

# Publications

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## Federal Court Grants Summary Judgment in ESOP Releveraging Case, Rejecting Novel Dilution Theory

### Key Takeaways

- A federal district court in Arkansas granted summary judgment in favor of an ESOP sponsor, its board and the ESOP trustee, rejecting claims that a two-step releveraging transaction violated ERISA fiduciary duties.
- The court held that decisions regarding ESOP repurchase obligation strategy, such as releveraging, are generally corporate business decisions, not fiduciary acts subject to ERISA — particularly where the board spent considerable time with qualified third-party advisors workshopping various alternatives to releveraging.
- The court also reinforced that ESOP trustees satisfy their fiduciary duties where they engage in a robust, well-documented process, rely on independent advisors and negotiate favorable transaction terms for the plan.

The U.S. District Court for the Western District of Arkansas granted summary judgment to all defendants in *Shipp et al. v. Central States Manufacturing, Inc.*, dismissing ERISA fiduciary breach claims arising from a 2020 ESOP releveraging transaction. The ruling rejects a novel dilution theory and clarifies that releveraging decisions to manage repurchase obligations are typically business judgments, not fiduciary acts — reinforcing that a careful, well-documented process remains the strongest defense to ERISA claims.

Read on for a closer look at the claims, the court’s analysis and what the decision means for ESOP sponsors, boards and trustees.

### Case Overview – Releveraging Transaction and Plaintiffs’ Claims

The plaintiffs — three former senior-level employees in their capacities as ESOP participants — alleged that the Central States Manufacturing, Inc., its board and the independent third-party trustee of the company’s ESOP breached ERISA fiduciary duties and engaged in a prohibited transaction by implementing a two-step releveraging transaction, which the company felt was critical to the long-term financial health of the company and therefore the ESOP. The board reviewed several proposed structures and strategies, including some sessions in which the trustee was present, before the company elected to proceed with a two-step releveraging transaction whereby the company would

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repurchase shares from departing employees after they were distributed from the ESOP, and then the ESOP would repurchase the same number of shares from the company with a 30-year promissory note. As the company paid off the promissory note, the repurchased shares would be released from the suspense account and allocated to active participants in the ESOP.

The crux of the plaintiff's claims centered around the second step of the releveraging transaction, and they argued that their existing shares held in the ESOP were diluted when the repurchased shares were transferred back to the ESOP and held in the suspense account. This dilutive effect, according to the plaintiffs, was the result of a fiduciary breach by the company, the ESOP trustee and the company's board, and also constituted a prohibited transaction.

The court rejected these claims in full, concluding that no ERISA violations occurred and that defendants were entitled to judgment as a matter of law, at one point stating that plaintiffs "insinuation that GreatBanc merely 'rubber stamp[ed]' the transaction is borderline frivolous."

### **Court's Analysis – Releveraging as a Corporate, Not Fiduciary, Decision**

The court's ruling emphasizes the distinction between corporate decision-making and fiduciary conduct under ERISA. The plaintiffs' core theory was that the releveraging transaction caused impermissible dilution of their ESOP account value, which was a direct result of a breach of fiduciary duties owed to plaintiffs. While the court recognized this as a novel argument, it was ultimately found unpersuasive. The court noted that no participant lost shares, the ESOP paid below fair market value for the shares it repurchased in the releveraging transaction and the releveraging transaction did not reduce overall company equity value.

The court held that the company's decision to pursue a releveraging strategy to address repurchase obligations was a business decision made to preserve the financial health of the company, not a fiduciary act. Recognizing that essentially all of an employer's significant business decisions affect the value of its stock — and as a result, affect the value of benefits available under the ESOP — the court emphasized that business decisions that affect stock value do not automatically implicate ERISA fiduciary duties. Accordingly, business decisions do not automatically implicate nor violate ERISA fiduciary duty liability.

### **Board and Trustee Conduct – Process Matters**

The court noted that over several months the board workshopped at least ten scenarios and "thoroughly vetted" releveraging alongside other strategies for dealing with repurchase obligation, including through using multiple outside advisors. With respect to the ESOP trustee, the court emphasized that the months' long evaluative process of examining the releveraging transaction was "objectively reasonable and prudent." As a result, and recognizing the ESOP trustee's use of independent financial advisors, extensive diligence and negotiation of favorable pricing for the repurchase, the court found no reasonable basis on which plaintiffs could claim that the ESOP trustee failed to satisfy its duties of loyalty and prudence to the ESOP and its participants.

### **Implications for ESOP Sponsors, Trustees and Advisors**

This decision highlights that corporate decisions are distinct from fiduciary acts, and emphasizes the importance of documenting and undertaking a diligent process when undertaking a decision to re-leverage and more broadly when fiduciary obligations are at

play. The *Shipp* decision reinforces that courts will defer to fiduciaries who follow a disciplined, well-supported decision-making process.

For information and guidance on ESOP transactions and fiduciary considerations, please contact the eAlert authors or your regular Polsinelli attorney.