedure is appropriate in all cases and the actions

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required to be taken to satisfy the duty to monitor will vary in accordance with the facts and circumstances of the particular transaction.<sup>3</sup> In addition, the courts have found that the duty to monitor also requires a certain degree of self-education on the part of the sellers and directors of the company in order for them to ask the proper questions of the trustee and its advisors and to be knowledgeable enough to determine whether the trustee is discharging its fiduciary duties. To make matters a bit more complicated, this latter requirement itself triggers a duty to disclose all relevant information as some courts have noted that the board cannot reasonably rely on the acts of a trustee or other fiduciary if it knows that that trustee or other fiduciary does not have the proper information needed for them to perform their valuation and other duties.<sup>4</sup>

## **The Role of the Independent Trustee and Board Interaction**

On the other hand, an important fact in the context of an ESOP transaction is that an independent trustee is engaged so that they act independently and are not influenced by management or the sellers. An independent trustee, for example, will never share with the company or the sellers the valuation that it relies upon for purposes of a transaction or the details of its valuation process. Therefore, a review by the board of the valuation as part of its duty to monitor is not possible. In addition, to ensure that the trustee maintains its independence the board should preclude itself from “meddling with the trustee’s performance of its duties.”<sup>5</sup> In *Fish*, the company’s board of directors met with the independent trustee two times in the course of a four-month transaction. It otherwise generally relied on the company’s management team to negotiate with and provide information to the trustee. Ultimately, the court found that through this process the board satisfied its duty to monitor as it had gained a foundational understanding of the nature of the trustee’s responsibilities, a basic understanding of the work performed by the trustee and an awareness that the trustee was acting in the exclusive interests of the ESOP participants.

## **Trustee Certification and Fairness Opinion in ESOP Transactions**

Further, it is standard practice in all ESOP transactions to require the trustee to provide the company with a trustee certificate through which the trustee certifies, in part, that it finds that the purchase price is not in excess of adequate consideration and that the transaction is prudent, in the interests of the ESOP participants and for the exclusive purpose of providing benefits to the ESOP participants. It is also standard practice for the trustee, in making this certification, to rely upon and attach to the certificate a copy of the adequate consideration and fairness opinion of its financial advisor. This opinion by the financial advisor generally opines that (i) the price paid by the ESOP for the company stock does not exceed fair market value, (ii) the interest on any ESOP loan is not in excess of a reasonable rate of interest, (iii) the terms of the ESOP loan are at least as favorable to the ESOP as would be the terms of a comparable loan between independent parties and (iv) the terms of the overall transaction are fair to the ESOP from a financial point of view. This opinion will describe the transaction, and the various documents and information reviewed and relied upon by the financial advisor. Both the trustee certificate and the opinion are reviewed by the company and its advisors prior to the closing of the transaction. It stands to reason that in reviewing the trustee certificate and fairness opinion the company should be able to identify whether there are any errors or gaps in what the trustee and its financial advisor are relying upon. All of the information and documents reviewed by the trustee and its advisors, as described in the opinion, should provide the selling shareholders and the board with some assurance that the trustee has discharged its fiduciary duties.

## **Will A Special Meeting Sufficiently Fulfill the Duty to Monitor?**

Not necessarily. As with all cases, facts play an important role and sufficient bad facts will

inevitably undo the protection that even the best of processes can provide. Nonetheless, the insertion of this meeting into standard practice in connection with an ESOP transaction – and provided the company allows the trustee to operate independently and does not insert itself into the decision-making process – is likely to hold great weight as proof that the board of directors is properly monitoring the trustee and thereby discharging its fiduciary duty.

[1] *Su v. Bensen*, No. CV-19-03178-PHX-ROS (D. Ariz. Aug. 15, 2024).

[2] See gen., 29 C.F.R. § 2509.75-8, Q&A 17.

[3] *Id.*

[4] See, e.g., *Foster v. Adams & Assocs. Inc.*, No. 18-cv-02723-JSC, 2020 BL 250202, at \*6 (N.D. Cal. July 6, 2020)

[5] See, *Fish v. Greatbanc Tr. Co.*, No. 09 C 1668, 2016 BL 330978, at \*63 (N.D. Ill. Sept. 1, 2016).