



| The ESOP Association

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The ESOP Association Provides Model Regulation Language for U.S. Department of Labor Rulemaking Defining Adequate Consideration

Framework Provided to Dept. of Labor, Congress, and White House as a Model for Fair, Transparent Regulation to Grow ESOPs While Safeguarding Employee Interests

Model Regulation is Work Product of Effort by Leading ESOP Experts and Vetted by Key Stakeholders Across Valuation, Legal, Finance, and Trustee Disciplines

Washington, DC – The ESOP Association today released a model framework for the U.S. Department of Labor’s (DOL) current rulemaking regarding what is known as the “adequate consideration exemption” for ESOP transactions. The exemption enables the proper formation and operation of Employee Stock Ownership Plans and their ownership of employer securities on behalf of the employees of the sponsoring firm. It remains an undefined, but bedrock requirement without which ESOPs cannot exist. Yet the primary regulator, the U.S. Department of Labor, has failed to promulgate a regulation properly describing adequate consideration in the nearly 50 years since ERISA was signed into law.

Adequate consideration, as described by ERISA, is “the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary [of Labor]”. Since the passage of ERISA, the DOL has not further defined the components of the Adequate Consideration Exemption, especially what constitutes a “good faith” effort on behalf of an ESOP Trustee. This has resulted in a half-century of regulatory uncertainty that has had a chilling effect on ESOP formation and less retirement security for millions of American households.

The ESOP community has been asking that DOL promulgate rulemaking defining standards for both good faith and fair market value, as they are both crucial to promoting Congress’s goal of encouraging the proliferation of ESOPs. The ESOP Association’s model rule is intended to ensure ESOP fiduciaries, plan sponsors, service providers, and parties transacting with ESOPs are able to satisfy ERISA’s obligations, thereby adequately protecting ESOP participants’ interests while encouraging

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retirement security through new ESOP formation. This regulatory certainty will encourage companies and their shareholders to establish new ESOPs and reverse the years-long deceleration in the growth of employee ownership, which has been driven largely by the current nebulous statutory standard.

“The ESOP Association’s proposed adequate consideration framework is the culmination of a deliberative and inclusive process led by many of the brightest minds in the ESOP community,” said Jim Bonham, President and CEO of The ESOP Association. “Too many business owners and companies turn away from forming an ESOP for fear and expense of EBSA second-guessing and the ambiguous and costly nature of the current regulatory vacuum. The vacuum also fertilizes an environment for frivolous and costly lawsuits that cause current ESOPs to dissolve rather than attempt to fend off the barrage. Our model regulation would ensure the safeguards for employees intended by ERISA are maintained, while employing a fair and transparent definition of adequate consideration to grow ESOPs and employee ownership in America.”

The ESOP Association’s initial draft was presented at the association’s annual Professionals’ Forum on February 8 for comprehensive debate and discussion by the more than 350 ESOP professional service providers in attendance. After further review and consideration, The ESOP Association’s Board of Directors unanimously voted to adopt the final framework on February 16.

The proposed regulation contains three major sections: delineating the scope of the rule, addressing and defining “good faith” and a process for determining good faith, and applications of a fair market value standard. The ESOP Association’s draft language explains that:

- “Good faith” has four distinct elements that, taken together, provide the necessary threshold by which ESOP fiduciaries should be judged as having engaged in a prudent process;
- “Fair market value” is a well-understood concept within longstanding Treasury Department guidance and regulation and the model regulation draws heavily from existing regulation, as Congress clearly intended by directing DOL to promulgate the regulation in consultation with the Treasury Department;
- Good faith and fair market value are concepts that are linked and intertwined as part of a process, with guidance on how that process should reasonably be undertaken;
- Notably, the model regulation properly recognizes that good faith predicates any evaluation of fair market value and that merely the arrival of a different valuation by different qualified appraisers is not evidence of a failure in adequate consideration.

“We received exhaustive stakeholder input from ESOPs and professional service providers across all aspects of ESOP transactions affected by this rule, and it represents an earnest effort to describe a meaningful and productive outcome for all parties, including regulators,” Bonham said. “We strongly urge the Department of Labor to incorporate the Association’s work into the standard for defining adequate consideration, and ask our Congressional champions and the Biden Administration to do the same. This is a fair, prudent, and highly credible proposal that takes into consideration decades of cases and real-world experience.”

The full text of The ESOP Association’s proposed rule defining adequate consideration [can be found at the association’s website](#).

About the ESOP Association

The ESOP Association is the largest organization in the world supporting employee-owned companies, the more than 10 million U.S. employees who participate in an ESOP, and the professionals who provide services to them. Headquartered at the International Employee Ownership Center in Washington, DC and operating as a 501(c)6 organization with the affiliated Employee Ownership Foundation, The ESOP Association conducts and funds academic research, provides more than 160 annual conferences and events attended by nearly 15,000 individuals, and advocates on behalf of employee owners and their businesses to federal and state lawmakers.

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